

## WHAT'S INSIDE

- 2 Mutual Fund Expense Ratios Have Declined Substantially over the Past Two Decades
- 14 Index Funds
- 24 Mutual Fund Load Fees
- 28 Conclusion
- 29 Notes
- 30 References
- 31 Appendix

*James Duvall, Assistant Economist, and Morris Mitler, Economist, prepared this report. Julieth Saenz, ICI Senior Research Associate, provided assistance.*

*Suggested citation: Duvall, James, and Morris Mitler. 2018. "Trends in the Expenses and Fees of Funds, 2017." ICI Research Perspective 24, no. 3 (April). Available at [www.ici.org/pdf/per24-03.pdf](http://www.ici.org/pdf/per24-03.pdf).*

*For a complete set of data files for each figure in this report, see [www.ici.org/info/per24-03\\_data.xls](http://www.ici.org/info/per24-03_data.xls).*

## Trends in the Expenses and Fees of Funds, 2017

### KEY FINDINGS

- » **On average, expense ratios for long-term mutual funds have declined substantially for more than 20 years.** In 1996, equity mutual fund expense ratios averaged 1.04 percent, falling to 0.59 percent in 2017. Hybrid mutual fund expense ratios averaged 0.95 percent in 1996, falling to 0.70 percent in 2017. Bond mutual fund expense ratios averaged 0.84 percent in 1996 compared with 0.48 percent in 2017.
- » **In 2017, average expense ratios for equity mutual funds fell 4 basis points to 0.59 percent.** Average hybrid and bond mutual fund expense ratios declined 3 basis points from their values in 2016, to 0.70 and 0.48, respectively.
- » **The average expense ratios for money market funds rose 5 basis points in 2017 to 0.25 percent.** This increase was indirectly related to the Federal Reserve raising short-term interest rates three times in 2017. These actions prompted fund advisers to continue paring expense waivers that most money market funds offered during the period of near-zero short-term interest rates that had prevailed in the post-financial crisis era.
- » **Expense ratios of target date mutual funds averaged 0.44 percent in 2017.** Since 2008, the expense ratios of target date mutual funds have fallen 34 percent. Because these funds are attractive to individuals saving for retirement, investor demand for them have flourished in recent years. Ninety-five percent of target date mutual funds are funds of funds—mutual funds that invest in other funds—the expense ratios of which fell from 0.65 percent in 2016 to 0.58 percent in 2017.
- » **Average expense ratios for both actively managed and index equity mutual funds have fallen since 1996.** In 2017, the average expense ratio of actively managed equity mutual funds fell to 0.78 percent, down from 1.08 percent in 1996. Index equity mutual fund expense ratios fell from 0.27 percent in 1996 to 0.09 percent in 2017. Investor interest in lower-cost equity mutual funds, both actively managed and indexed, has fueled this trend, as has asset growth and resulting economies of scale.
- » **Economies of scale and intense competition are putting downward pressure on expense ratios of exchange-traded funds (ETFs).** In 2017, the expense ratios of index equity ETFs fell to 0.21 percent (down from 0.34 percent in 2009). Expense ratios of index bond ETFs, down from a recent peak of 0.26 percent in 2013, fell to 0.18 percent in 2017.

## Key findings continued

- » **In 2017, average expense ratios for index equity ETFs fell 1 basis point to 0.21 percent.** Average index bond ETF expense ratios declined 2 basis points from their value in 2016, to 0.18 percent.
- » **Inflows to actively managed and index funds continued to be concentrated in relatively low-cost funds.** Actively managed domestic equity funds with expense ratios among the lowest 5 percent saw inflows, while actively managed world equity and actively managed bond and hybrid funds with expense ratios in the lowest quartile received inflows. Index funds experienced inflows in every quartile of expense ratios and for each investment category, but like actively managed funds, these inflows were concentrated in funds with the lowest costs.
- » **No-load mutual fund share classes continue to experience positive net new cash flow.** In 2017, no-load mutual fund share classes received net inflows of \$447 billion, while load mutual fund share classes experienced net outflows of \$296 billion. This disparity, in large part, reflects a growing trend—investors paying intermediaries for advice and assistance directly out of their pockets rather than indirectly through funds.

---

## Mutual Fund Expense Ratios Have Declined Substantially over the Past Two Decades

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 shown in the fund's prospectus and shareholder reports, is the fund's total annual expenses expressed as a percentage of its net assets. Unlike sales loads, fund expenses are paid from fund assets.

Many factors affect a mutual fund's expense ratio, including its investment objective, its 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.

On an asset-weighted basis,\* average expense ratios incurred by mutual fund investors have fallen substantially over the past two decades (Figure 1).<sup>1</sup> In 1996, equity mutual fund investors incurred expense ratios of 1.04 percent, on average, or \$1.04 for every \$100 in assets. By 2017, that average had fallen to 0.59 percent. Hybrid and bond mutual fund expense ratios also have declined since 1996. The average hybrid mutual fund expense ratio fell from 0.95 percent in 1996 to 0.70 percent in 2017, and the average bond mutual fund expense ratio fell from 0.84 percent to 0.48 percent.<sup>2,3</sup> The average expense ratio for money market funds dropped from 0.52 percent to 0.25 percent over this period.

---

\* Unless otherwise noted, this report calculates average expense ratios on an asset-weighted basis. See note 1 on page 30.

FIGURE 1

**Average Expense Ratios for Long-Term Mutual Funds Have Fallen***Percent, 1996–2017*

	<b>Equity</b>	<b>Hybrid</b>	<b>Bond</b>	<b>Money market</b>
1996	1.04%	0.95%	0.84%	0.52%
1997	0.99	0.92	0.82	0.51
1998	0.95	0.89	0.80	0.50
1999	0.98	0.90	0.78	0.50
2000	0.99	0.89	0.76	0.49
2001	0.99	0.89	0.75	0.46
2002	1.00	0.89	0.74	0.44
2003	1.00	0.90	0.75	0.42
2004	0.95	0.85	0.72	0.42
2005	0.91	0.81	0.69	0.42
2006	0.88	0.78	0.67	0.40
2007	0.86	0.77	0.64	0.38
2008	0.83	0.77	0.61	0.35
2009	0.87	0.84	0.64	0.33
2010	0.83	0.82	0.63	0.24
2011	0.79	0.80	0.62	0.21
2012	0.77	0.79	0.61	0.18
2013	0.74	0.80	0.61	0.17
2014	0.70	0.78	0.57	0.13
2015	0.67	0.77	0.54	0.13
2016	0.63	0.73	0.51	0.20
2017	0.59	0.70	0.48	0.25

Note: Expense ratios are measured as asset-weighted averages. Data exclude 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 Morningstar

The declines in the expense ratios of equity, hybrid, and bond mutual funds in 2017 primarily reflect a long-running shift by investors toward lower-cost funds or fund share classes. In particular, investors have been moving toward no-load share classes—those that had neither a front-end load fee, nor a back-end load fee, nor a 12b-1 fee of more than 0.25 percent.

### Equity Mutual Funds

Equity mutual fund expense ratios declined for the eighth straight year in 2017, falling 4 basis points in 2017.\* Some fund costs—such as transfer agency fees, accounting and audit fees, and director fees—are relatively fixed in dollar terms, regardless of fund size. As a result, when fund assets rise, these relatively fixed costs make up a smaller proportion of a fund’s expense ratio.

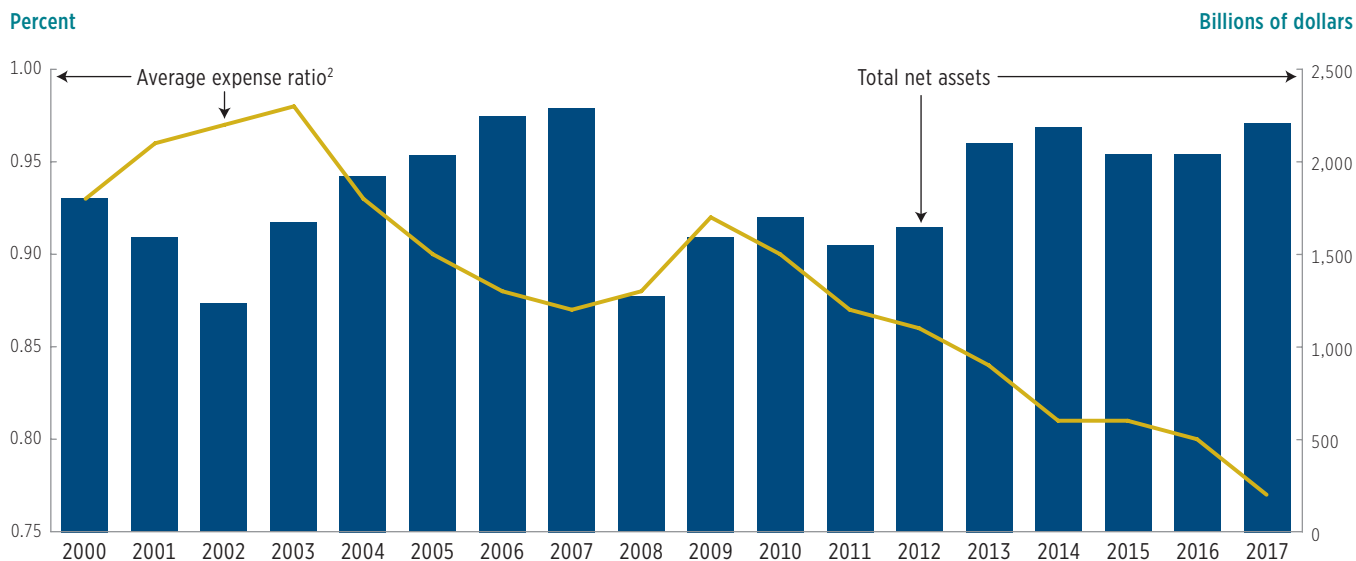
Consequently, asset growth tends to contribute to changes in fund expense ratios. During the 2007–2009 financial crisis, actively managed domestic equity mutual fund assets decreased markedly (Figure 2), leading their expense ratios to rise in 2009. As the stock market recovered, however, actively managed domestic equity mutual fund assets rebounded and their expense ratios fell. Since 2008, assets in these funds have grown substantially and their expense ratios have fallen significantly.

Additional factors have contributed to lower average expense ratios of equity and other long-term mutual funds. First, the average expense ratio of equity mutual funds has declined as a result of growth in index fund investing (see Index Funds on page 14).

FIGURE 2

### Mutual Fund Expense Ratios Tend to Fall as Fund Assets Rise

Share classes of actively managed domestic equity mutual funds continuously in existence since 2000<sup>1</sup>



<sup>1</sup> Calculations are based on a fixed sample of share classes. Data exclude mutual funds available as investment choices in variable annuities, index mutual funds, and mutual funds that invest primarily in other mutual funds.

<sup>2</sup> Expense ratios are measured as asset-weighted averages.

Sources: Investment Company Institute, Lipper, and Morningstar

\* Occasionally, this report will refer to increases or decreases of expense ratios in basis points. Basis points simplify percentages written in decimal form. A basis point equals one-hundredth of 1 percent (0.01 percent), so 100 basis points equals 1 percentage point. When applied to \$1.00, 1 basis point equals \$0.0001; 100 basis points equals one cent (\$0.01).

Second, since 2000, fund investors have increasingly compensated financial professionals for assistance through payments outside of funds (see Mutual Fund Load Fees on page 24). An important aspect of this development has been that an increasing share of fund assets are held in no-load share classes, which tend to have below-average expense ratios. The decrease in the asset-weighted average expense ratios of equity mutual funds in 2017 reflected a continuation of this long-running trend.

In addition to varying from year to year, fund expense ratios can also vary by fund type (Figure 3).<sup>4</sup> For example,

bond and money market mutual funds tend to have lower expense ratios than equity and hybrid mutual funds. Among equity mutual funds, expense ratios tend to be higher for funds that specialize in a given sector—such as healthcare or real estate—or those that invest in equities around the world, because the assets such funds hold tend to be more costly to manage. Even within a particular investment objective, mutual fund expense ratios can vary considerably. For example, 10 percent of equity mutual funds that focus on growth stocks have expense ratios of 0.70 percent or less, while the top 10 percent have expense ratios of 1.95 percent or more. This variation reflects,

FIGURE 3

### Mutual Fund Expense Ratios Vary Across Investment Objectives

Percent, 2017

Investment objective	10th percentile	Median	90th percentile	Asset-weighted average	Simple average
<b>Equity mutual funds<sup>1</sup></b>	<b>0.66%</b>	<b>1.18%</b>	<b>2.00%</b>	<b>0.59%</b>	<b>1.25%</b>
Growth	0.70	1.14	1.95	0.73	1.21
Sector	0.76	1.33	2.13	0.76	1.37
Value	0.68	1.10	1.89	0.70	1.18
Blend	0.40	1.00	1.80	0.36	1.04
World	0.80	1.28	2.10	0.73	1.36
<b>Hybrid mutual funds<sup>1</sup></b>	<b>0.65</b>	<b>1.15</b>	<b>1.98</b>	<b>0.70</b>	<b>1.26</b>
<b>Bond mutual funds<sup>1</sup></b>	<b>0.45</b>	<b>0.81</b>	<b>1.61</b>	<b>0.48</b>	<b>0.93</b>
Investment grade	0.35	0.69	1.49	0.35	0.77
World	0.65	1.00	1.80	0.61	1.12
Government	0.29	0.74	1.60	0.40	0.82
High-yield	0.63	0.95	1.76	0.73	1.05
Municipal	0.48	0.77	1.57	0.51	0.90
<b>Money market funds<sup>1</sup></b>	<b>0.17</b>	<b>0.40</b>	<b>0.66</b>	<b>0.25</b>	<b>0.40</b>
<b>Memo:</b>					
<b>Target date mutual funds<sup>2</sup></b>	<b>0.36</b>	<b>0.77</b>	<b>1.49</b>	<b>0.44</b>	<b>0.85</b>
<b>Index equity mutual funds<sup>1</sup></b>	<b>0.06</b>	<b>0.33</b>	<b>1.53</b>	<b>0.09</b>	<b>0.61</b>

<sup>1</sup> Data exclude mutual funds available as investment choices in variable annuities and mutual funds that invest primarily in other mutual funds.

<sup>2</sup> Data include mutual funds that invest primarily in other mutual funds, but exclude mutual funds available as investment choices in variable annuities. Ninety-five percent of target date mutual funds invest primarily in other mutual funds.

Note: Each fund's share class is weighted equally for the median, 10th, and 90th percentiles.

Sources: Investment Company Institute and Morningstar

among other things, the fact that some growth funds focus more on small- or mid-cap stocks and others focus more on large-cap stocks. This is important because portfolios of small- and mid-cap stocks tend to cost more to manage because information about these types of stocks is less readily available, and therefore portfolio managers invest more time into doing research.

## Hybrid Mutual Funds

Assets in hybrid mutual funds (which invest in a mix of equities and bonds) have more than quadrupled since 2000, to more than \$1.5 trillion in 2017, accounting for nearly 10 percent of long-term mutual fund total net assets. Their expense ratios have fallen from 0.95 percent in 1996 to 0.70 percent in 2017 (Figure 1).

From 2009 to 2013, the average expense ratio of hybrid mutual funds was influenced by developments in “alternative strategy” mutual funds.\* Hybrid alternative strategy mutual funds may offer fund investors exposure to a wide range of asset classes, protection against market downturns or volatility, or a lower correlation with the equity market, but such strategies can be costly to manage. These funds attracted \$68 billion in net inflows, helping to boost their total net assets from \$29 billion to \$110 billion. This, combined with the fact that alternative strategy mutual funds tend to have higher-than-average expense ratios, boosted the asset-weighted expense ratio of hybrid mutual funds. After 2013, inflows to hybrid alternative strategy mutual funds tapered off and their assets expanded at a much more moderate pace.

Since 2013, total net assets of other hybrid mutual funds with lower expense ratios have experienced proportionally larger growth than alternative strategy mutual funds, contributing to the continued decline in the expense ratios of hybrid mutual funds (Figure 1). In 2017, the average

expense ratio of hybrid mutual funds fell 3 basis points to 0.70 percent, largely owing to investor demand for balanced mutual funds.† Total net assets in balanced mutual funds grew by 15 percent in 2017; they were the only category of hybrid mutual funds to receive inflows. Balanced mutual funds tend to have lower expense ratios than other types of hybrid mutual funds because the majority of index hybrid mutual fund total net assets are in balanced mutual funds.

## Bond Mutual Funds

In 2017, the asset-weighted average expense ratio for bond mutual funds fell 3 basis points to 0.48 percent (Figure 1), marking the eighth straight year that the expense ratios of bond mutual funds have either remained unchanged or have fallen. In total, from 2009 to 2017, the average expense ratio of bond mutual funds fell 25 percent (16 basis points).

The 2017 decline in large part reflects continued investor demand for investment grade bond mutual funds. These funds represented 45 percent of bond mutual fund total net assets in 2017 and had \$138 billion in net inflows for the year, following \$84 billion in net inflows in 2016. Additionally, the asset-weighted average expense ratio of investment grade bond mutual funds was 0.35 percent in 2017 (Figure 3), down from 0.37 percent in 2016.

An increase in total net assets held in index bond mutual funds also contributed to the lower asset-weighted expense ratio for bond mutual funds. In 2017, net inflows into index bond mutual funds accounted for more than one-third of total inflows into all bond mutual funds. This, combined with the fact that the expense ratios of index funds tend to be lower than those of actively managed funds with the same investment objectives, helped lower the average expense ratio of bond mutual funds (see Index Funds on page 14).

---

\* Alternative strategy mutual funds are included primarily in ICI’s hybrid mutual fund category.

† Balanced mutual funds invest in a mix of equity securities and bonds with the three-part objective of conserving principal, providing income, and achieving long-term growth of both principal and income. For more information on definitions of ICI’s investment objectives, please see [www.ici.org/research/stats/iob\\_update/classification/iob\\_definitions](http://www.ici.org/research/stats/iob_update/classification/iob_definitions).

### *Analyzing the Asset-Weighted Average Expense Ratio*

Mechanically, the expense ratios of equity, hybrid, and bond mutual funds may have fallen in 2017 for one of several reasons:

- » Expense ratios of individual funds may have fallen
- » Assets may have shifted to lower-cost funds
- » New, lower-cost funds may have entered the market
- » Higher-cost funds may have left the market

To determine which reason (or combination of reasons) it was, this analysis breaks down the asset-weighted average expense ratio into two components. The first component measures how much the asset-weighted average expense ratio declined because the expense ratios of individual funds fell. This can be determined by calculating what the asset-weighted expense ratio would hypothetically be for a group of funds if the expense ratios of the individual funds in the group changed as they actually did between 2016 and 2017, but the assets in those funds remained unchanged.

For instance, assume the asset-weighted average expense ratio of a group of funds actually declined by 4 basis points, while the hypothetical average that holds assets constant for each fund in that group fell by 1 basis point. In this case, then, 1 basis point of the decline arose because the expense ratios of individual funds fell.

The second component is just the difference between the fund expense ratios and the first component. It accounts for all other factors that could have affected the asset-weighted average, including assets shifting toward lower-cost funds, lower-cost funds entering the business, or higher-cost funds closing.

Continuing with this hypothetical example, if the asset-weighted average fell 4 basis points and 1 basis point of that reflected reductions in the expense ratios of individual funds, the second component—reflecting factors such as assets shifting toward lower-cost funds—accounted for the remainder of the decline, or 3 basis points.

The asset-weighted average expense ratios for equity, hybrid, and bond mutual funds each fell by 3 basis points or more in 2017. Breaking down expense ratios in the manner described above shows that for each of these three types of funds, the decline in their asset-weighted average expense ratios was mostly due to assets moving toward lower-cost funds (and other factors, including the opening of new lower-cost funds and the closing of higher-cost funds) (Figure 4).

FIGURE 4

## Analyzing the Decline in Average Expense Ratios

Percent

Category	Expense ratio		Total decline	Decline in 2017 due to:	
	2016	2017		Lower expense ratios <sup>1</sup> Percentage of total decline	Assets shifting toward lower-cost funds and other factors <sup>2</sup> Percentage of total decline
Equity	0.63	0.59	0.04	22%	78%
Hybrid	0.73	0.70	0.03	18	82
Bond	0.51	0.48	0.03	1	99

<sup>1</sup> Tabulations are based on a consistent sample; that is, a share class must have existed in both 2016 and 2017.

<sup>2</sup> Other factors include the opening of new lower-cost funds and the closing of older higher-cost funds.

Note: Expense ratios are measured as asset-weighted averages. Data 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 Morningstar

This does not mean, however, that the expense ratios of most funds were unchanged. In 2017, less than 50 percent of the share classes of equity, hybrid, and bond mutual funds had expense ratios that were unchanged (Figure 5). Among the remaining share classes, most saw their expense ratios fall.

FIGURE 5

## More Than Half of Mutual Fund Share Classes Saw Their Expense Ratios Change

2017

Category	Percentage of total share classes for which expense ratios in 2017:		
	Fell	Were unchanged	Rose
Equity	43%	37%	20%
Hybrid	40	41	19
Bond	32	47	21

Note: Tabulations are based on a consistent sample; that is, a share class must have existed in both 2016 and 2017.

Sources: Investment Company Institute and Morningstar



## Money Market Funds

The average expense ratio of money market funds rose to 0.25 percent in 2017, an increase of 5 basis points from the previous year (Figure 1). This represents the second year that money market fund expense ratios have risen, continuing a reversal from the historical trend in which money market fund expense ratios had remained steady or fallen each year since 1996.

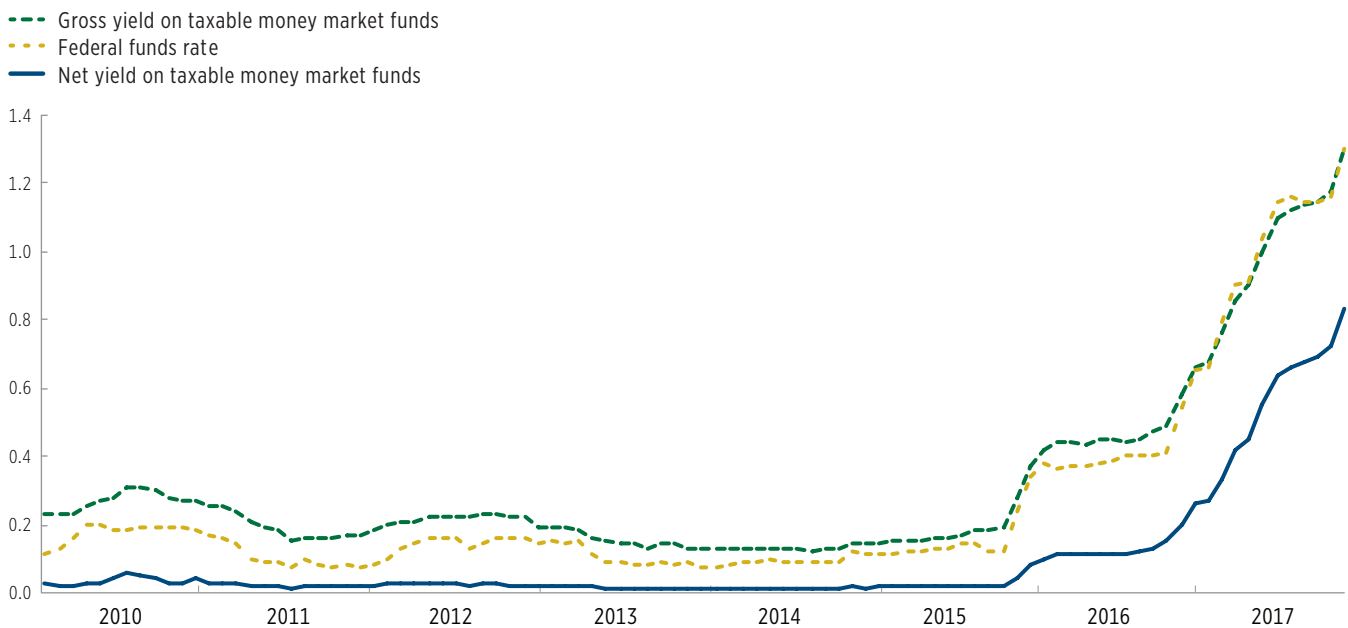
From 2000 to 2009, a combination of two factors played a significant role in reducing the average expense ratios of money market funds. First, the market share of institutional share classes (which tend to have larger average account balances and therefore tend to have lower expense ratios)

rose to two-thirds of money market fund total net assets. Second, expense ratios of retail money market fund share classes declined 21 percent over this period.<sup>5</sup> After 2009, however, other factors pulled down the average expense ratios of these funds—primarily developments that stemmed from the ultralow interest rate environment. Over 2008–2009, the Federal Reserve sharply reduced short-term interest rates. By 2009, the federal funds rate was hovering only a little more than zero. Gross yields on taxable money market funds (the yield before deducting the fund’s expense ratio), which closely track short-term interest rates, fell to all-time lows. This situation remained in stasis from 2010 to late 2015 (Figure 6).

FIGURE 6

### Taxable Money Market Fund Yields

Percent; monthly, January 2010–December 2017

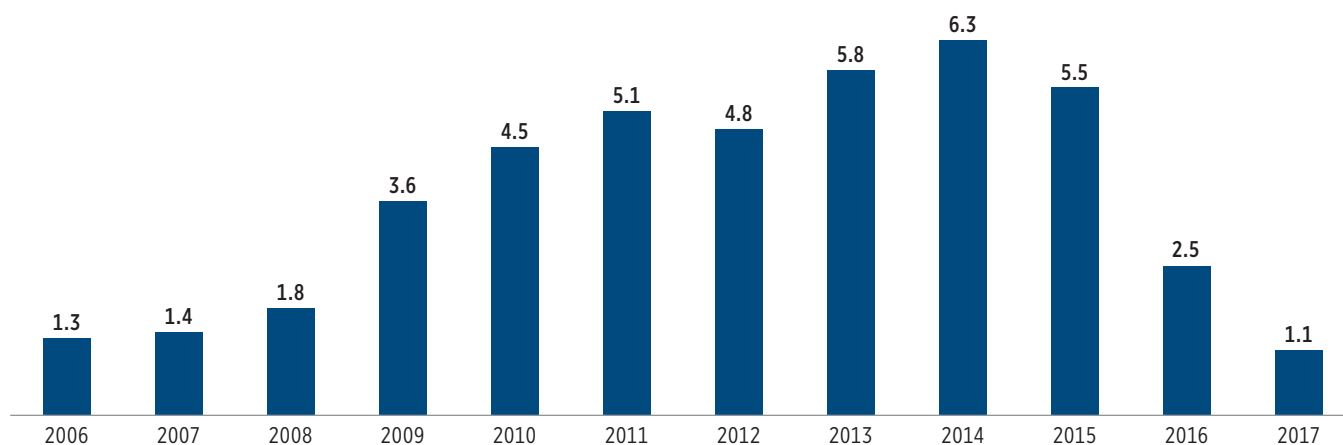


Sources: iMoneyNet and Federal Reserve Board

In this environment, most money market funds adopted expense waivers<sup>6</sup> to ensure that net yields (the yield on a fund after deducting fund expenses) did not fall below zero.<sup>7</sup> With an expense waiver, a fund’s adviser agrees to absorb the cost of all or a portion of a fund’s fees and expenses for some time. The expense waiver, by reducing the fund’s expense ratio, boosts the fund’s net yield. These expense waivers are costly for fund advisers, reducing their revenues and profits. From 2009 to 2015, advisers waived an estimated \$36 billion in money market fund expenses (Figure 7). It was expected that when short-term interest rates rose and pushed up gross yields on money market funds, advisers would reduce or eliminate expense waivers, causing the expense ratios of money market funds to rise somewhat.<sup>8</sup>

That, ultimately, is what happened. In December 2015, the Federal Reserve raised the federal funds rate by 0.25 percent, signifying a strengthening economy. The Federal Reserve raised the federal funds rate four more times in 2016 and 2017, each time by 0.25 percent.<sup>9</sup> These actions were reflected in short-term interest rates and gross yields on money market funds. With gross yields rising, there has been less chance that the net yields of money market funds might fall below zero. Consequently, advisers have pared back the expense waivers they had provided to their money market funds. For example, at the end of 2015, 97 percent of money market fund share classes had expense waivers. That dropped to 66 percent by the end of 2017, and expenses waived dropped sharply from an estimated \$5.5 billion in 2015 to an estimated \$1.1 billion in 2017.

FIGURE 7  
**Money Market Funds Reduced Expense Waivers in 2017**  
*Money market fund expenses waived, billions of dollars, 2006–2017*



Sources: Investment Company Institute and iMoneyNet

## Funds of Funds

Funds of funds are mutual funds that invest in other funds. The market for funds of funds has expanded considerably in recent years.<sup>10</sup> By year-end 2017, there were 1,400 funds of funds with \$2,216 billion in total net assets (Figure 8).

The great majority (85 percent) of funds of funds are hybrid mutual funds. Hybrid funds of funds invest in a mix of equity, bond, and even other hybrid funds. Hybrid funds of funds are often target date mutual funds (see Target Date Mutual Funds on page 13). They also may be asset

FIGURE 8

### Funds of Funds Have Grown Rapidly in Recent Years

#### Number of funds of funds, 2008–2017

Year	Total	Equity	Hybrid	Bond
2008	839	123	706	10
2009	945	131	804	10
2010	979	147	819	13
2011	1,083	157	905	21
2012	1,154	163	961	30
2013	1,257	173	1,050	34
2014	1,331	174	1,116	41
2015	1,402	178	1,185	39
2016	1,441	173	1,227	41
2017	1,400	164	1,195	41

#### Total net assets of funds of funds, billions of dollars, 2008–2017

Year	Total	Equity	Hybrid	Bond
2008	\$469	\$43	\$425	\$1
2009	680	55	623	2
2010	915	81	825	9
2011	1,036	81	939	16
2012	1,272	93	1,150	28
2013	1,560	129	1,394	38
2014	1,695	128	1,520	47
2015	1,722	137	1,532	54
2016	1,870	150	1,664	57
2017	2,216	179	1,971	67

Source: Investment Company Institute

allocation funds, which have exposure to equities, bonds, or other securities, often in a mix that may change in response to market conditions to achieve a given investment objective.

In 2017, the asset-weighted average expense ratio of funds of funds was 0.58 percent, down from 0.65 percent in 2016 (Figure 9).<sup>11, 12</sup> From 2005 to 2017, the average expense ratio of funds of funds fell 43 percent, from 1.01 percent to 0.58 percent.

FIGURE 9

### Expense Ratios of Funds of Funds

Percent, 2005–2017

Year	Asset-weighted average	Simple average	Median
2005	1.01%	1.56%	1.52%
2006	0.96	1.44	1.39
2007	0.94	1.44	1.35
2008	0.92	1.40	1.34
2009	0.91	1.38	1.31
2010	0.87	1.34	1.28
2011	0.83	1.30	1.23
2012	0.82	1.26	1.19
2013	0.80	1.21	1.14
2014	0.76	1.19	1.10
2015	0.70	1.12	1.04
2016	0.65	1.08	1.01
2017	0.58	1.04	0.97

Note: Data exclude mutual funds available as investment choices in variable annuities.

Sources: Investment Company Institute, Lipper, and Morningstar

## Target Date Mutual Funds

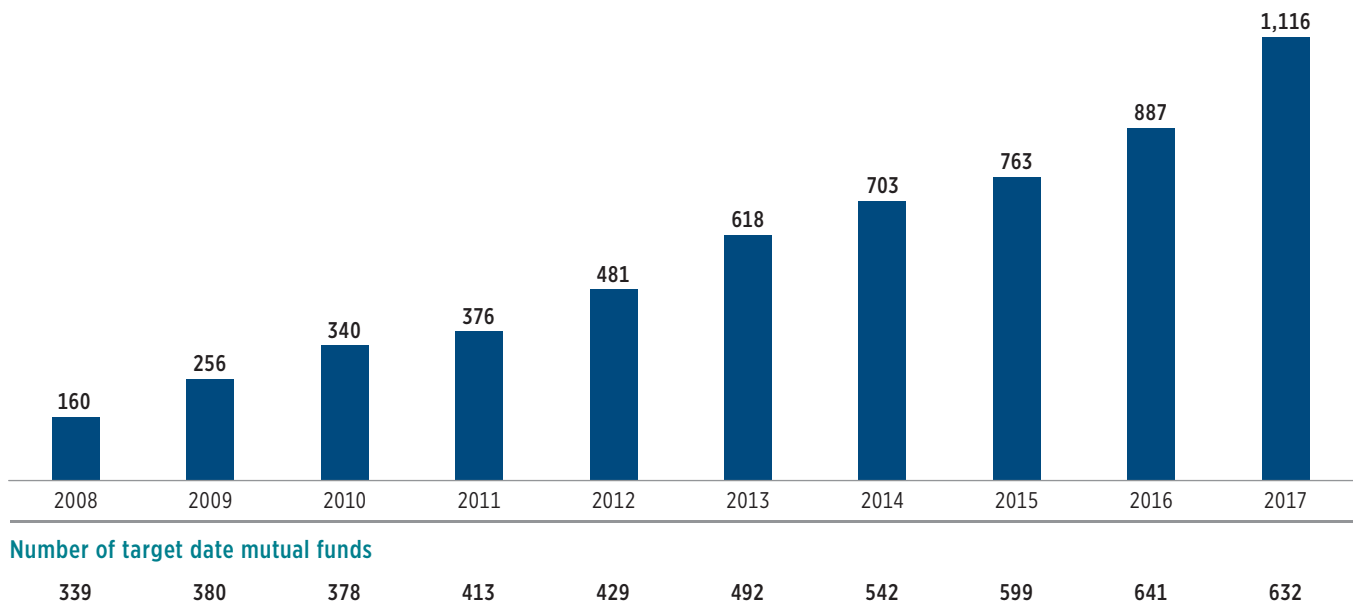
Much of the growth in funds of funds stems from investor interest in target date mutual funds. Target date mutual funds usually invest through a fund-of-funds structure, meaning they primarily hold and invest in shares of other mutual funds and exchange-traded funds (ETFs)—95 percent of target date mutual funds are funds of funds, and 43 percent of funds of funds are target date mutual funds. A target date (also known as *lifecycle*) mutual fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund’s name. This change in investment mix over time is typically referred to as the *glide path* for the fund. At year-end 2017, target date mutual funds had \$1,116 billion in total net assets (Figure 10).

The strong investor demand for target date mutual funds likely reflects a number of factors. Investors value the features of target date mutual funds, including diversification and the glide path; these are especially attractive for individuals saving for retirement in 401(k) plans and individual retirement accounts (IRAs).<sup>13</sup> Additionally, target date funds often are used as a qualified default option<sup>14</sup> for 401(k) plans.<sup>15</sup> As a result, newly hired employees that do not select any investment choices will often have their 401(k) contributions invested in target date funds. At year-end 2015, for example, 48.1 percent of the account balances of recently hired 401(k) plan participants in their twenties were invested in target date funds.<sup>16</sup>

FIGURE 10

### Target Date Mutual Fund Assets Have Significantly Increased Since 2008

Billions of dollars, total net assets; year-end, 2008–2017



Note: Data include mutual funds that invest primarily in other mutual funds.

Source: Investment Company Institute

The average expense ratio of target date mutual funds has declined sharply in recent years. In 2008, investors on average paid 0.67 percent to invest in target date mutual funds (Figure 11).<sup>17</sup> By 2017, the average expense ratio had fallen by 23 basis points to 0.44 percent.

## Index Funds

An index fund generally seeks to replicate the return on a specified financial market 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. This approach to portfolio management is a primary reason that index funds—whether mutual funds or ETFs—tend to have below-average expense ratios. By contrast, under an active management approach, managers have more discretion to increase or reduce exposure to sectors or securities within their funds’ investment mandates. Active managers may also undertake significant research about individual stocks or bonds, about market sectors, or geographic regions. This approach offers

investors the chance to earn superior returns, or to meet other investment objectives such as limiting downside risk, managing volatility, under- or over-weighting various sectors, and altering asset allocations in response to market conditions. These characteristics tend to make active management more costly than management of an index fund.

## Index Mutual Funds

Growth in index mutual funds has contributed to the decline in asset-weighted average expense ratios of equity and bond mutual funds. From 2000 to 2017, index mutual fund total net assets increased significantly, from \$384 billion to \$3.4 trillion (Figure 12). This rapid growth contributed to a rise in index mutual funds’ share of long-term mutual fund total net assets, which has nearly tripled from 7.5 percent in 2000 to 21.2 percent in 2017 (Figure 13). Within index mutual funds, index equity mutual funds accounted for the lion’s share (81 percent) of index mutual fund total net assets in 2017.

FIGURE 11

### Expense Ratios of Target Date Mutual Funds

Percent, 2008–2017

Year	Asset-weighted average	Simple average	Median
2008	0.67%	1.23%	1.18%
2009	0.67	1.20	1.14
2010	0.65	1.14	1.11
2011	0.61	1.11	1.09
2012	0.59	1.07	1.04
2013	0.58	1.04	1.01
2014	0.57	1.03	0.96
2015	0.54	0.91	0.87
2016	0.50	0.87	0.82
2017	0.44	0.85	0.77

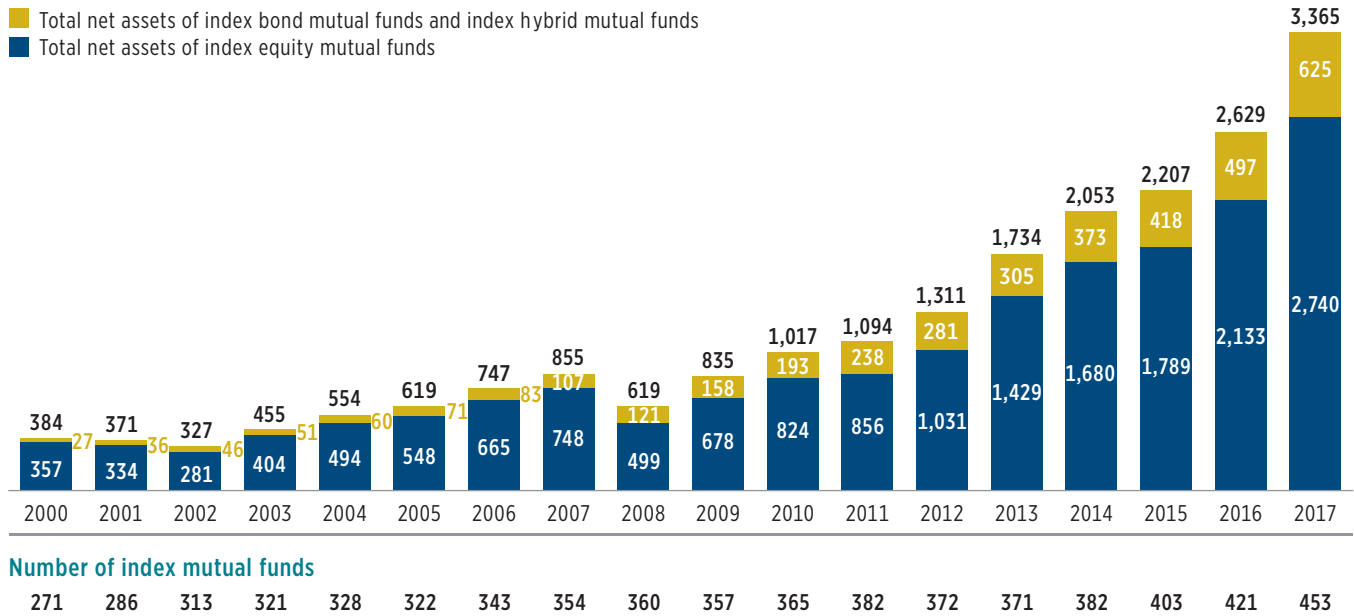
Note: Data include mutual funds that invest primarily in other mutual funds but exclude mutual funds available as investment choices in variable annuities.

Sources: Investment Company Institute, Lipper, and Morningstar

FIGURE 12

### Total Net Assets and Number of Index Mutual Funds Have Increased in Recent Years

Billions of dollars; year-end, 2000–2017



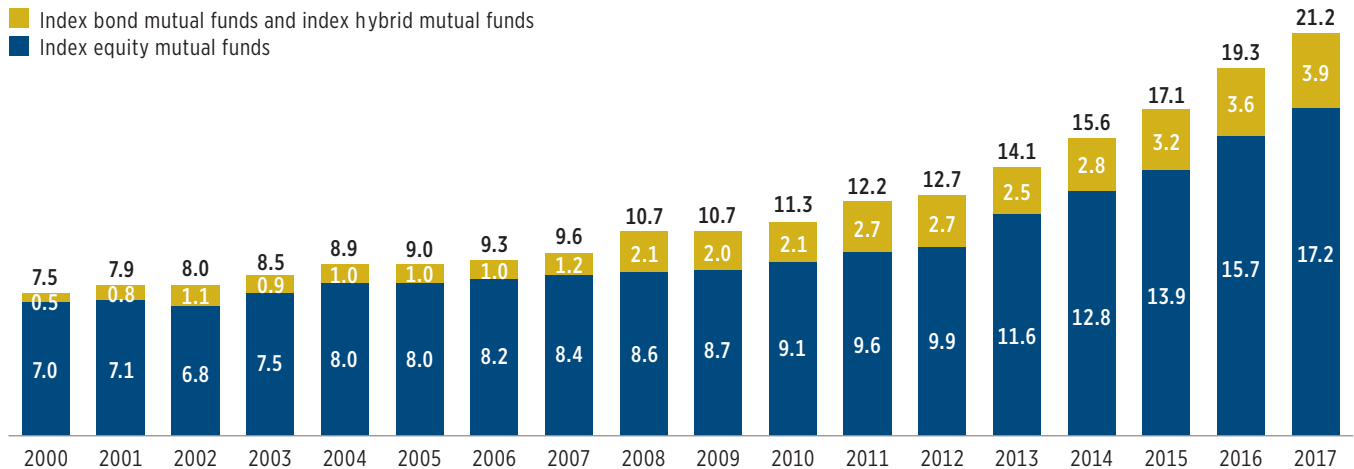
Note: Data exclude mutual funds that invest primarily in other mutual funds. Components may not add to the total because of rounding.

Source: Investment Company Institute

FIGURE 13

### Index Mutual Funds' Share Continued to Rise

Percentage of long-term mutual funds' total net assets, 2000–2017



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

Source: Investment Company Institute

Index mutual funds tend to have below-average expense ratios for several reasons. First, their approach to portfolio management—in which managers generally seek to replicate the return on a specified index by buying and holding all, or a representative sample of, the securities in their target indexes—lends itself to being less costly. This is because index funds’ portfolios tend not to change frequently, and therefore have low turnover rates.

Second, the investment focus of index mutual funds helps keep their expense ratios low. Assets of index equity mutual funds are concentrated more heavily in large-cap blend funds that target US large-cap indexes, such as the S&P 500. Assets of actively managed equity mutual funds, on the other hand, are more widely distributed across stocks of varying market 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 US large-cap stocks.

Third, index mutual funds are larger on average than actively managed funds, which, through economies of scale, helps reduce fund expense ratios. In 2017, the size of the average index equity mutual fund (\$7.1 billion) was four times as large as the size of the average actively managed equity mutual fund (\$1.8 billion).

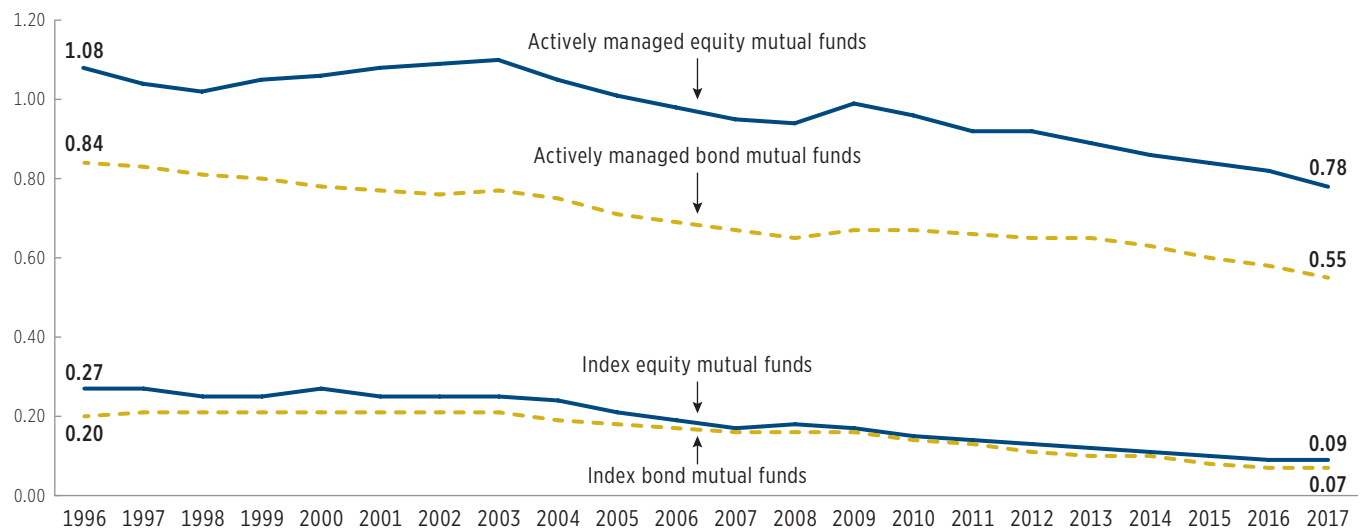
Finally, index mutual fund investors who hire financial professionals might pay for that service out of pocket, rather than through the fund’s expense ratio (see Mutual Fund Load Fees on page 24). In contrast, actively managed mutual funds more commonly have share classes that bundle those costs into the expense ratio.

These reasons, among others, help explain why index mutual funds generally have lower expense ratios than actively managed mutual funds. It is important to note that both index and actively managed mutual funds have contributed to the decline in the average expense ratios of mutual funds (Figure 14). From 1996 to 2017, the average

FIGURE 14

### Expense Ratios of Actively Managed and Index Mutual Funds Have Fallen

Percent, 1996–2017



Note: Expense ratios are measured as asset-weighted averages. Data exclude 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 Morningstar



expense ratio of index equity mutual funds fell from 0.27 percent to 0.09 percent, and the average expense ratio for actively managed equity mutual funds fell from 1.08 percent to 0.78 percent. Over the same period, the average expense ratios of index bond mutual funds fell from 0.20 percent to 0.07 percent and those of actively managed bond mutual funds fell from 0.84 percent to 0.55 percent.

The downward trend in the average expense ratios of both index and actively managed mutual funds reflects, in part, investors' increasing tendency to buy lower-cost funds. Investor demand for index mutual funds is disproportionately concentrated in funds with the lowest

costs. In 2017, for example, 78 percent of index equity mutual fund total net assets were in funds with expense ratios that were among the lowest 25 percent of all index equity mutual funds.<sup>18</sup>

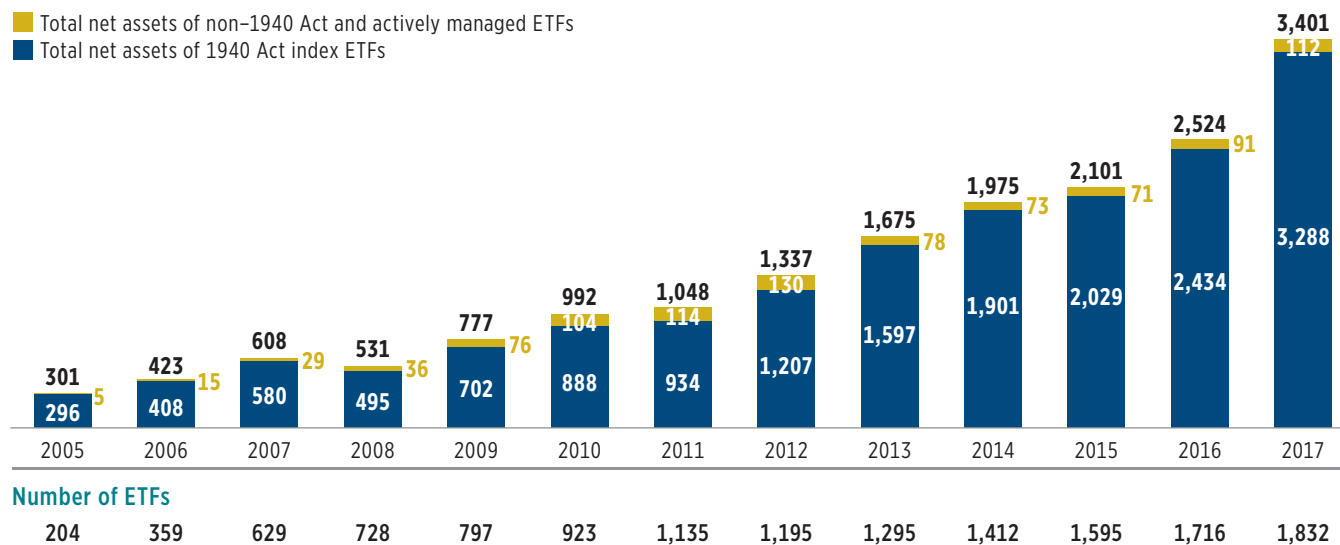
### Index Exchange-Traded Funds

ETFs have grown in popularity over the past decade as investors increasingly are attracted to the specific features of these funds. General trends in investing and money management also have bolstered the demand for ETFs.<sup>19</sup> ETF total net assets have grown rapidly in recent years, from \$301 billion at year-end 2005 to \$3.4 trillion at year-end 2017 (Figure 15).

FIGURE 15

### Total Net Assets and Number of ETFs Have Increased in Recent Years

Billions of dollars; year-end, 2005–2017



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

Source: Investment Company Institute

ETFs are largely index-based and registered with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940. Actively managed ETFs and ETFs not registered under the 1940 Act represented only 3.3 percent of ETF total net assets at year-end 2017.<sup>20</sup> As is true of index mutual funds, most of the assets in ETFs are in funds that focus on equities. Equity ETFs account for more than 80 percent of the total net assets of ETFs.

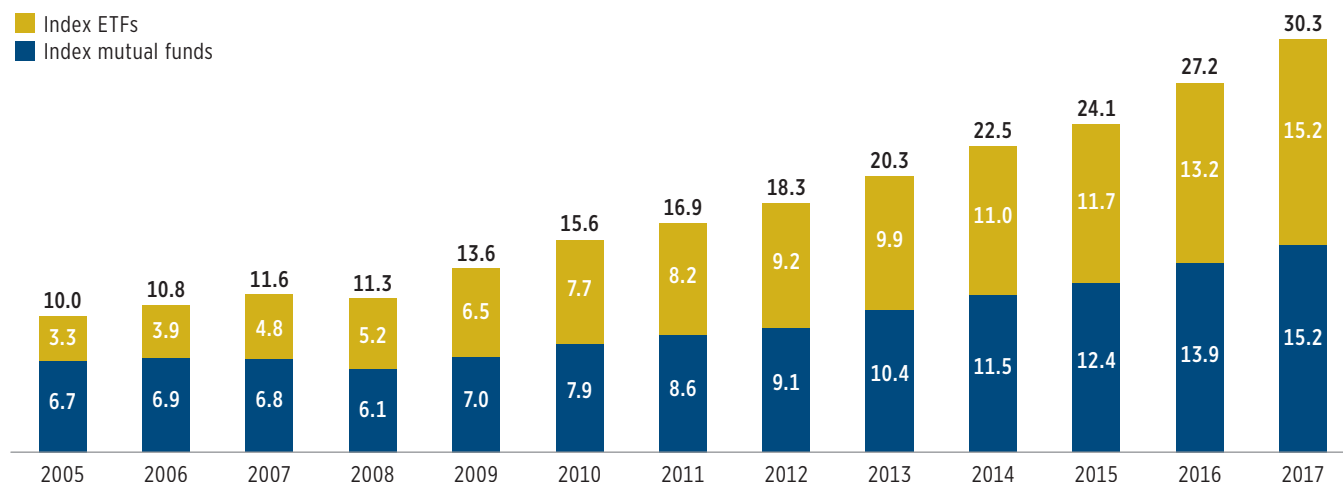
As index funds have grown in popularity, their share of the assets in long-term funds has also grown. In 2005, index ETFs and index mutual funds accounted for 10.0 percent of the total net assets in long-term funds. That share rose to 30.3 percent by 2017 (Figure 16). Over the same time, the share attributable to index ETFs has increased significantly. In 2005, just 3.3 percent of the total net assets of long-term funds were in index ETFs, and by 2017 that share had risen to 15.2 percent. Index ETFs accounted for half of the 30.3 percent of the market share of index mutual funds and index ETFs in 2017.

ETFs fit well within the business model of compensating financial professionals through an asset-based fee. Compensation to financial professionals for distribution or account servicing and maintenance will typically be paid by the investor directly (rather than indirectly through a 12b-1 fee charged by the fund). Although some ETFs do bundle distribution fees in their expense ratios to cover marketing and distribution expenses, these fees are usually very small, ranging between 0.01 and 0.04 percent. Also, financial professionals often provide programs that offer investors a suite of ETFs suited to their investment goals. In such cases, investors would typically pay financial professionals an asset-based fee in addition to the expense ratios of the ETFs in the suite of ETFs selected.

FIGURE 16

### Market Shares of Index Mutual Funds and Index ETFs Have Grown

Percentage of long-term mutual fund and ETF total net assets; year-end, 2005–2017



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

Source: Investment Company Institute

Because ETFs are generally index funds and typically do not bundle distribution and account servicing or maintenance fees in their expense ratios, their expense ratios are typically low.

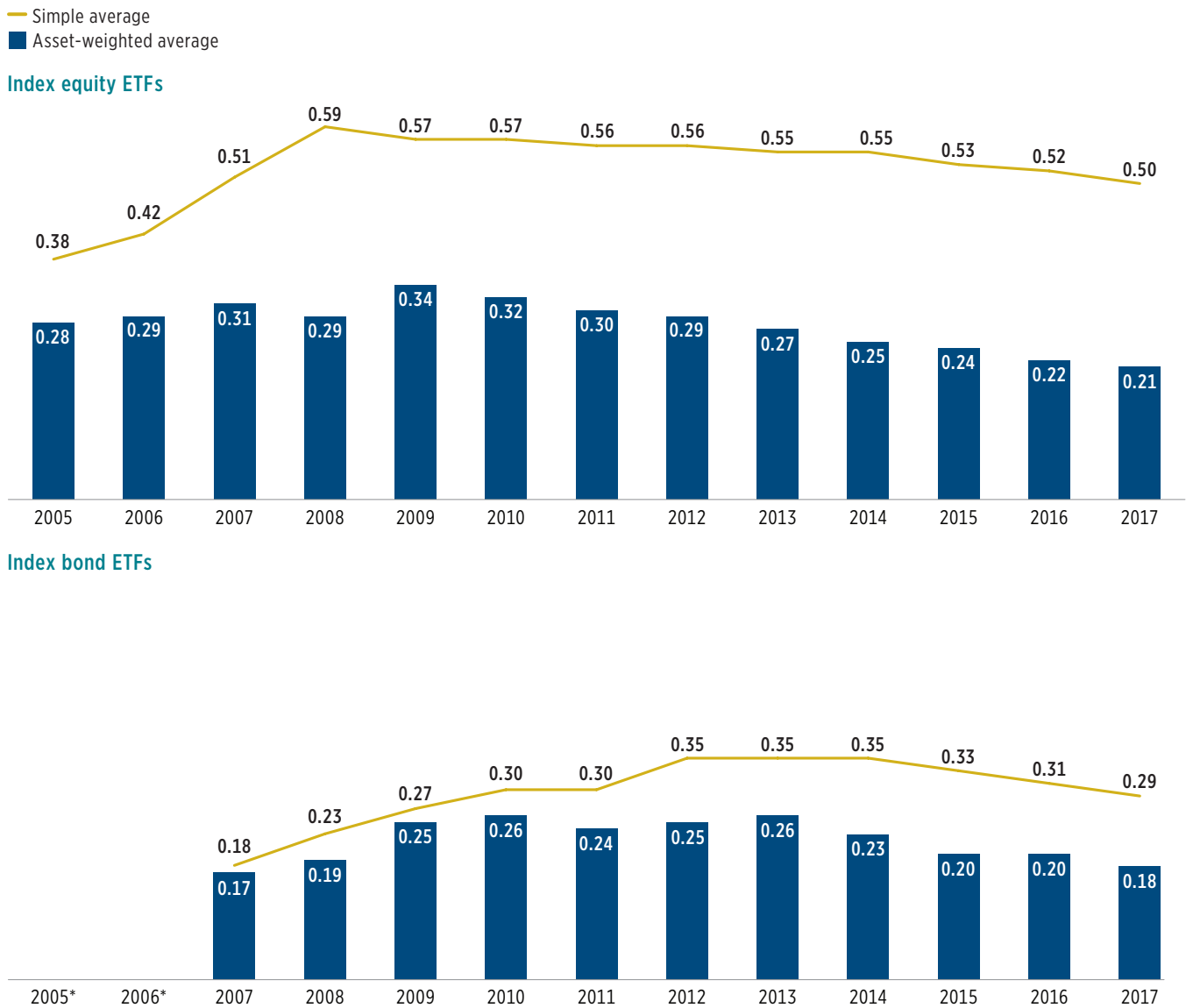
### Index Equity ETFs

In 2017, the asset-weighted average equity ETF expense ratio was 0.21 percent, down 1 basis point from 2016, and down from a peak of 0.34 percent in 2009 (Figure 17). Several factors have influenced the pattern in equity ETF expense ratios since 2005.

FIGURE 17

### Expense Ratios Incurred by Index ETF Investors Have Declined in Recent Years

Percent, 2005–2017



\* Data for index bond ETFs are excluded prior to 2007 because of a limited number of funds.

Note: Data exclude ETFs not registered under the Investment Company Act of 1940 and ETFs that invest primarily in other ETFs.

Sources: Investment Company Institute and Morningstar

Expansion into a variety of equity asset classes contributed to the rise in ETF expense ratios from 2005 to 2009. Until the mid-2000s, assets in ETFs were predominantly in funds that tracked broad-based, large-cap, domestic equity indexes, such as the S&P 500. As the demand for ETFs grew, fund sponsors began offering a much wider variety of equity ETFs, such as those tracking indexes of international stocks or indexes of narrower segments of the domestic stock market or even of particular industries. From 2005 to 2009, net share issuance to sector and world equity ETFs amounted to \$245 billion, outpacing net share issuance of broad-based domestic equity ETFs by about 39 percent. World and sector equity ETFs tend to have higher expense ratios than ETFs focusing on broad-based domestic equity indexes (Figure 18).<sup>21</sup>

Beginning in 2009, competition and economies of scale within the ETF industry appear to have put downward pressure on equity ETF expense ratios. The number of equity ETFs more than quadrupled from 2004 to 2009 and then more than doubled again over the next eight years. By the end of 2017, 1,399 equity ETFs competed for investors' business. In addition, new ETF sponsors have entered the marketplace to compete for market share. Even with a steady stream of new types of equity ETF offerings, the rapid growth in equity ETF total net assets has allowed many equity ETFs to increase in size and reduce their expense ratios because of economies of scale.

FIGURE 18

### Index ETF Expense Ratios Vary Across Investment Objectives

Percent, 2017

Investment objective	10th percentile	Median	90th percentile	Asset-weighted average	Simple average
<b>Index equity ETFs</b>	<b>0.14%</b>	<b>0.48%</b>	<b>0.95%</b>	<b>0.21%</b>	<b>0.50%</b>
Blend	0.10	0.38	0.95	0.13	0.45
Growth	0.07	0.30	0.64	0.19	0.34
Value	0.09	0.30	0.64	0.22	0.34
Sector	0.14	0.50	0.95	0.27	0.54
World	0.25	0.50	0.85	0.32	0.54
<b>Index hybrid ETFs</b>	<b>0.49</b>	<b>0.63</b>	<b>0.87</b>	<b>0.56</b>	<b>0.66</b>
<b>Index bond ETFs</b>	<b>0.08</b>	<b>0.24</b>	<b>0.50</b>	<b>0.18</b>	<b>0.29</b>
Corporate	0.07	0.15	0.25	0.10	0.17
World	0.25	0.46	0.50	0.36	0.42
Government	0.07	0.15	0.95	0.18	0.31
High-yield	0.30	0.44	0.80	0.46	0.48
Municipal	0.18	0.25	0.35	0.24	0.26
<b>Memo:</b>					
<b>Active equity ETFs</b>	<b>0.48</b>	<b>0.83</b>	<b>1.05</b>	<b>0.86</b>	<b>0.84</b>

Note: Each fund's share class is weighted equally for the median, 10th, and 90th percentiles. Data exclude ETFs not registered under the Investment Company Act of 1940 and ETFs that invest primarily in other ETFs.

Sources: Investment Company Institute and Morningstar

## Index Bond ETFs

The asset-weighted average bond ETF expense ratio was 0.18 percent in 2017, down 2 basis points from 2016, and down 8 basis points from a recent peak of 0.26 percent in 2013 (Figure 17).

Like the pattern of expense ratios in equity ETFs, the expense ratios of bond ETFs rose earlier on, but then began to fall in more recent years. The reasons are much the same. Bond ETFs are a relatively new product. The first equity ETF registered with the SEC under the 1940 Act opened in 1993, whereas the first bond ETFs did not open until 2002. Three of the first four bond ETFs targeted indexes of US government bond returns (the fourth targeted an index of US investment grade corporate bonds). From 2002 to 2006, relatively few additional bond ETFs were brought to market. By the end of 2006, two-thirds of the assets of bond ETFs were in funds tied to US government bond indexes. Such ETFs tend to have low expense ratios (Figure 18), in large part reflecting that the markets for US Treasury and agency securities are deep and liquid, making it relatively inexpensive to manage portfolios of those securities.

Bond ETFs began to grow and diversify in 2007. The number of bond ETFs jumped from six to 49, in part because sponsors opened the first high-yield and world bond ETFs. Following the 2007–2009 financial crisis, the share of ETF total net assets in US government bond ETFs declined. Low yields on US government bonds may have prompted increased demand by investors for the higher yields typically offered by corporate, high-yield, and world bonds, leading to growth in bond ETFs holding these types of securities. Portfolios of high-yield bonds and world bonds, though, are typically more costly to manage. Thus, as diversity increased in the bond ETF market, the asset-weighted average expense ratio of bond ETFs also rose.

In recent years, however, the market for bond ETFs has been maturing. As total net assets have increased significantly, economies of scale have helped reduce fund expense ratios. In addition, competition has intensified in the bond ETF space, with more funds and sponsors

contending for investor dollars. In part reflecting these developments, the expense ratios of bond ETFs have been falling since 2013.

## Understanding the Differences in Index Mutual Fund and Index ETF Expense Ratios

When compared to index mutual funds, index ETF expense ratios are somewhat higher. In 2017, index equity mutual funds had an asset-weighted average expense ratio of 0.09 percent (Figure 14) compared with 0.21 percent for index equity ETFs (Figure 17). Similarly, index bond mutual funds had an asset-weighted average expense ratio of 0.07 percent in 2017 compared with 0.18 percent for index bond ETFs. Two factors largely explain these differences.

First, total net assets in index mutual funds are more highly concentrated in categories that, by their nature, tend to have lower-than-average expense ratios—for example, expense ratios of domestic equity funds (for both mutual funds and ETFs) tend to be lower than those of funds that target specific markets, regions, or sectors. This is important because 79 percent of the total net assets of index equity mutual funds as of 2017 were in index domestic equity mutual funds (excluding sector equity). In contrast, domestic equity ETFs (excluding sector equity ETFs) represented a smaller share (58 percent) of index equity ETF total net assets in 2017.

Another primary reason for the difference between index mutual funds' and index ETFs' expense ratios is average fund size, which plays a role in reducing fund expense ratios through economies of scale. In 2017, the average fund size for (long-term) index mutual funds was \$7.4 billion, more than three times the average fund size of index ETFs (\$2.1 billion). Even for domestic equity funds (excluding sector funds), there is a significant difference in average fund size (\$7.9 billion for index mutual funds compared with \$3.7 billion for index ETFs). Compared to the market for index mutual funds, the index ETF market is still relatively young. As the ETF market continues to mature and existing ETFs become larger, the gap between the asset-weighted average expense ratio for index ETFs and index mutual funds seems likely to close.

## *Fund Flows Are Concentrated in the Lowest-Cost Fund Share Classes*

Fund investors have moved toward lower-cost funds or fund share classes, in both actively managed and index funds, in recent years. One way to see this is to examine how fund flows respond to fund expense ratios. Figure 19 plots the sum of net new cash flow or net share issuance into funds that have been sorted and grouped into quartiles based on their expense ratios. The lowest quartile of expense ratios is further split into three ranges; funds with expense ratios below the fifth percentile, those between the fifth and the 10th percentiles, and those between the 10th and the 25th percentiles. Additionally, the expense ratios representing these quartiles are different for active and index funds, and for each investment category. For example, 25 percent of actively managed domestic equity funds have an expense ratio less than 0.87 percent, compared with 0.20 percent for index domestic equity funds.\*

### **Domestic Equity Funds**

Inflows to domestic equity funds were heavily concentrated in the lowest cost funds in 2017 (Figure 19, top panel). Actively managed domestic equity funds experienced significant outflows in 2017, but those with the smallest expense ratios (i.e., below the fifth percentile) received inflows of \$3 billion. While index domestic equity funds saw inflows in each quartile of expense ratios, funds with expense ratios below the fifth percentile had \$115 billion in net inflows. Further, the vast majority (\$208 billion) of inflows into index domestic equity funds went to funds in the lowest quartile of expense ratios. Although overall flows between actively managed funds and index funds stand in stark contrast to one another, it is important to note that investors continued to purchase, on net, actively managed domestic equity funds with the lowest expense ratios.

### **World Equity Funds**

Investors in world equity funds also concentrated their purchases in lower-cost funds in 2017 (Figure 19, middle panel). Like actively managed domestic equity funds, actively managed world equity funds saw inflows focused in funds with expense ratios below the fifth percentile (\$25 billion). However, in contrast to actively managed domestic equity funds, the entire lowest quartile of expense ratios among actively managed world equity funds, on net, received inflows. Inflows into index world equity funds were \$165 billion in funds with expense ratios in the lowest quartile, and like index domestic equity funds, index world equity funds experienced inflows in each expense quartile.

### **Bond and Hybrid Funds**

In contrast to actively managed domestic and world equity funds, actively managed bond and hybrid funds had strong inflows to funds with expense ratios in the entirety of the lowest quartile in 2017 (Figure 19, bottom panel). In particular, actively managed bond and hybrid funds had \$196 billion of inflows in funds with expense ratios in the lowest quartile, compared with net outflows of \$114 billion for domestic equity funds and net inflows of only \$18 billion for world equity funds. Index bond and hybrid funds received \$178 billion in net inflows among funds with expense ratios below the median in 2017.

\* For detail on the expense ratios that define the ranges between the different percentiles in Figure 19, see the appendix on page 31.

FIGURE 19

## Fund Inflows Are Concentrated in Funds with Lower Expense Ratios

Net new cash flow to mutual funds and net share issuance of ETFs in billions of dollars, by expense ratio quartiles, 2017



\* Data include mutual funds and ETFs.

Note: Data exclude funds available as investment choices in variable annuities, funds that invest primarily in other funds, new funds without reported expense ratios, and funds with missing expense ratios.

Sources: Investment Company Institute and Morningstar

## Mutual Fund Load Fees

Many mutual fund investors pay for the services of a financial professional.<sup>22</sup> 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 may provide ongoing services, such as periodically reviewing investors' portfolios, adjusting asset allocations, and responding to customer inquiries.

Traditionally, fund shareholders usually compensated financial professionals through a front-end load fee—a onetime, up-front payment for current and future services. Over the last 30 to 40 years, the way in which investors compensate financial professionals, also described as “distribution structures,” has increasingly shifted towards the use of asset-based fees.<sup>23</sup>

Asset-based fees are assessed as a percentage of the assets that a financial professional manages for an investor, rather than as a percentage of the dollars initially invested. 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 financial professionals. Alternatively, investors may pay the professional an asset-based fee directly. In such cases, the financial professional typically would recommend the purchase of some mix of ETFs and no-load mutual funds (no-load mutual funds have neither a front-end load fee, nor a back-end load fee, nor a 12b-1 fee of more than 0.25 percent).

In part because of the trend toward asset-based fees, the total net assets of load share classes have fallen as a percentage of all long-term mutual fund total net assets, while the total net assets of no-load share classes have increased substantially. For example, the total net assets of load share classes have fallen from 42 percent of long-term mutual fund total net assets at year-end 2000 to just 15 percent at year-end 2017 (Figure 20). Beginning in 2010, load share classes have seen net outflows of more than \$1.0 trillion (Figure 21), and gross sales of back-end load share classes have dwindled almost to zero (Figure 22).

By contrast, no-load share classes have seen net inflows and rising assets since the beginning of 2000. No-load share classes have accumulated the bulk of the net inflows to long-term mutual funds during this time and have experienced net inflows of nearly \$2.0 trillion from 2010 alone. At year-end 2000, no-load share classes accounted for 43 percent of long-term mutual fund total net assets, rising to 70 percent by year-end 2017.



FIGURE 20

**Total Net Assets of Long-Term Mutual Funds Are Concentrated in No-Load Share Classes***Billions of dollars, selected years*

	2000	2005	2010	2011	2012	2013	2014	2015	2016	2017
<b>All long-term mutual funds</b>	<b>\$5,119</b>	<b>\$6,865</b>	<b>\$9,030</b>	<b>\$8,942</b>	<b>\$10,361</b>	<b>\$12,331</b>	<b>\$13,149</b>	<b>\$12,897</b>	<b>\$13,616</b>	<b>\$15,899</b>
<b>Load</b>	<b>2,133</b>	<b>2,313</b>	<b>2,352</b>	<b>2,176</b>	<b>2,361</b>	<b>2,651</b>	<b>2,614</b>	<b>2,440</b>	<b>2,370</b>	<b>2,382</b>
Front-end <sup>1</sup>	1,485	1,728	1,882	1,751	1,892	2,148	2,115	1,989	1,946	1,990
Back-end <sup>2</sup>	493	271	78	50	39	32	24	15	9	6
Level <sup>3</sup>	145	288	381	367	417	459	468	429	408	378
Other <sup>4</sup>	7	16	8	7	11	10	7	6	6	7
Unclassified <sup>5</sup>	3	9	3	1	2	2	1	(*)	1	2
<b>No-load<sup>6</sup></b>	<b>2,195</b>	<b>3,427</b>	<b>5,089</b>	<b>5,224</b>	<b>6,261</b>	<b>7,598</b>	<b>8,382</b>	<b>8,373</b>	<b>9,093</b>	<b>11,056</b>
Retail	1,620	2,403	3,067	2,991	3,464	4,142	4,639	4,586	4,875	5,647
Institutional	576	1,023	2,022	2,233	2,798	3,456	3,743	3,787	4,219	5,409
<b>Variable annuities</b>	<b>784</b>	<b>1,039</b>	<b>1,291</b>	<b>1,251</b>	<b>1,398</b>	<b>1,630</b>	<b>1,672</b>	<b>1,597</b>	<b>1,638</b>	<b>1,794</b>
<b>"R" share classes<sup>7</sup></b>	<b>8</b>	<b>86</b>	<b>297</b>	<b>290</b>	<b>340</b>	<b>452</b>	<b>480</b>	<b>487</b>	<b>514</b>	<b>666</b>

<sup>1</sup> Front-end load > 1 percent. Primarily includes Class A shares; includes sales where front-end loads are waived.

<sup>2</sup> Front-end load = 0 percent and contingent deferred sales load (CDSL) > 2 percent. Primarily includes Class B shares.

<sup>3</sup> Front-end load ≤ 1 percent, CDSL ≤ 2 percent, and 12b-1 fee > 0.25 percent. Primarily includes Class C shares; excludes institutional share classes.

<sup>4</sup> This category contains all other load share classes not classified as front-end load, back-end load, or level load.

<sup>5</sup> This category contains load share classes with missing load fee data.

<sup>6</sup> Front-end load = 0 percent, CDSL = 0 percent, and 12b-1 fee ≤ 0.25 percent.

<sup>7</sup> "R" shares include assets in any share class that ICI designates as a "retirement share class." These share classes are sold predominantly to employer-sponsored retirement plans. However, other share classes—including retail and institutional share classes—also contain investments made through 401(k) plans or IRAs.

(\*) = total net assets of less than \$500 million

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

Sources: Investment Company Institute, Lipper, and Morningstar

FIGURE 21

**No-Load Mutual Fund Share Classes Garnered Positive Net New Cash Flow in 2017***Billions of dollars, selected years*

	2000	2005	2010	2011	2012	2013	2014	2015	2016	2017
<b>All long-term mutual funds</b>	<b>\$229</b>	<b>\$192</b>	<b>\$244</b>	<b>\$28</b>	<b>\$200</b>	<b>\$162</b>	<b>\$98</b>	<b>-\$122</b>	<b>-\$197</b>	<b>\$67</b>
<b>Load</b>	<b>72</b>	<b>12</b>	<b>-62</b>	<b>-130</b>	<b>-77</b>	<b>-70</b>	<b>-174</b>	<b>-130</b>	<b>-234</b>	<b>-296</b>
Front-end <sup>1</sup>	18	41	-56	-100	-67	-56	-160	-101	-183	-221
Back-end <sup>2</sup>	25	-47	-27	-23	-16	-11	-9	-7	-5	-2
Level <sup>3</sup>	30	18	21	-6	6	-2	-4	-22	-46	-72
Other <sup>4</sup>	-1	(*)	(*)	(*)	-1	(*)	(*)	(*)	(*)	(*)
Unclassified <sup>5</sup>	(*)	-1	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
<b>No-load<sup>6</sup></b>	<b>106</b>	<b>139</b>	<b>265</b>	<b>168</b>	<b>299</b>	<b>270</b>	<b>338</b>	<b>77</b>	<b>117</b>	<b>447</b>
Retail	78	65	55	-46	16	38	111	8	-37	33
Institutional	29	73	210	214	283	232	226	69	154	414
<b>Variable annuities</b>	<b>51</b>	<b>18</b>	<b>8</b>	<b>-21</b>	<b>-26</b>	<b>-51</b>	<b>-64</b>	<b>-67</b>	<b>-78</b>	<b>-112</b>
<b>"R" share classes<sup>7</sup></b>	<b>(*)</b>	<b>24</b>	<b>33</b>	<b>10</b>	<b>4</b>	<b>13</b>	<b>-2</b>	<b>-2</b>	<b>-2</b>	<b>27</b>

<sup>1</sup> Front-end load > 1 percent. Primarily includes Class A shares; includes sales where front-end loads are waived.

<sup>2</sup> Front-end load = 0 percent and contingent deferred sales load (CDSL) > 2 percent. Primarily includes Class B shares.

<sup>3</sup> Front-end load ≤ 1 percent, CDSL ≤ 2 percent, and 12b-1 fee > 0.25 percent. Primarily includes Class C shares; excludes institutional share classes.

<sup>4</sup> This category contains all other load share classes not classified as front-end load, back-end load, or level load.

<sup>5</sup> This category contains load share classes with missing load fee data.

<sup>6</sup> Front-end load = 0 percent, CDSL = 0 percent, and 12b-1 fee ≤ 0.25 percent.

<sup>7</sup> "R" shares include assets in any share class that ICI designates as a "retirement share class." These share classes are sold predominantly to employer-sponsored retirement plans. However, other share classes—including retail and institutional share classes—also contain investments made through 401(k) plans or IRAs.

(\*) = inflow or outflow of less than \$500 million

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

Sources: Investment Company Institute, Lipper, and Morningstar

FIGURE 22

**Gross Sales of Long-Term Mutual Funds Are Concentrated in No-Load Share Classes***Billions of dollars, selected years*

	2000	2005	2010	2011	2012	2013	2014	2015	2016	2017
<b>All long-term mutual funds</b>	<b>\$2,294</b>	<b>\$1,740</b>	<b>\$2,701</b>	<b>\$2,860</b>	<b>\$2,963</b>	<b>\$3,510</b>	<b>\$3,609</b>	<b>\$3,506</b>	<b>\$3,555</b>	<b>\$3,940</b>
<b>Load</b>	<b>973</b>	<b>520</b>	<b>566</b>	<b>543</b>	<b>509</b>	<b>598</b>	<b>544</b>	<b>490</b>	<b>427</b>	<b>365</b>
Front-end <sup>1</sup>	704	394	445	438	403	474	431	387	352	307
Back-end <sup>2</sup>	176	33	7	4	3	3	2	2	1	(*)
Level <sup>3</sup>	90	85	111	98	99	119	109	99	73	56
Other <sup>4</sup>	3	6	2	2	4	3	1	2	1	1
Unclassified <sup>5</sup>	(*)	2	1	(*)	(*)	(*)	(*)	(*)	1	1
<b>No-load<sup>6</sup></b>	<b>1,051</b>	<b>955</b>	<b>1,706</b>	<b>1,897</b>	<b>2,049</b>	<b>2,498</b>	<b>2,689</b>	<b>2,616</b>	<b>2,735</b>	<b>3,185</b>
Retail	781	602	934	948	973	1,153	1,226	1,229	1,226	1,333
Institutional	269	353	771	949	1,076	1,345	1,463	1,387	1,509	1,852
<b>Variable annuities</b>	<b>268</b>	<b>225</b>	<b>318</b>	<b>310</b>	<b>295</b>	<b>287</b>	<b>236</b>	<b>248</b>	<b>246</b>	<b>186</b>
<b>"R" share classes<sup>7</sup></b>	<b>2</b>	<b>40</b>	<b>112</b>	<b>111</b>	<b>109</b>	<b>126</b>	<b>139</b>	<b>152</b>	<b>148</b>	<b>204</b>

<sup>1</sup> Front-end load > 1 percent. Primarily includes Class A shares; includes sales where front-end loads are waived.

<sup>2</sup> Front-end load = 0 percent and contingent deferred sales load (CDSL) > 2 percent. Primarily includes Class B shares.

<sup>3</sup> Front-end load ≤ 1 percent, CDSL ≤ 2 percent, and 12b-1 fee > 0.25 percent. Primarily includes Class C shares; excludes institutional share classes.

<sup>4</sup> This category contains all other load share classes not classified as front-end load, back-end load, or level load.

<sup>5</sup> This category contains load share classes with missing load fee data.

<sup>6</sup> Front-end load = 0 percent, CDSL = 0 percent, and 12b-1 fee ≤ 0.25 percent.

<sup>7</sup> "R" shares include assets in any share class that ICI designates as a "retirement share class." These share classes are sold predominantly to employer-sponsored retirement plans. However, other share classes—including retail and institutional share classes—also contain investments made through 401(k) plans or IRAs.

(\*) = gross sales of less than \$500 million

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

Sources: Investment Company Institute, Lipper, and Morningstar

Within no-load funds, the total net assets of both retail and institutional share classes have grown considerably since the beginning of 2010. From 2010 to 2017, total net assets in no-load institutional share classes, however, have grown faster, rising from 22 percent to 34 percent of long-term mutual fund total net assets, compared with an increase of 34 percent to 36 percent for no-load retail share classes.

Some movement toward no-load funds can be attributed to “do-it-yourself” investors. But two other factors likely explain most of the shift. First, sales of no-load share classes through sales channels that compensate financial professionals with asset-based fees outside 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 often invest in institutional no-load share classes. Evidently, gross sales to no-load mutual funds without 12b-1 fees

have grown to 85 percent of total gross sales to long-term mutual funds (Figure 23). The shift toward no-load share classes has been important in driving down the average expense ratio of mutual funds.

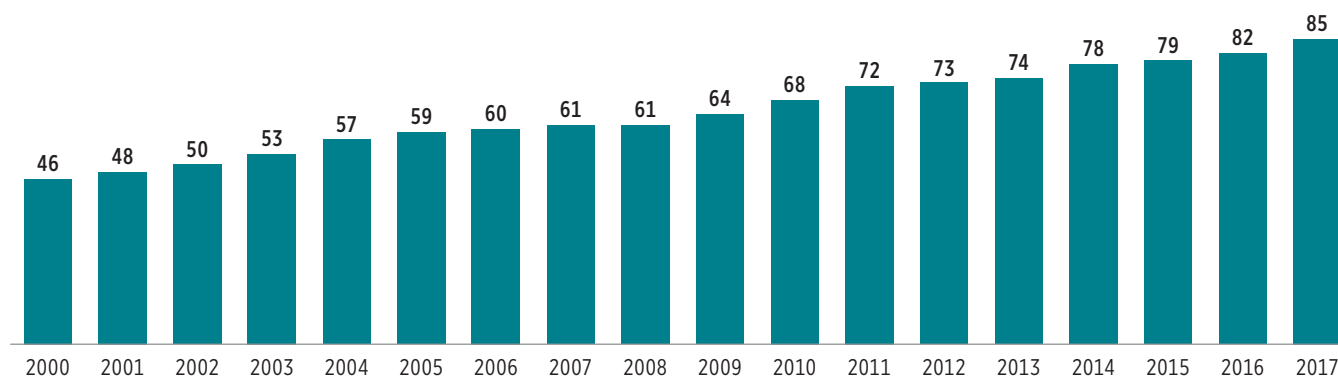
## Conclusion

Expense ratios of long-term mutual funds declined in 2017 as a result of increased 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 continued to rise as an indirect response to the rise in short-term interest rates associated with a firming of monetary policy. Strong asset growth and competitive pressures, fueled by individuals saving for retirement, continue to put downward pressure on target date mutual fund expense ratios. Expense ratios of ETFs decreased in 2017, reflecting a maturing market that is characterized by economies of scale and intense competition.

FIGURE 23

### The Majority of Long-Term Mutual Fund Gross Sales Went to No-Load Mutual Funds Without 12b-1 Fees

Percentage of long-term mutual fund gross sales,\* 2000–2017



\* Long-term mutual fund data exclude mutual funds available as investment choices in variable annuities, mutual funds that ICI designates as “retirement share classes,” and mutual funds that invest primarily in other mutual funds.

Sources: Investment Company Institute, Lipper, and Morningstar

## Notes

- <sup>1</sup> ICI uses asset-weighted averages to summarize the expenses and fees that shareholders pay through 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 the expense ratio of each fund share class by its year-end total net assets.
- <sup>2</sup> Mutual funds that invest primarily in other mutual funds are not included in this section but are analyzed separately in a later section (see page 11).
- <sup>3</sup> To assess the expenses and fees incurred by individual shareholders in long-term mutual funds, this report 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 mutual funds represent investments made on behalf of retail investors, such as through defined contribution plans, IRAs, broker-dealers investing on behalf of retail clients, 529 plans, and other accounts (such as omnibus accounts).
- <sup>4</sup> Use of Morningstar data requires the following disclaimer: © 2017 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.
- <sup>5</sup> For further discussion, see Gallagher 2014.
- <sup>6</sup> ICI uses the term *expense waivers* to refer to fee waivers and/or expense reimbursements.
- <sup>7</sup> See Gallagher 2014.
- <sup>8</sup> See Gallagher 2014.
- <sup>9</sup> See [www.federalreserve.gov/monetarypolicy/openmarket.htm](http://www.federalreserve.gov/monetarypolicy/openmarket.htm).
- <sup>10</sup> Some funds of funds also invest in ETFs.
- <sup>11</sup> See note 4.
- <sup>12</sup> A 2006 SEC rule requires a fund of funds to include both direct and indirect expenses in the expense ratio reported in its prospectus fee table. The expense ratios shown in Figure 9 account for both the expenses that a fund pays directly out of its assets (direct expenses) and the expenses of the underlying funds in which it invests (acquired fund fees or indirect expenses).
- <sup>13</sup> As of year-end 2017, 87 percent of target date mutual fund assets were held in IRAs and defined contribution retirement plans. See Investment Company Institute 2018a.
- <sup>14</sup> When 401(k) plan participants are enrolled automatically or otherwise do not specify how their contributions should be allocated among plan investment choices, the plan sponsor may invest the contributions in a qualified default investment alternative (QDIA). The Pension Protection Act of 2006 required that QDIAs include a mix of asset classes consistent with capital preservation, long-term capital appreciation, or both. The Department of Labor (DOL) QDIA regulation (29 CFR 2550.404c-5) allows three types of investments to 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 focuses only on target date mutual funds.
- <sup>15</sup> See Exhibit 2.10 in BrightScope and Investment Company Institute 2018, which shows the increased use of target date funds in 401(k) plans.
- <sup>16</sup> The latest available data from the DOL are for plan year 2015. In the EBRI/ICI 401(k) database, from which this statistic was generated, funds include mutual funds, bank collective trusts, life insurance separate accounts, and any pooled investment product primarily invested in the security indicated. See Holden et al. 2017.
- <sup>17</sup> See note 4.
- <sup>18</sup> See Investment Company Institute 2018b.
- <sup>19</sup> For a discussion on understanding ETFs and the features that make them attractive to investors, see Antoniewicz and Heinrichs 2014.
- <sup>20</sup> Actively managed ETFs are excluded from the analysis in this report except when indicated. The analysis also excludes ETFs not registered under the Investment Company Act of 1940 (which are ETFs that invest primarily in commodities, currencies, and futures).
- <sup>21</sup> See note 4.
- <sup>22</sup> Among households owning mutual fund shares outside employer-sponsored retirement plans, 79 percent own fund shares through investment professionals. See Holden, Schrass, and Bogdan 2017.
- <sup>23</sup> See, for example, Damato and Pessin 2010.

## References

Antoniewicz, Rochelle, and Jane Heinrichs. 2014. "Understanding Exchange-Traded Funds: How ETFs Work." *ICI Research Perspective* 20, no. 5 (September). Available at [www.ici.org/pdf/per20-05.pdf](http://www.ici.org/pdf/per20-05.pdf).

BrightScope and Investment Company Institute. 2018. *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2015*. San Diego, CA: BrightScope and Washington, DC: Investment Company Institute. Available at [www.ici.org/pdf/ppr\\_18\\_dcplan\\_profile\\_401k.pdf](http://www.ici.org/pdf/ppr_18_dcplan_profile_401k.pdf).

Damato, Karen, and Jaime Levy Pessin. 2010. "Shift from Commissions to Fees Has Benefits for Fund Investors." *Wall Street Journal*, February 1.

Gallagher, Emily. 2014. "Trends in the Expenses and Fees of Mutual Funds, 2013." *ICI Research Perspective* 20, no. 2 (May). Available at [www.ici.org/pdf/per20-02.pdf](http://www.ici.org/pdf/per20-02.pdf).

Holden, Sarah, Jack VanDerhei, Luis Alonso, and Steven Bass. 2017. "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2015." *ICI Research Perspective* 23, no. 6 (August) and EBRI Issue Brief, no. 436. Available at [www.ici.org/pdf/per23-06.pdf](http://www.ici.org/pdf/per23-06.pdf).

Holden, Sarah, Daniel Schrass, and Michael Bogdan. 2017. "Characteristics of Mutual Fund Investors, 2017." *ICI Research Perspective* 23, no. 8 (October). Available at [www.ici.org/pdf/per23-08.pdf](http://www.ici.org/pdf/per23-08.pdf).

Investment Company Institute. 2018a. "The US Retirement Market, Fourth Quarter 2017" (March). Text available at [www.ici.org/research/stats/retirement/ret\\_17\\_q4](http://www.ici.org/research/stats/retirement/ret_17_q4). Data available at [www.ici.org/research/stats/retirement](http://www.ici.org/research/stats/retirement).

Investment Company Institute. 2018b, forthcoming. *2018 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry*. Washington, DC: Investment Company Institute. Available May 2018 at [www.icifactbook.org](http://www.icifactbook.org).

### Additional Reading

- » **The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2016**  
[www.ici.org/pdf/per23-04.pdf](http://www.ici.org/pdf/per23-04.pdf)
- » ***The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2015***  
[www.ici.org/pdf/ppr\\_18\\_dcplan\\_profile\\_401k.pdf](http://www.ici.org/pdf/ppr_18_dcplan_profile_401k.pdf)
- » **The US Retirement Market, Fourth Quarter 2017**  
[www.ici.org/research/stats/retirement](http://www.ici.org/research/stats/retirement)
- » **Understanding Exchange-Traded Funds: How ETFs Work**  
[www.ici.org/pdf/per20-05.pdf](http://www.ici.org/pdf/per20-05.pdf)
- » ***2018 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry (Forthcoming)***  
[www.ici.org/pdf/2018\\_factbook.pdf](http://www.ici.org/pdf/2018_factbook.pdf)
- » **For Money Market Funds, Massive Preparation Has Paid Off in Smooth Transition**  
[www.ici.org/viewpoints/view\\_16\\_mmf\\_transition\\_1](http://www.ici.org/viewpoints/view_16_mmf_transition_1)
- » **ICI Resources on 401(k) Plans**  
[www.ici.org/401k](http://www.ici.org/401k)
- » **ICI Resources on 12b-1 Fees**  
[www.ici.org/rule12b1fees](http://www.ici.org/rule12b1fees)

## Appendix

This appendix contains additional detail for Figure 19 on page 23 of this report. Figure A1 shows the data for Figure 19 in tabular form, and includes the expense ratios that define the ranges for each percentile or quartile.

FIGURE A1

### Low-Cost Funds Receive Majority of Inflows

Mutual funds and ETFs ranked from lowest to highest expense ratios, net flow in billions of dollars, 2017

#### Domestic Equity

Type of fund	Percentile of expense ratios					
	< 5th	≥ 5th to < 10th	≥ 10th to < 25th	≥ 25th to < 50th	≥ 50th to < 75th	≥ 75th
Actively managed						
Expense ratio	< 0.56%	≥ 0.56% to < 0.67%	≥ 0.67% to < 0.87%	≥ 0.87% to < 1.15%	≥ 1.15% to < 1.51%	≥ 1.51%
Net flow	\$3	-\$35	-\$82	-\$80	-\$51	-\$27
Index						
Expense ratio	< 0.06%	≥ 0.06% to < 0.08%	≥ 0.08% to < 0.20%	≥ 0.20% to < 0.42%	≥ 0.42% to < 0.78%	≥ 0.78%
Net flow	\$115	\$31	\$62	\$13	\$5	\$2

#### World equity

Type of fund	Percentile of expense ratios					
	< 5th	≥ 5th to < 10th	≥ 10th to < 25th	≥ 25th to < 50th	≥ 50th to < 75th	≥ 75th
Actively managed						
Expense ratio	< 0.73%	≥ 0.73% to < 0.84%	≥ 0.84% to < 1.04%	≥ 1.04% to < 1.30%	≥ 1.30% to < 1.73%	≥ 1.73%
Net flow	\$25	-\$22	\$15	-\$10	-\$12	-\$8
Index						
Expense ratio	< 0.06%	≥ 0.06% to < 0.11%	≥ 0.11% to < 0.35%	≥ 0.35% to < 0.49%	≥ 0.49% to < 0.68%	≥ 0.68%
Net flow	\$3	\$74	\$88	\$11	\$14	\$13

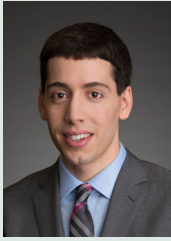
#### Bond and hybrid

Type of fund	Percentile of expense ratios					
	< 5th	≥ 5th to < 10th	≥ 10th to < 25th	≥ 25th to < 50th	≥ 50th to < 75th	≥ 75th
Actively managed						
Expense ratio	< 0.39%	≥ 0.39% to < 0.48%	≥ 0.48% to < 0.65%	≥ 0.65% to < 0.90%	≥ 0.90% to < 1.36%	≥ 1.36%
Net flow	\$98	\$61	\$37	-\$7	-\$47	-\$32
Index						
Expense ratio	< 0.05%	≥ 0.05% to < 0.06%	≥ 0.06% to < 0.10%	≥ 0.10% to < 0.22%	≥ 0.22% to < 0.44%	≥ 0.44%
Net flow	\$21	\$16	\$82	\$59	\$18	\$3

Note: Data exclude funds available as investment choices in variable annuities, funds that invest primarily in other funds, new funds without reported expense ratios, and funds with missing expense ratios.

Sources: Investment Company Institute and Morningstar

### James Duvall



James Duvall is an assistant economist in industry and financial analysis in ICI's research department. Since joining in 2012, Duvall has supported senior staff with analysis on both US and global fund assets and flows, as well as research on the fees and expenses of funds. He graduated *summa cum laude* from Virginia Tech with a BS in mathematics and a BA in economics.

### Morris Mitler



Morris Mitler is an economist in industry and financial analysis at ICI, where he conducts research on the US and global mutual fund and closed-end fund industries. He also conducts economic analysis to better understand the costs, benefits, and effects of proposed laws and regulations governing mutual funds and ETFs (e.g., leverage, Rule 30(e)(3), summary prospectus, and derivatives). Before joining ICI in 2016, Morris spent five years as a financial economist at the Public Company Accounting Oversight Board; he has also done consulting work at Fannie Mae and the US Department of Housing and Urban Development. He earned a BA in economics from the University of San Diego, as well as an MA in economics and an MS and PhD in finance from the George Washington University.



1401 H Street, NW  
Washington, DC 20005  
202-326-5800  
[www.ici.org](http://www.ici.org)

Copyright © 2018 by the Investment Company Institute. All rights reserved.

The Investment Company Institute (ICI) is a leading global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers.