

# ICI RESEARCH PERSPECTIVE

MARCH 2019 // VOL. 25, NO. 1

## Trends in the Expenses and Fees of Funds, 2018

### KEY FINDINGS

- » **On average, expense ratios for long-term mutual funds have declined substantially for more than 20 years.** In 1997, equity mutual fund expense ratios averaged 0.99 percent, falling to 0.55 percent in 2018. Hybrid mutual fund expense ratios averaged 0.92 percent in 1997, falling to 0.66 percent in 2018. Bond mutual fund expense ratios averaged 0.82 percent in 1997, compared with 0.48 percent in 2018.
- » **In 2018, average expense ratios for equity mutual funds fell 4 basis points to 0.55 percent.** Average hybrid mutual fund expense ratios declined 4 basis points to 0.66 percent in 2018, and average bond mutual fund expense ratios remained unchanged.
- » **The average expense ratios for money market funds rose 1 basis point to 0.26 percent in 2018.** As the Federal Reserve continued to raise rates in 2018, fund advisers kept their use of expense waivers low. Expense waivers had been offered widely 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 0.40 percent in 2018.** Since 2008, the expense ratios of target date mutual funds have fallen 40 percent. Because these funds are attractive to individuals saving for retirement, investor demand for them has 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 0.59 percent in 2017 to 0.55 percent in 2018.
- » **Average expense ratios for both actively managed and index equity mutual funds have fallen since 1997.** In 2018, the average expense ratio of actively managed equity mutual funds fell to 0.76 percent, down from 1.04 percent in 1997. Index equity mutual fund expense ratios fell from 0.27 percent in 1997 to 0.08 percent in 2018. 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.

Key findings continued »

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Suggested citation: Duvall, James. 2019. "Trends in the Expenses and Fees of Funds, 2018." *ICI Research Perspective* 25, no. 1 (March). Available at [www.ici.org/pdf/per25-01.pdf](http://www.ici.org/pdf/per25-01.pdf).

For a complete set of data files for each figure in this report, see [www.ici.org/info/per25-01\\_data.xls](http://www.ici.org/info/per25-01_data.xls).

The following assumptions, unless otherwise specified, apply to all data in this report: (1) funds of funds are excluded from the data to avoid double counting, (2) mutual funds available as investment choices in variable annuities are excluded, (3) long-term mutual funds include equity, hybrid, and bond mutual funds, (4) dollars and percentages may not add to the totals presented because of rounding, and (5) this report calculates average expense ratios on an asset-weighted basis (see note 1 on page 30).

### Key findings continued »

- » **Economies of scale and competition are putting downward pressure on expense ratios of exchange-traded funds (ETFs).** In 2018, the expense ratios of index equity ETFs fell to 0.20 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 0.16 percent in 2018.
- » **In 2018, average expense ratios for index equity ETFs fell 1 basis point to 0.20 percent.** Average index bond ETF expense ratios declined 2 basis points from their value in 2017, to 0.16 percent.
- » **Inflows to funds continued to be concentrated in relatively low-cost funds.** Actively managed world equity and actively managed bond and hybrid funds with expense ratios among the lowest 5 percent received inflows. Index domestic equity funds, index world equity funds, and index bond and hybrid funds with expense ratios in the lowest quartile received inflows.
- » **Institutional no-load mutual fund share classes continued to experience positive net new cash flow.** By contrast, most types of mutual fund share classes had outflows in 2018. This disparity, in large part, reflects two growing trends—investors paying intermediaries for advice and assistance directly out of their pockets rather than indirectly through funds, and the popularity of 401(k) plans and other retirement accounts, which often invest in institutional no-load share classes.

## 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 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 1997, equity mutual fund investors incurred expense ratios of 0.99 percent, on average, or \$0.99 for every \$100 in assets. By 2018, that average had fallen to 0.55 percent. Hybrid and bond mutual fund expense ratios also have declined since 1997. The average hybrid mutual fund expense ratio fell from 0.92 percent in 1997 to 0.66 percent in 2018, and the average bond mutual fund expense ratio fell from 0.82 percent to 0.48 percent.<sup>2,3</sup> The average expense ratio for money market funds dropped from 0.51 percent to 0.26 percent over this period.

FIGURE 1

### Average Expense Ratios for Long-Term Mutual Funds Have Fallen

Percent

Year	Equity	Hybrid	Bond	Money market
1997	0.99	0.92	0.82	0.51
1998	0.95	0.89	0.80	0.50
1999	0.98	0.90	0.77	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	0.73	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	0.76	0.54	0.13
2016	0.63	0.73	0.51	0.20
2017	0.59	0.70	0.48	0.25
2018	0.55	0.66	0.48	0.26

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

Sources: Investment Company Institute, Lipper, and Morningstar

The declining expense ratios of equity and hybrid mutual funds in 2018 primarily reflect a long-running shift by investors toward lower-cost funds or fund share classes. Expense ratios of bond mutual funds remained unchanged in 2018, but like equity and hybrid mutual funds, assets continued to move into 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 ninth straight year in 2018, falling 4 basis points in 2018.\* Some fund costs—such as transfer agency fees, accounting and audit fees, and director fees—are relatively fixed in dollar terms, regardless of

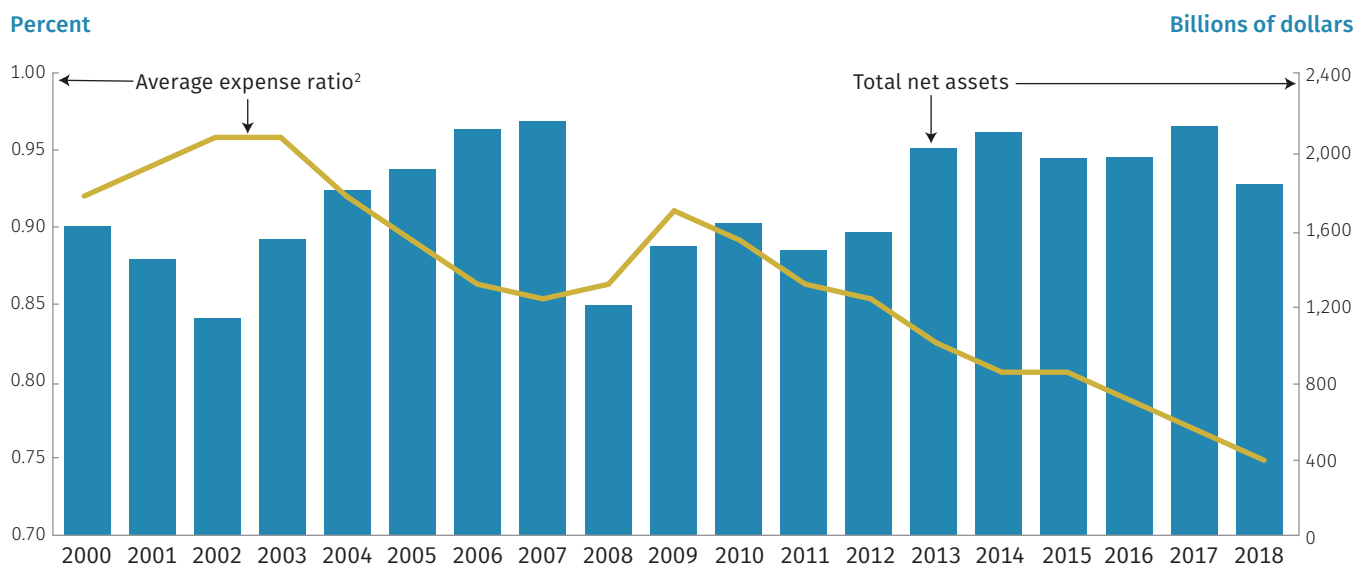
fund size. As a result, when fund assets rise, these relatively fixed costs make up a smaller proportion of a fund’s expense ratio.

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. In 2018, these competitive forces continued to place downward pressure on the expense ratios of actively managed domestic equity mutual funds, despite a downturn of 7 percent on domestic stock prices.†

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 index 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).

† As measured by the Wilshire 5000 Price Index.

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 Expense Ratios of Index Mutual Funds and Index ETFs on page 14).

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 2018 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 0.66 percent or less, while 10 percent have expense ratios of 1.91 percent or more. This variation reflects, among other things, the fact that some growth funds focus

FIGURE 3

### Mutual Fund Expense Ratios Vary Across Investment Objectives

Percent, 2018

Investment objective	10th percentile	Median	90th percentile	Asset-weighted average	Simple average
<b>Equity mutual funds</b>	<b>0.65</b>	<b>1.16</b>	<b>2.02</b>	<b>0.55</b>	<b>1.26</b>
Growth	0.66	1.10	1.91	0.71	1.19
Sector	0.77	1.31	2.15	0.73	1.40
Value	0.68	1.10	1.88	0.66	1.17
Blend	0.39	0.98	1.77	0.33	1.03
World	0.77	1.25	2.10	0.68	1.35
<b>Hybrid mutual funds</b>	<b>0.61</b>	<b>1.16</b>	<b>2.09</b>	<b>0.66</b>	<b>1.28</b>
<b>Bond mutual funds</b>	<b>0.44</b>	<b>0.81</b>	<b>1.63</b>	<b>0.48</b>	<b>0.94</b>
Investment grade	0.35	0.69	1.50	0.34	0.79
World	0.64	1.00	1.81	0.60	1.13
Government	0.29	0.76	1.60	0.39	0.84
High-yield	0.62	0.95	1.75	0.73	1.05
Municipal	0.46	0.76	1.59	0.52	0.90
<b>Money market funds</b>	<b>0.17</b>	<b>0.43</b>	<b>0.87</b>	<b>0.26</b>	<b>0.47</b>
<b>Memo:</b>					
<b>Target date mutual funds*</b>	<b>0.35</b>	<b>0.74</b>	<b>1.46</b>	<b>0.40</b>	<b>0.82</b>
<b>Index equity mutual funds</b>	<b>0.06</b>	<b>0.33</b>	<b>1.53</b>	<b>0.08</b>	<b>0.62</b>

\* Data include mutual funds that invest primarily in other mutual funds. 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

more on small- or mid-cap stocks and others focus more on large-cap stocks. 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 active portfolio managers invest more time into doing research.

### Hybrid Mutual Funds

Total net assets in hybrid mutual funds (which invest in a mix of equities and bonds) have grown modestly over the past few years, from \$1.3 trillion at year-end 2013 to nearly \$1.4 trillion in 2018, and now account for 9 percent of long-term mutual fund net assets. Despite only a slight increase in net assets, their expense ratios have fallen significantly, from 0.80 percent in 2013 to 0.66 percent in 2018 (Figure 1).

The decrease in average expense ratios since 2013 is largely because of a reallocation of net assets within hybrid mutual funds. Specifically, net assets in balanced mutual funds\* grew from \$428 billion at year-end 2013 to \$570 billion by year-end 2018—increasing their share of hybrid mutual fund net assets from 33 percent to 41 percent during the same period. Balanced mutual funds tend to have lower expense ratios than other types of hybrid mutual funds because the vast majority of index hybrid mutual fund total net assets are in balanced mutual funds.

### Bond Mutual Funds

After falling for four consecutive years, the asset-weighted average expense ratio for bond mutual funds remained unchanged in 2018, at 0.48 percent (Figure 1). Offsetting factors kept average expense ratios of bond mutual funds stable in 2018.

One factor is the change in bond mutual fund total net assets. Through economies of scale, mutual fund expense ratios tend to fall when fund assets rise, and vice versa. From 2013 to 2017, total net assets in bond mutual funds grew 22 percent, and as a result, average

expense ratios of bond mutual funds fell by 15 basis points. By year-end 2018, however, bond mutual fund assets decreased slightly from their level at year-end 2017. On its own, this decline in net assets led the average expense ratio of bond mutual funds to tick up about 1 basis point.

One offsetting factor is the general concentration of bond mutual fund assets in lower-cost funds. In 2018 specifically, some movement to lower-cost funds was a direct result of the continued tightening of US monetary policy. The US Treasury yield curve—the difference between the 10-year US Treasury and the 3-month US Treasury—flattened substantially in the fourth quarter of 2018, falling to just 24 basis points by year-end. During this time, money flowed into short- and ultrashort-term bond funds (which have comparatively low expense ratios), as investors took advantage of relatively attractive yields with low interest rate risk.

Another factor that worked to offset the decline in net assets in 2018 was the continued trend toward index funds. For example, in 2018, while actively managed bond mutual funds experienced net outflows of \$34 billion, index bond mutual funds had net inflows of nearly \$36 billion. Because expense ratios of index funds tend to be lower than those of actively managed funds with the same investment objectives, this helped to offset the impact on the average expense ratio from a decrease in all bond mutual fund net assets in 2018 (see Expense Ratios of Index Mutual Funds and Index ETFs on page 14).

### Money Market Funds

The average expense ratio of money market funds rose for the third consecutive year to 0.26 percent in 2018 (Figure 1). The past three years have generally been a reversal from the historical trend in which money market fund expense ratios had remained steady or fallen each year since 1997.

\* 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 fall for one of, or a combination 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

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 two years, 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 and hybrid mutual funds each fell by 4 basis points in 2018. 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 2018 due to:	
	2017	2018		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	0.59	0.55	0.04	9	91
Hybrid	0.70	0.66	0.04	6	94
Bond	0.48	0.48	N/A	N/A	N/A

<sup>1</sup> Tabulations are based on a consistent sample; that is, a share class must have existed in both 2017 and 2018.

<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.

Sources: Investment Company Institute and Morningstar

## Analyzing the Asset-Weighted Average Expense Ratio CONTINUED

This analysis does not mean, however, that the expense ratios of equity and hybrid mutual funds were unchanged. In 2018, nearly half of equity and hybrid mutual fund share classes decreased their

expense ratios (Figure 5). Meanwhile, a roughly even percentage of bond mutual fund share classes either decreased or increased their expense ratios.

FIGURE 5

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

2018

Category	Percentage of total share classes for which expense ratios in 2018:		
	<i>Fell</i>	<i>Were unchanged</i>	<i>Rose</i>
Equity	46	39	15
Hybrid	46	37	17
Bond	30	43	27

Note: Tabulations are based on a consistent sample; that is, a share class must have existed in both 2017 and 2018.

Sources: Investment Company Institute and Morningstar



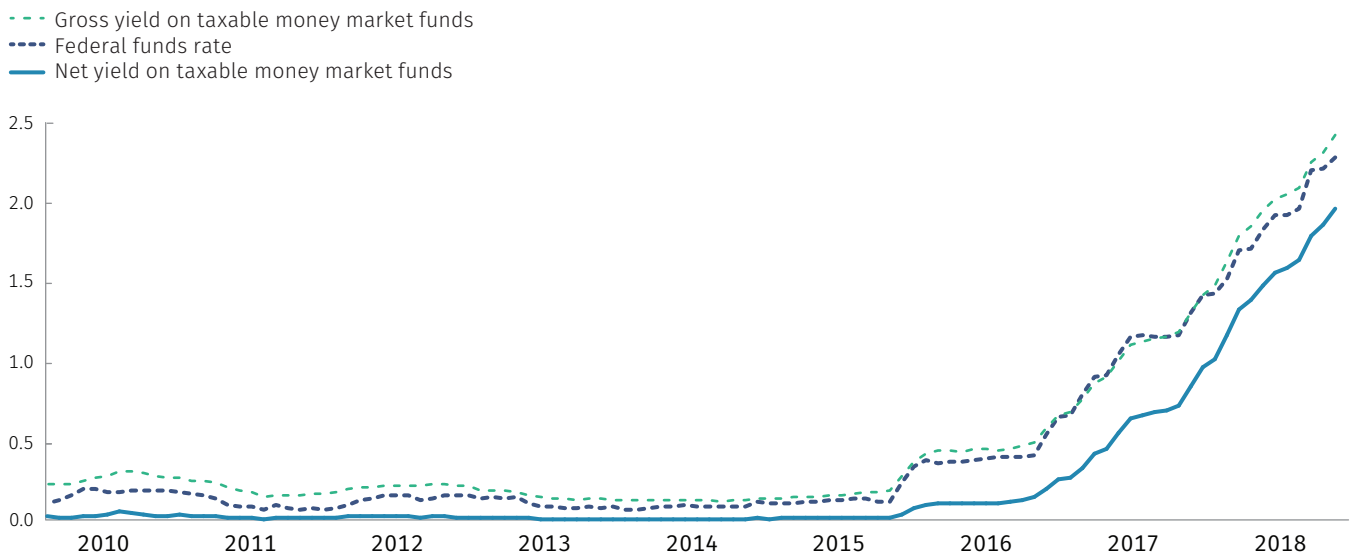
From 2000 to 2009, a combination of two factors played a significant role in reducing the average expense ratios of money market funds. First, the market share of institutional share classes (which tend to have larger average account balances and therefore tend to have lower expense ratios) rose to two-thirds 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 at 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 2018



Sources: iMoneyNet and Federal Reserve Board

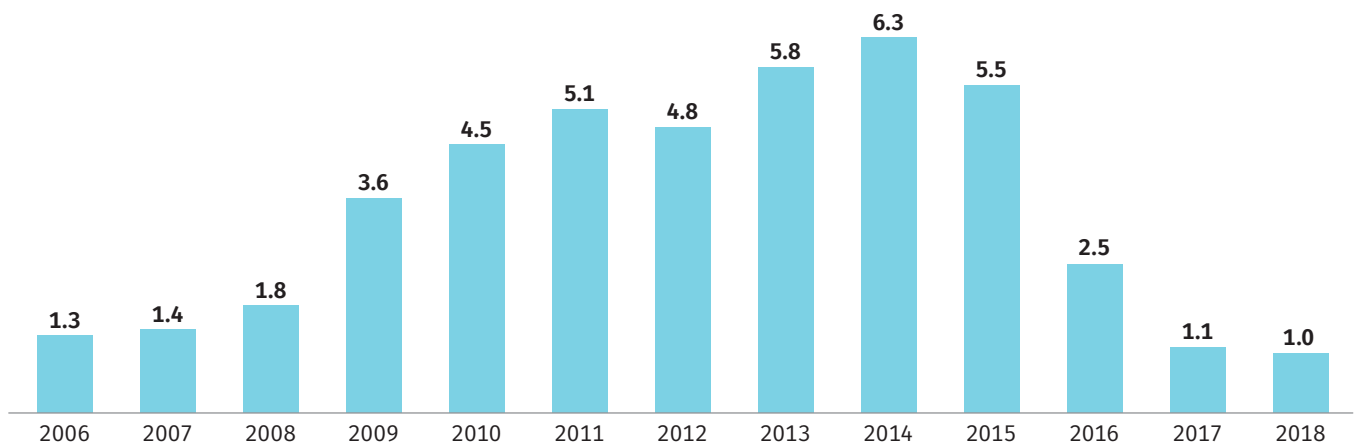
In this environment, most money market funds adopted expense waivers<sup>6</sup> to ensure that net yields (the yield on a fund after deducting fund expenses) did not fall below zero.<sup>7</sup> With an expense waiver, a fund’s adviser agrees to absorb the cost of all or a portion of a fund’s fees and 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 eight more times from 2016 to 2018, 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 72 percent by the end of 2018, and expenses waived dropped sharply from an estimated \$5.5 billion in 2015 to an estimated \$1.0 billion in 2018.

FIGURE 7

**Money Market Funds’ Use of Expense Waivers Remained Low in 2018**

Money market fund expenses waived, billions of dollars



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 2018, there were 1,521 funds of funds with \$2,103 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 12). They also may be asset 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.

FIGURE 8

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

#### Number of funds of funds

Year	Total	Equity	Hybrid	Bond
2008	838	122	706	10
2009	943	130	803	10
2010	977	146	818	13
2011	1,081	156	904	21
2012	1,146	163	953	30
2013	1,249	173	1,042	34
2014	1,322	174	1,107	41
2015	1,394	178	1,177	39
2016	1,432	173	1,218	41
2017	1,389	164	1,184	41
2018	1,521	181	1,288	52

#### Total net assets of funds of funds, billions of dollars

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	1,271	93	1,150	28
2013	1,558	129	1,391	38
2014	1,690	128	1,515	47
2015	1,715	137	1,525	54
2016	1,859	150	1,652	57
2017	2,198	179	1,952	67
2018	2,103	194	1,830	78

Source: Investment Company Institute

In 2018, the asset-weighted average expense ratio of funds of funds was 0.55 percent, down from 0.59 percent in 2017 (Figure 9).<sup>11, 12</sup> From 2005 to 2018, the average expense ratio of funds of funds fell 46 percent, from 1.01 percent to 0.55 percent.

### 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 2018, target date mutual funds had \$1,101 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 2016, for example, 49.3 percent of the account balances of recently hired 401(k) plan participants in their twenties were invested in target date funds.<sup>16</sup>

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 27 basis points to 0.40 percent.

FIGURE 9

### Expense Ratios of Funds of Funds Percent

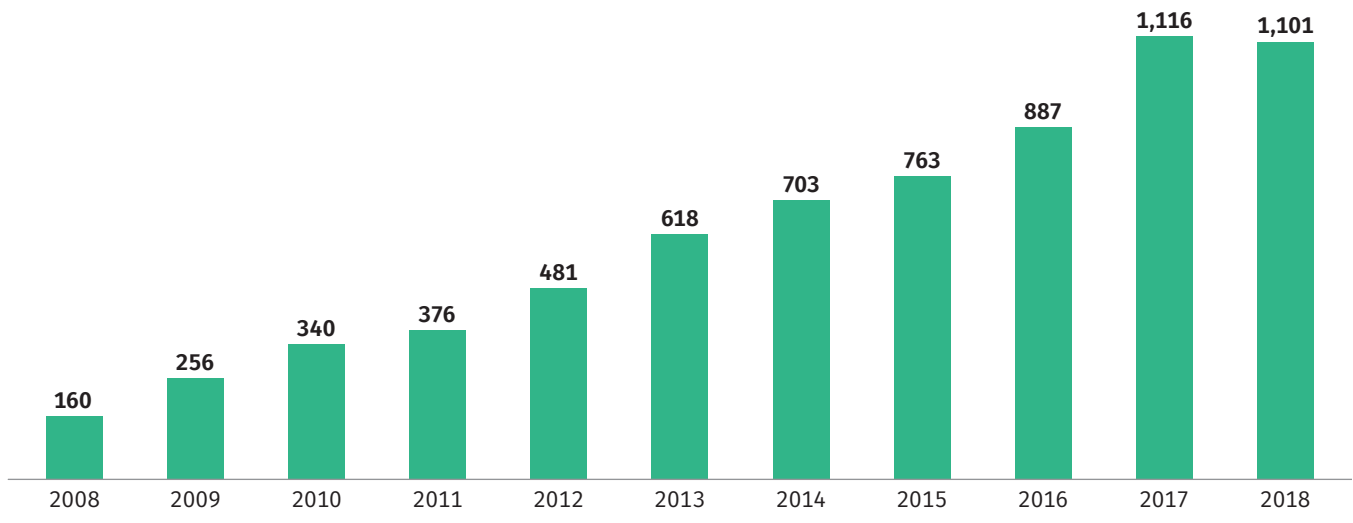
Year	Asset-weighted average	Simple average	Median
2005	1.01	1.56	1.52
2006	0.96	1.44	1.39
2007	0.94	1.44	1.35
2008	0.92	1.40	1.34
2009	0.91	1.38	1.31
2010	0.87	1.34	1.28
2011	0.83	1.30	1.23
2012	0.82	1.27	1.20
2013	0.80	1.22	1.15
2014	0.76	1.20	1.11
2015	0.71	1.12	1.05
2016	0.66	1.09	1.02
2017	0.59	1.04	0.97
2018	0.55	1.04	0.95

Sources: Investment Company Institute, Lipper, and Morningstar

FIGURE 10

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

Total net assets in billions of dollars, year-end



**Number of target date mutual funds**

339 380 378 413 429 492 542 599 641 632 685

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

Source: Investment Company Institute

FIGURE 11

**Expense Ratios of Target Date Mutual Funds**

Percent

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	0.53	0.91	0.87
2016	0.50	0.87	0.82
2017	0.44	0.84	0.76
2018	0.40	0.82	0.74

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

Sources: Investment Company Institute, Lipper, and Morningstar

## Expense Ratios of Index Mutual Funds and Index ETFs

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

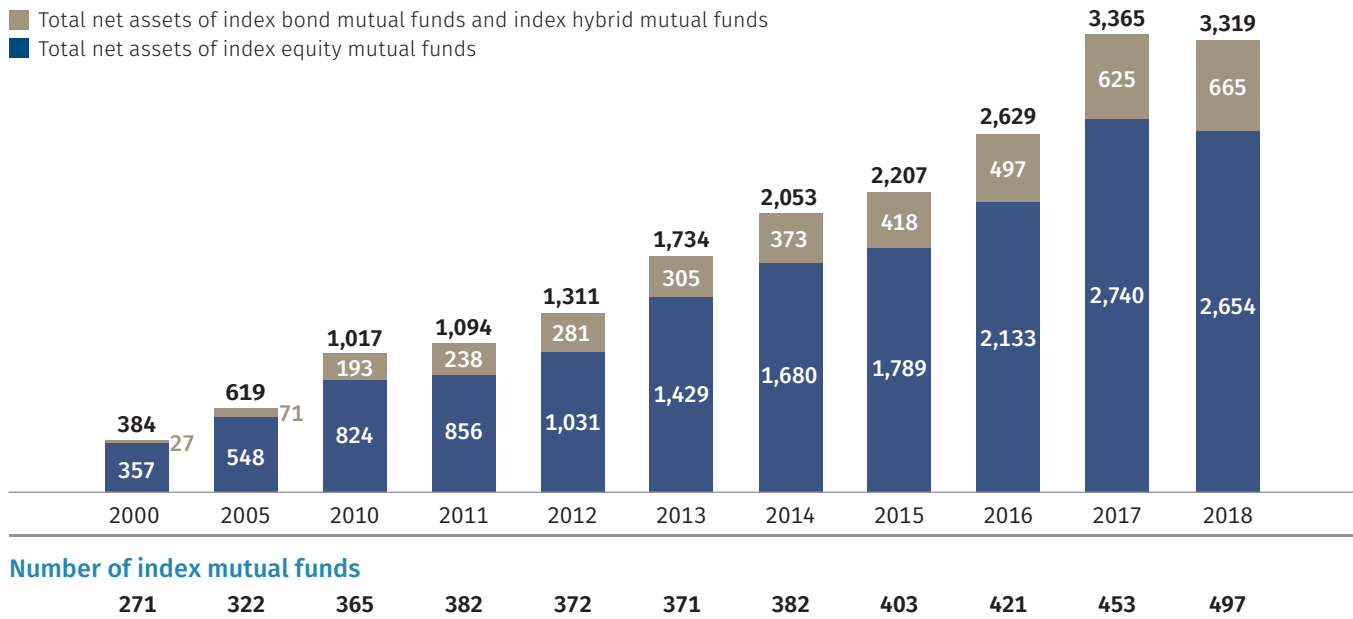
Growth in index mutual funds has contributed to the decline in asset-weighted average expense ratios of equity and bond mutual funds. From 2000 to 2018, index mutual fund total net assets increased significantly, from \$384 billion to \$3.3 trillion (Figure 12). This rapid growth contributed to a rise in index mutual funds' share of long-term mutual fund total net assets, which has tripled from 7.5 percent in 2000 to 22.6 percent in 2018 (Figure 13). Within index mutual funds, index equity mutual funds accounted for the lion's share (80 percent) of index mutual fund total net assets in 2018.

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.

FIGURE 12

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

Billions of dollars, year-end

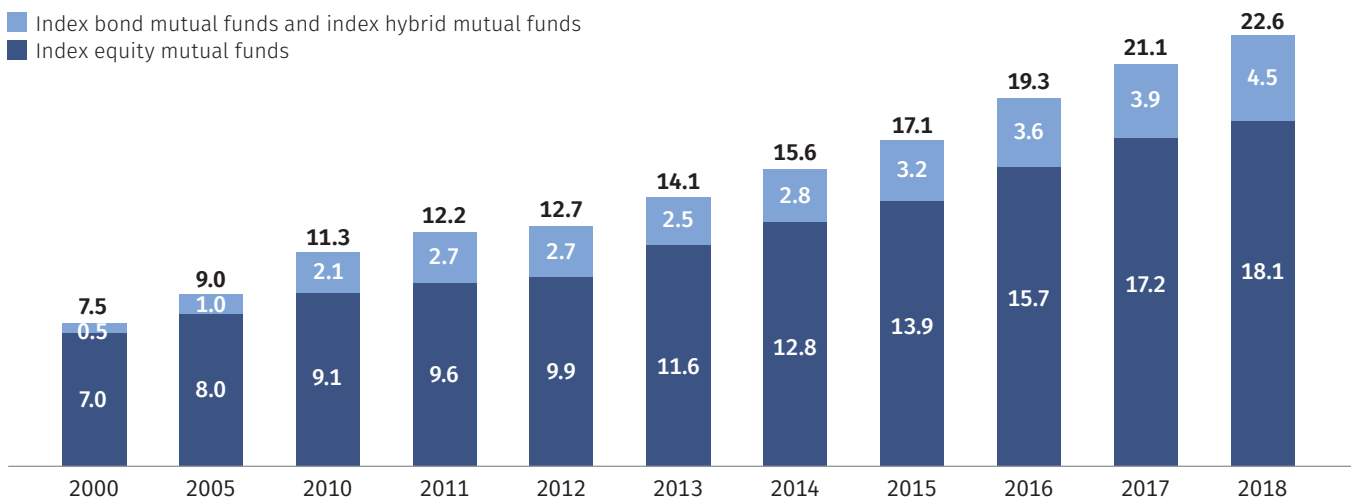


Source: Investment Company Institute

FIGURE 13

**Index Mutual Funds Continued Their Steady Growth**

Percentage of long-term mutual funds' total net assets, year-end



Source: Investment Company Institute

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 2018, the size of the average index equity mutual fund (\$6.3 billion) was more than four times as large as the size of the average actively managed equity mutual fund (\$1.5 billion).

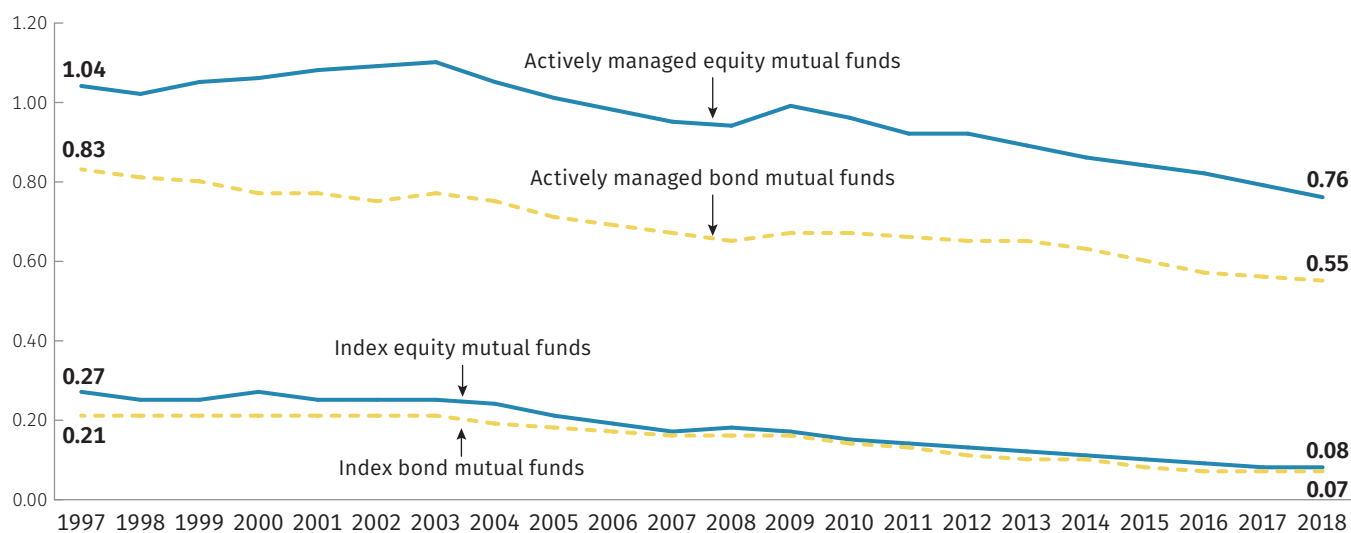
Finally, index mutual fund investors who hire financial professionals might pay for that service out of pocket, rather than through the fund's expense ratio (see Mutual Fund Load Fees on page 24). In contrast, actively managed mutual funds more commonly have share classes that bundle those costs into 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, however, that both index and actively managed mutual funds have contributed to the decline in the average expense ratios of mutual funds (Figure 14). From 1997 to 2018, the average expense ratio of index equity mutual funds fell from 0.27 percent to 0.08 percent, and the average expense ratio for actively managed equity mutual funds fell from 1.04 percent to 0.76 percent. Over the same period, the average expense ratios of index bond mutual funds fell from 0.21 percent to 0.07 percent and those of actively managed bond mutual funds fell from 0.83 percent to 0.55 percent.

FIGURE 14

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

Percent



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

Sources: Investment Company Institute, Lipper, and Morningstar



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 2018, for example, 80 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 2018 (Figure 15).

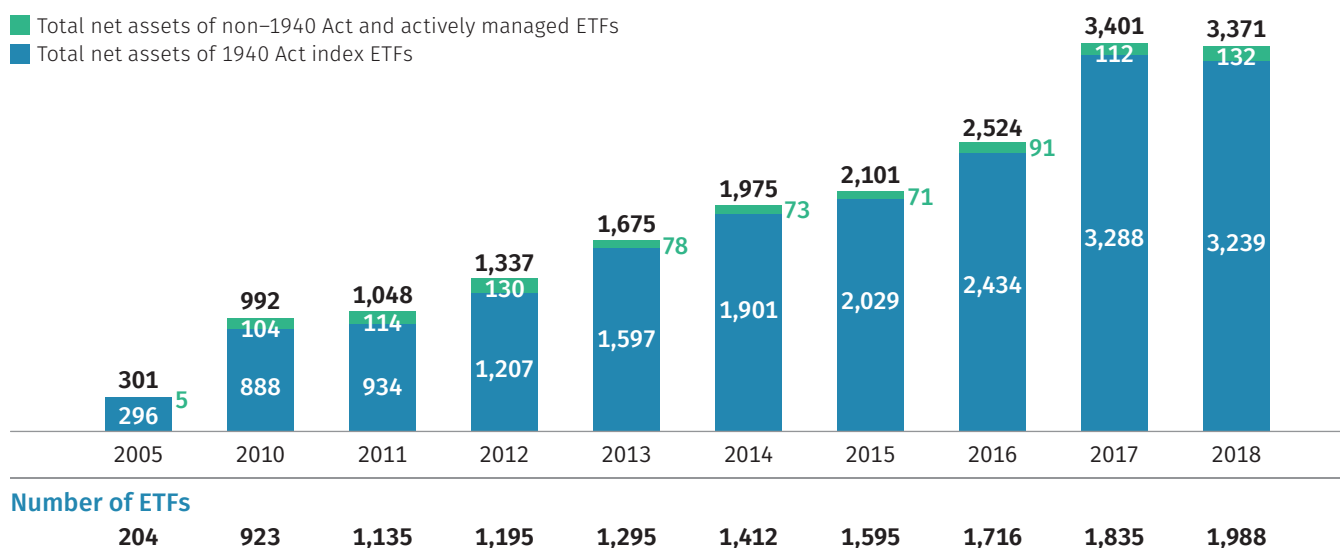
ETFs are largely index-based and registered with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940. Actively managed ETFs and ETFs not registered under the 1940 Act represented only 3.9 percent of ETF total net assets at year-end 2018.<sup>20</sup> As is true of index mutual funds, most of the assets in ETFs are in funds that focus on equities. Equity ETFs account for 79 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

FIGURE 15

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

Billions of dollars, year-end



Source: Investment Company Institute

10.0 percent of the total net assets in long-term funds. That share rose to 31.4 percent by 2018 (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 2018 that share had risen to 15.7 percent. Index ETFs accounted for half of the 31.4 percent of the market share of index mutual funds and index ETFs in 2018.

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

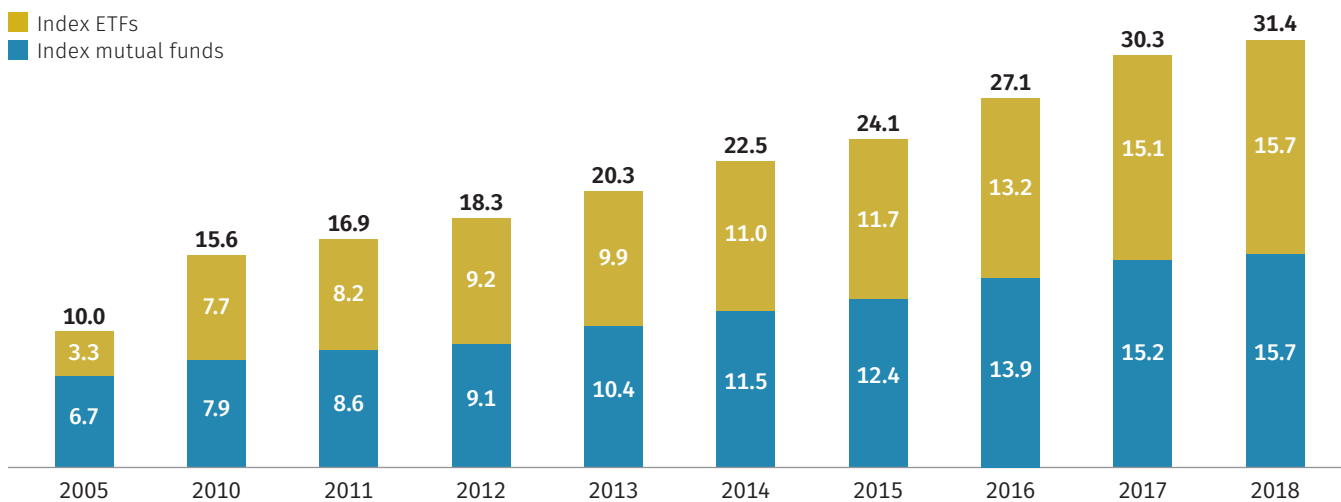
through a 12b-1 fee charged by the fund). Although some ETFs do bundle distribution fees in their expense ratios to cover marketing and distribution expenses, these fees are usually very small, ranging between 0.01 and 0.06 percent. Also, financial professionals often provide programs that offer investors 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.

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.

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



Source: Investment Company Institute

## Index Equity ETFs

In 2018, the asset-weighted average equity ETF expense ratio was 0.20 percent, down 1 basis point from 2017, 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.

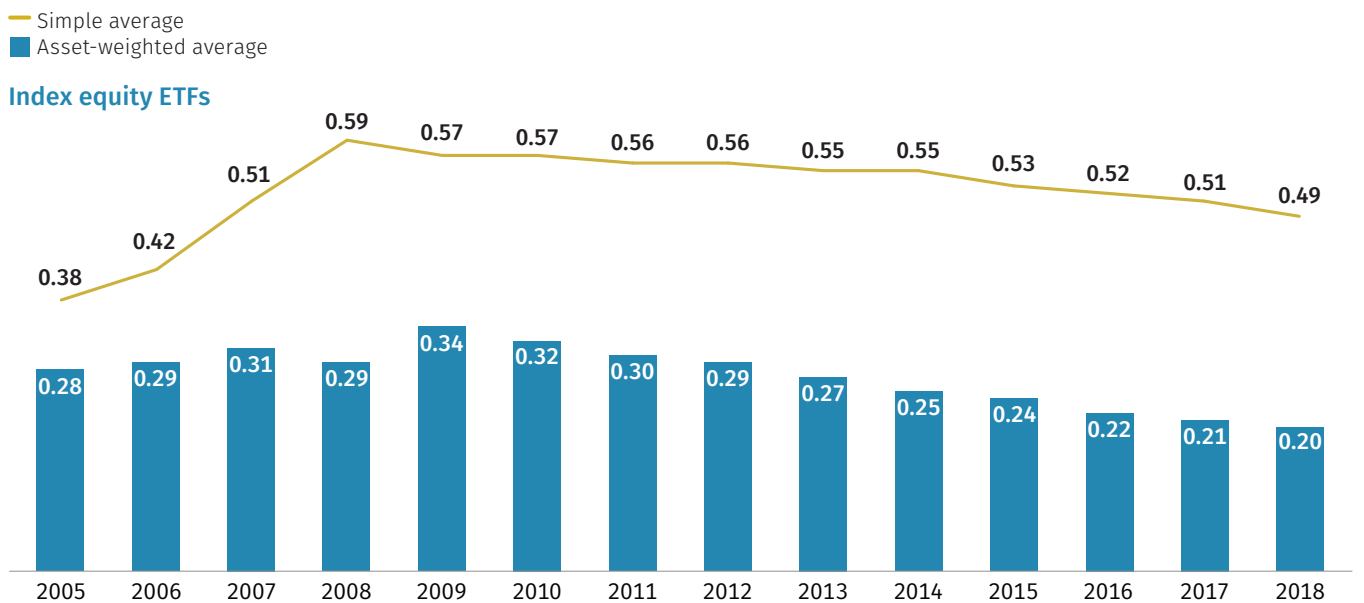
Expansion into a variety of equity asset classes contributed to the rise in ETF expense ratios from 2005 to 2009. Until the mid-2000s, assets in ETFs were

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

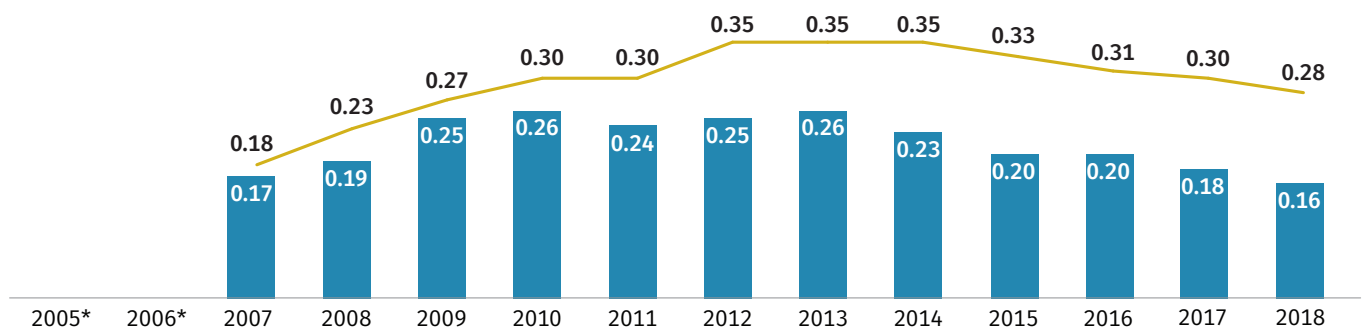
FIGURE 17

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

Percent



### Index bond ETFs



\* Data for 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.

Sources: Investment Company Institute and Morningstar

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 nine years. By the end of 2018, 1,510 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.

### **Index Bond ETFs**

The asset-weighted average bond ETF expense ratio was 0.16 percent in 2018, down 2 basis points from 2017, and down 10 basis points from a recent peak of 0.26 percent in 2013 (Figure 17).

FIGURE 18

### **Index ETF Expense Ratios Vary Across Investment Objectives**

Percent, 2018

Investment objective	10th percentile	Median	90th percentile	Asset-weighted average	Simple average
<b>Index equity ETFs</b>	<b>0.13</b>	<b>0.47</b>	<b>0.95</b>	<b>0.20</b>	<b>0.49</b>
Growth	0.07	0.30	0.64	0.19	0.36
Sector	0.13	0.50	0.95	0.26	0.56
Value	0.08	0.30	0.64	0.21	0.34
Blend	0.10	0.35	0.95	0.12	0.43
World	0.25	0.53	0.82	0.30	0.54
<b>Index hybrid ETFs</b>	<b>0.56</b>	<b>0.68</b>	<b>0.95</b>	<b>0.60</b>	<b>0.70</b>
<b>Index bond ETFs</b>	<b>0.07</b>	<b>0.20</b>	<b>0.50</b>	<b>0.16</b>	<b>0.28</b>
Corporate	0.06	0.10	0.25	0.09	0.15
World	0.24	0.41	0.50	0.31	0.40
Government	0.07	0.15	0.95	0.14	0.31
High-yield	0.25	0.41	0.63	0.45	0.43
Municipal	0.18	0.25	0.35	0.23	0.25
<b>Memo:</b>					
<b>Active equity ETFs</b>	<b>0.40</b>	<b>0.75</b>	<b>1.07</b>	<b>0.79</b>	<b>0.77</b>

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

Sources: Investment Company Institute and Morningstar

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 2018, index equity mutual funds had an asset-weighted average expense ratio of 0.08 percent (Figure 14) compared with 0.20 percent for index equity ETFs (Figure 17). Similarly, index bond mutual funds had an asset-weighted average expense ratio of 0.07 percent in 2018 compared with 0.16 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 2018 were in index domestic equity mutual funds (excluding sector equity). In contrast, domestic equity ETFs (excluding sector equity ETFs) represented a smaller share (60 percent) of index equity ETF total net assets in 2018.

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 2018, the average fund size for long-term index mutual funds was \$7.1 billion, more than three times the average fund size of index ETFs (\$2.2 billion). Even for domestic equity funds (excluding sector funds), there is a significant difference in average fund size (\$7.1 billion for index mutual funds compared with \$3.5 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 0.86 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 index funds in 2018 (Figure 19, top panel). Actively managed domestic equity funds experienced significant outflows in 2018 across all quartiles, but those with the smallest expense ratios (i.e., below the 10th percentile) experienced the least. While index domestic equity funds saw net inflows in all but the third quartile of expense ratios, funds with expense ratios below the

fifth percentile had \$99 billion in net inflows. Further, the vast majority (\$154 billion) of inflows into index domestic equity funds went to funds in the lowest quartile of expense ratios.

### **World Equity Funds**

Investors in world equity funds also concentrated their purchases in lower-cost funds in 2018 (Figure 19, middle panel). Actively managed world equity funds only saw inflows focused in funds with expense ratios below the fifth percentile (\$26 billion). Inflows into index world equity funds were \$124 billion in funds with expense ratios in the lowest quartile, and like index domestic equity funds, index world equity funds experienced net inflows in all but one expense quartile.

### **Bond and Hybrid Funds**

Like world equity funds, actively managed bond and hybrid funds had strong inflows to funds with expense ratios below the fifth percentile (Figure 19, bottom panel). In particular, actively managed bond and hybrid funds had \$51 billion of inflows in funds with expense ratios below the fifth percentile, compared with net outflows of \$16 billion for domestic equity funds and net inflows of \$26 billion for world equity funds. Index bond and hybrid funds received \$108 billion in net inflows among funds with expense ratios below the median in 2018.

\* For detail on the expense ratios that define the ranges between the different percentiles in Figure 19, see the appendix on page 29.

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

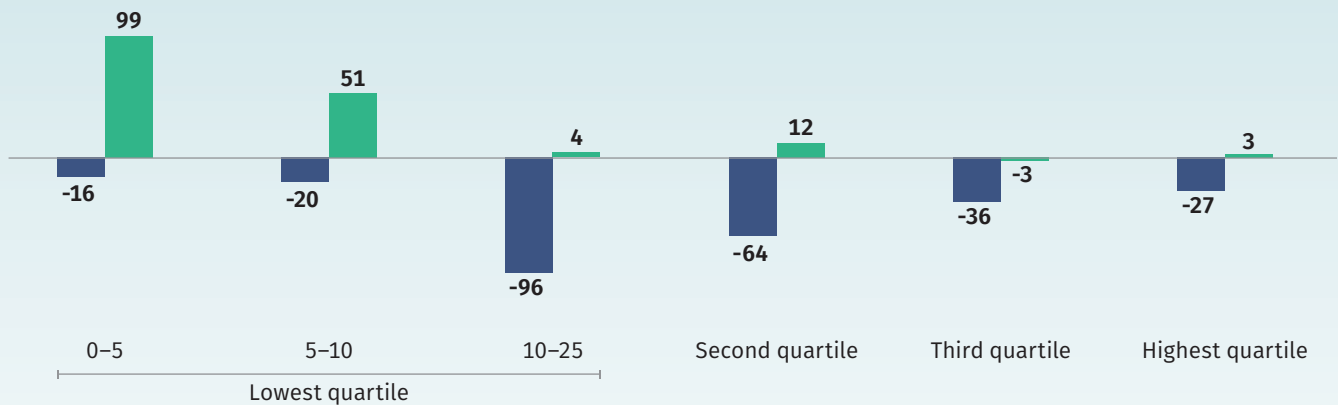
FIGURE 19

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

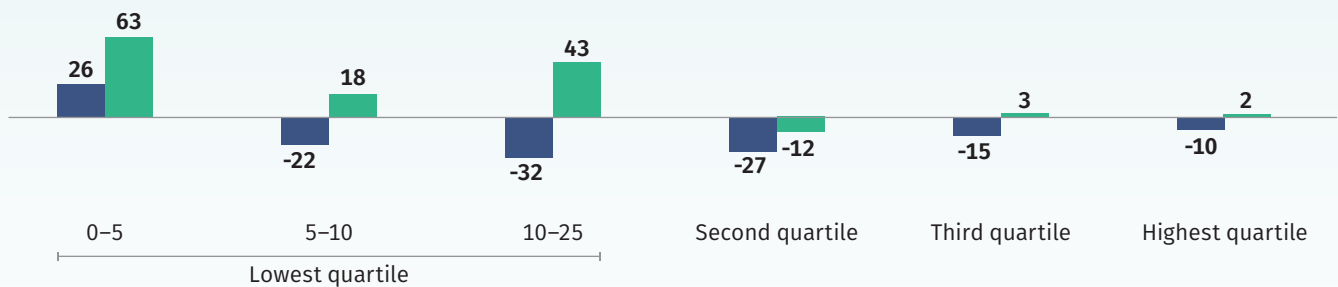
Net new cash flow to and net share issuance of mutual funds and ETFs in billions of dollars, by expense ratio quartiles, 2018

■ Actively managed funds\*  
■ Index funds\*

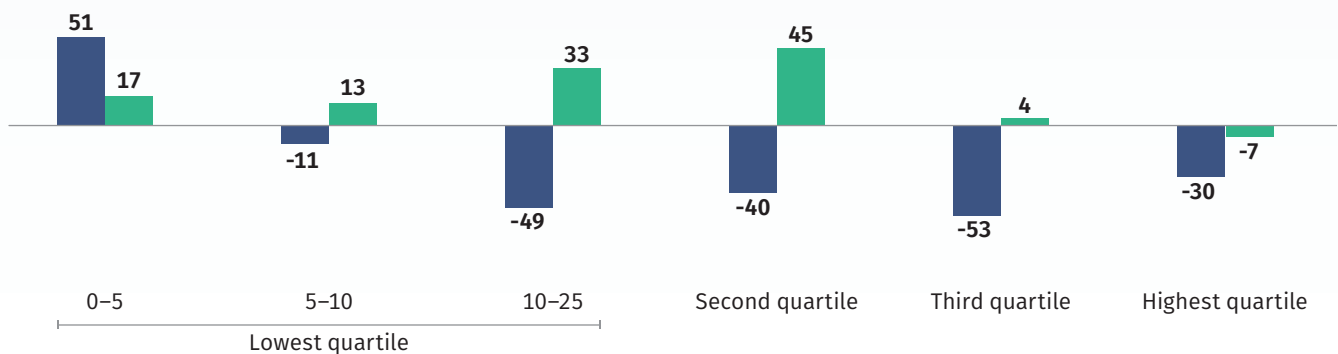
#### Domestic equity



#### World equity



#### Bond and hybrid



\* Data include mutual funds and ETFs.

Note: Data exclude 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 known as *distribution structures*—has increasingly shifted toward 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

FIGURE 20

### Total Net Assets of Long-Term Mutual Funds Are Concentrated in No-Load Share Classes

Billions of dollars, year-end

	2000	2005	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>All long-term mutual funds</b>	<b>5,111</b>	<b>6,862</b>	<b>9,028</b>	<b>8,939</b>	<b>10,360</b>	<b>12,331</b>	<b>13,152</b>	<b>12,903</b>	<b>13,625</b>	<b>15,917</b>	<b>14,670</b>
<b>Load</b>	<b>2,124</b>	<b>2,311</b>	<b>2,350</b>	<b>2,175</b>	<b>2,360</b>	<b>2,650</b>	<b>2,613</b>	<b>2,439</b>	<b>2,369</b>	<b>2,382</b>	<b>2,063</b>
Front-end <sup>1</sup>	1,484	1,728	1,881	1,750	1,892	2,148	2,115	1,989	1,946	1,989	1,763
Back-end <sup>2</sup>	487	271	78	50	39	32	24	15	9	6	4
Level <sup>3</sup>	145	288	381	367	417	459	467	429	408	378	280
Other <sup>4</sup>	6	16	8	7	11	10	7	6	6	7	6
Unclassified <sup>5</sup>	2	7	2	(*)	1	1	(*)	(*)	1	2	10
<b>No-load<sup>6</sup></b>	<b>2,195</b>	<b>3,426</b>	<b>5,090</b>	<b>5,226</b>	<b>6,264</b>	<b>7,601</b>	<b>8,388</b>	<b>8,381</b>	<b>9,105</b>	<b>11,077</b>	<b>10,378</b>
Retail	1,620	2,403	3,066	2,990	3,463	4,141	4,639	4,586	4,874	5,644	5,072
Institutional	575	1,023	2,024	2,235	2,801	3,460	3,749	3,795	4,231	5,433	5,307
<b>Variable annuities</b>	<b>784</b>	<b>1,039</b>	<b>1,290</b>	<b>1,249</b>	<b>1,396</b>	<b>1,628</b>	<b>1,671</b>	<b>1,596</b>	<b>1,636</b>	<b>1,793</b>	<b>1,587</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>	<b>642</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

Sources: Investment Company Institute, Lipper, and Morningstar



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 net assets, while the net assets of no-load share classes have increased substantially. For example, the net assets of load share classes have fallen from 42 percent of long-term mutual fund net assets at year-end 2000 to

just 14 percent at year-end 2018 (Figure 20). Beginning in 2010, load share classes have seen net outflows of nearly \$1.4 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 \$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 71 percent by year-end 2018.

FIGURE 21

**Institutional No-Load Mutual Fund Share Classes Garnered Positive Net New Cash Flow in 2018**

Billions of dollars, annual

	2000	2005	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>All long-term mutual funds</b>	<b>231</b>	<b>192</b>	<b>244</b>	<b>28</b>	<b>200</b>	<b>163</b>	<b>100</b>	<b>-120</b>	<b>-193</b>	<b>72</b>	<b>-350</b>
<b>Load</b>	<b>74</b>	<b>12</b>	<b>-63</b>	<b>-129</b>	<b>-77</b>	<b>-70</b>	<b>-173</b>	<b>-130</b>	<b>-234</b>	<b>-291</b>	<b>-224</b>
Front-end <sup>1</sup>	18	41	-56	-100	-67	-57	-160	-101	-183	-218	-156
Back-end <sup>2</sup>	27	-47	-27	-23	-16	-11	-9	-7	-5	-2	-1
Level <sup>3</sup>	30	18	21	-6	6	-2	-4	-22	-46	-71	-66
Other <sup>4</sup>	(*)	(*)	(*)	(*)	-1	(*)	(*)	(*)	(*)	(*)	(*)
Unclassified <sup>5</sup>	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
<b>No-load<sup>6</sup></b>	<b>106</b>	<b>138</b>	<b>266</b>	<b>169</b>	<b>299</b>	<b>271</b>	<b>339</b>	<b>79</b>	<b>122</b>	<b>450</b>	<b>-7</b>
Retail	78	65	55	-46	16	38	112	8	-36	38	-97
Institutional	28	73	211	214	284	233	228	71	158	412	90
<b>Variable annuities</b>	<b>51</b>	<b>18</b>	<b>7</b>	<b>-22</b>	<b>-27</b>	<b>-51</b>	<b>-64</b>	<b>-67</b>	<b>-79</b>	<b>-112</b>	<b>-129</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>26</b>	<b>10</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

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, annual

	2000	2005	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>All long-term mutual funds</b>	<b>2,291</b>	<b>1,739</b>	<b>2,701</b>	<b>2,860</b>	<b>2,963</b>	<b>3,511</b>	<b>3,611</b>	<b>3,500</b>	<b>3,560</b>	<b>3,925</b>	<b>4,116</b>
<b>Load</b>	<b>971</b>	<b>519</b>	<b>565</b>	<b>543</b>	<b>509</b>	<b>598</b>	<b>544</b>	<b>490</b>	<b>427</b>	<b>365</b>	<b>354</b>
Front-end <sup>1</sup>	704	394	445	438	403	474	431	387	352	307	303
Back-end <sup>2</sup>	175	33	7	4	3	3	2	2	1	(*)	(*)
Level <sup>3</sup>	90	85	111	98	99	119	109	99	73	56	49
Other <sup>4</sup>	2	6	2	2	4	3	1	2	1	1	1
Unclassified <sup>5</sup>	(*)	1	1	(*)	(*)	(*)	(*)	(*)	1	1	1
<b>No-load<sup>6</sup></b>	<b>1,050</b>	<b>955</b>	<b>1,706</b>	<b>1,897</b>	<b>2,050</b>	<b>2,501</b>	<b>2,692</b>	<b>2,611</b>	<b>2,741</b>	<b>3,173</b>	<b>3,361</b>
Retail	781	602	934	948	973	1,153	1,226	1,229	1,226	1,331	1,413
Institutional	269	353	772	949	1,078	1,347	1,466	1,381	1,515	1,842	1,947
<b>Variable annuities</b>	<b>268</b>	<b>225</b>	<b>318</b>	<b>309</b>	<b>294</b>	<b>286</b>	<b>236</b>	<b>248</b>	<b>245</b>	<b>184</b>	<b>205</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>203</b>	<b>195</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

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 2018, total net assets in no-load institutional share classes, however, have grown faster, rising from 22 percent to 36 percent of long-term mutual fund total net assets, compared with an increase of 34 percent to 35 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 87 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.

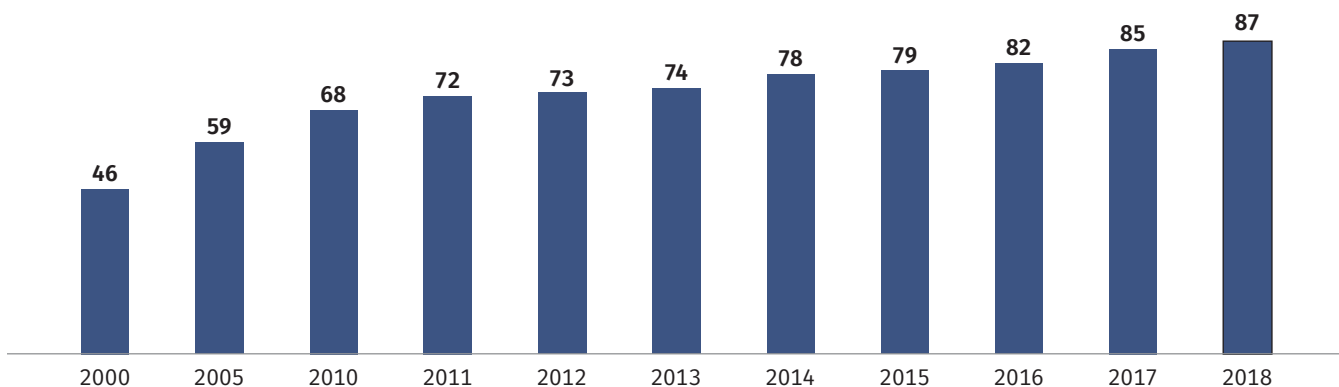
## Conclusion

Expense ratios of equity and hybrid mutual funds declined in 2018 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 bond mutual funds remained unchanged in 2018, as the effect of declining net assets offset the continued trend toward lower-cost funds. Expense ratios of money market funds remained unchanged in 2018 as funds continued to balance reductions in expense waivers with 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, continued to put downward pressure on target date mutual fund expense ratios. Expense ratios of ETFs decreased in 2018, reflecting a maturing market that is characterized by economies of scale and 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



Sources: Investment Company Institute, Lipper, and Morningstar

## Additional Reading

- » **The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2017**  
[www.ici.org/pdf/per24-04.pdf](http://www.ici.org/pdf/per24-04.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 2018**  
[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)
- » **2019 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry (forthcoming)**  
[www.ici.org/pdf/2019\\_factbook.pdf](http://www.ici.org/pdf/2019_factbook.pdf) or [www.icifactbook.org](http://www.icifactbook.org)
- » **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, 2018

Domestic equity						
Type of fund	Percentile of expense ratios					
	< 5th	≥ 5th to < 10th	≥ 10th to < 25th	≥ 25th to < 50th	≥ 50th to < 75th	≥ 75th
<b>Actively managed</b>						
Expense ratio	< 0.55%	≥ 0.55% to < 0.66%	≥ 0.66% to < 0.86%	≥ 0.86% to < 1.13%	≥ 1.13% to < 1.51%	≥ 1.51%
Net flow	-\$16	-\$20	-\$96	-\$64	-\$36	-\$27
<b>Index</b>						
Expense ratio	< 0.05%	≥ 0.05% to < 0.08%	≥ 0.08% to < 0.20%	≥ 0.20% to < 0.41%	≥ 0.41% to < 0.70%	≥ 0.70%
Net flow	\$99	\$51	\$4	\$12	-\$3	\$3
World equity						
Type of fund	Percentile of expense ratios					
	< 5th	≥ 5th to < 10th	≥ 10th to < 25th	≥ 25th to < 50th	≥ 50th to < 75th	≥ 75th
<b>Actively managed</b>						
Expense ratio	< 0.68%	≥ 0.68% to < 0.81%	≥ 0.81% to < 1.00%	≥ 1.00% to < 1.27%	≥ 1.27% to < 1.69%	≥ 1.69%
Net flow	\$26	-\$22	-\$32	-\$27	-\$15	-\$10
<b>Index</b>						
Expense ratio	< 0.09%	≥ 0.09% to < 0.12%	≥ 0.12% to < 0.32%	≥ 0.32% to < 0.49%	≥ 0.49% to < 0.66%	≥ 0.66%
Net flow	\$63	\$18	\$43	-\$12	\$3	\$2
Bond and hybrid						
Type of fund	Percentile of expense ratios					
	< 5th	≥ 5th to < 10th	≥ 10th to < 25th	≥ 25th to < 50th	≥ 50th to < 75th	≥ 75th
<b>Actively managed</b>						
Expense ratio	< 0.38%	≥ 0.38% to < 0.47%	≥ 0.47% to < 0.65%	≥ 0.65% to < 0.90%	≥ 0.90% to < 1.38%	≥ 1.38%
Net flow	\$51	-\$11	-\$49	-\$40	-\$53	-\$30
<b>Index</b>						
Expense ratio	< 0.05%	≥ 0.05% to < 0.06%	≥ 0.06% to < 0.10%	≥ 0.10% to < 0.20%	≥ 0.20% to < 0.41%	≥ 0.41%
Net flow	\$17	\$13	\$33	\$45	\$4	-\$7

Note: Data exclude new funds without reported expense ratios and funds with missing expense ratios.

Sources: Investment Company Institute 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: © 2019 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 2018, 86 percent of target date mutual fund assets were held in IRAs and defined contribution retirement plans. See Investment Company Institute 2019a.
- <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 2016. 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. 2018.
- <sup>17</sup> See note 4.
- <sup>18</sup> See Investment Company Institute 2019b.
- <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, 78 percent own fund shares through investment professionals. See Holden, Schrass, and Bogdan 2018.
- <sup>23</sup> See, for example, Damato and Pessin 2010.

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