

US Fund Expenses and Fees

Mutual funds provide investors with many investment-related services, and for those services, investors incur two primary types of expenses and fees: ongoing expenses and sales loads. Average expense ratios (i.e., ongoing expenses) paid by US mutual fund investors have fallen substantially over time. For example, on an asset-weighted basis, average expense ratios for equity mutual funds fell from 0.99 percent in 2000 to 0.44 percent in 2022, a 56 percent decline. Mutual fund share classes with sales loads are far less commonly sold today than they were a few decades ago. In 2022, the vast majority of gross sales to long-term mutual funds went to share classes that charge neither a sales load nor a 12b-1 fee.

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Trends in Mutual Fund Expenses

Mutual fund investors incur two primary types of expenses and fees: ongoing expenses and sales loads. Ongoing expenses cover portfolio management, fund administration, daily fund accounting and pricing, shareholder services (such as call centers and websites), distribution charges (known as 12b-1 fees), and other operating costs. These expenses are included in a fund's expense ratio—the fund's annual expenses expressed as a percentage of its assets. Because expenses are paid from fund assets, investors pay these expenses indirectly. Sales loads are paid at the time of share purchase (front-end loads), when shares are redeemed (back-end loads), or over time (level loads). Mutual fund share classes with a sales load are far less commonly sold today than they were a few decades ago as investors have gravitated toward funds without them (see *The Shift to No-Load Funds* on page 76).

On an asset-weighted basis, average expense ratios* incurred by mutual fund investors have fallen substantially (Figure 6.1). In 2000, equity mutual fund investors incurred expense ratios of 0.99 percent, on average, or 99 cents for every \$100 invested. By 2022, that average had fallen to 0.44 percent, a 56 percent decline. Hybrid and bond mutual fund expense ratios have also declined over this period, by 34 percent and 51 percent, respectively.

* In this chapter, unless otherwise noted, average expense ratios are calculated on an asset-weighted basis. ICI's fee research 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's share class by its year-end assets.

The fund investment categories used in this chapter are broad and encompass diverse investment styles (e.g., active and index), a range of general investment types (e.g., equity, bond, and hybrid funds), and a variety of arrangements for shareholder services, recordkeeping, or distribution charges (known as 12b-1 fees). This material is intended to provide general information on fees incurred by investors through funds as well as insight into average fees across the marketplace. It is not intended for benchmarking fees and expenses incurred by a particular investor, or charged by a particular fund or other investment product.

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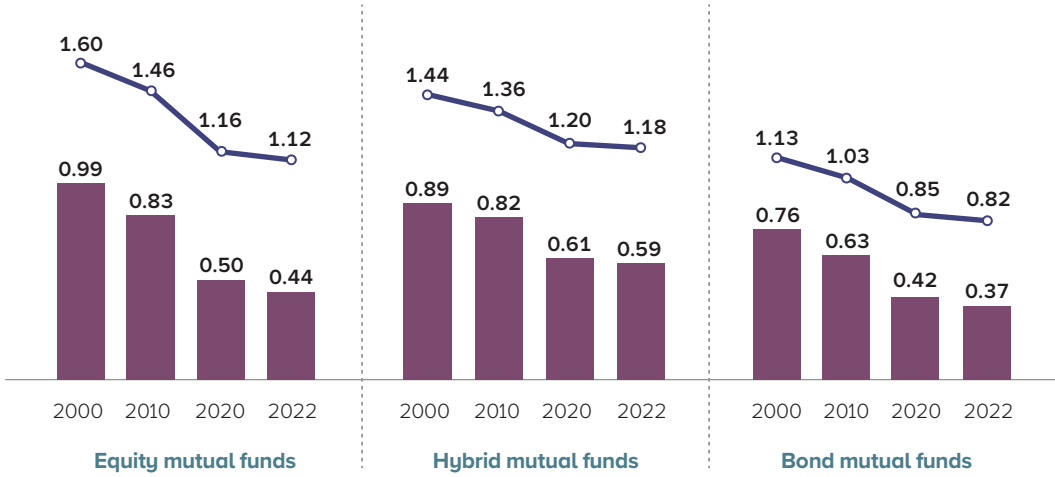


FIGURE 6.1

Expense Ratios Incurred by Mutual Fund Investors Have Declined Substantially Since 2000

Percent

○ Simple average
■ Asset-weighted average



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

Sources: Investment Company Institute, Lipper, and Morningstar. See *ICI Research Perspective*, "Trends in the Expenses and Fees of Funds, 2022."

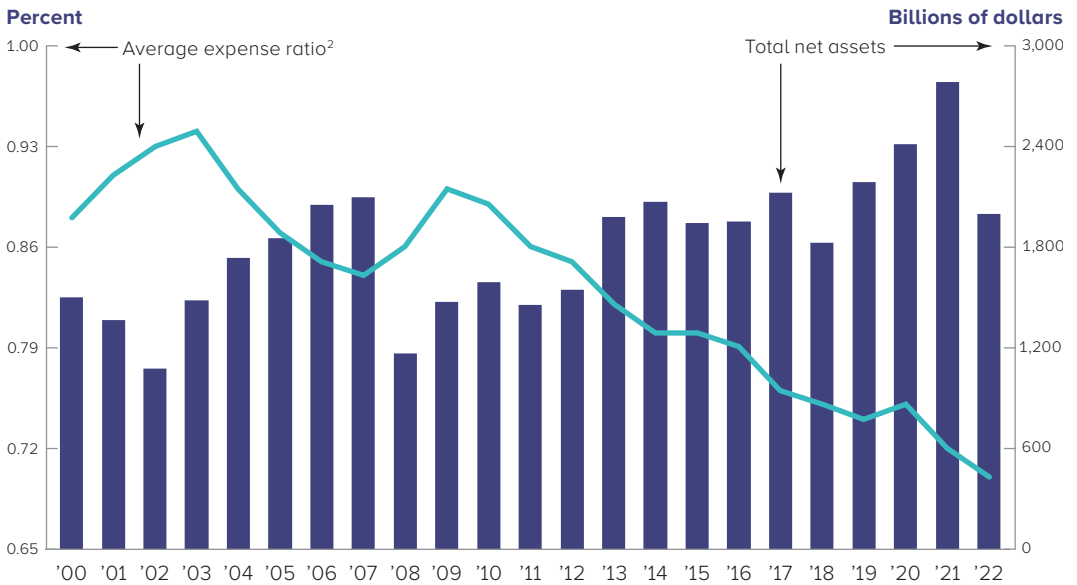
Understanding the Decline in Mutual Fund Expense Ratios

Several factors help account for the steep drop in mutual fund expense ratios. First, expense ratios often vary inversely with fund assets. Some fund costs included in expense ratios—such as transfer agency fees, accounting and audit fees, and directors’ fees—are more or less fixed in dollar terms. This means that when a fund’s assets rise, these costs contribute less to a fund’s expense ratio. Thus, if the assets of a fixed sample of funds rise over time, the sample’s average expense ratio tends to fall over the same period (Figure 6.2).

FIGURE 6.2

Mutual Fund Expense Ratios Tend to Fall as Fund Assets Rise

Share classes of actively managed domestic equity mutual funds continuously in existence since 2000¹



¹ Calculations are based on a fixed sample of share classes. Data exclude mutual funds available as investment choices in variable annuities and index mutual funds.

² Expense ratios are measured as asset-weighted averages.

Sources: Investment Company Institute, Lipper, and Morningstar. See *ICI Research Perspective*, “Trends in the Expenses and Fees of Funds, 2022.”

Another factor contributing to the decline of the average expense ratios of long-term mutual funds is the shift toward no-load share classes, particularly institutional no-load share classes, which tend to have below-average expense ratios. In part, this shift reflects a change in how investors pay for services from brokers and other financial professionals (see page 76).

The Shift to No-Load Funds

Many mutual fund investors engage an investment professional, such as a broker, an investment adviser, or a financial planner. Among households owning mutual fund shares outside employer-sponsored retirement plans, 67 percent own mutual fund shares through investment professionals (see Figure 7.6). These professionals can provide many benefits to investors, such as helping them identify financial goals, analyzing an existing financial portfolio, determining an appropriate asset allocation, and—depending on the type of financial professional—providing investment advice or recommendations to help investors achieve their financial goals. The investment professional also may provide ongoing services, such as responding to investors' inquiries or periodically reviewing and rebalancing their portfolios.

Over the past few decades, the way that fund shareholders compensate financial professionals has changed significantly, moving away from sales loads (e.g., front-end loads) and toward asset-based fees. An important element in the changing distribution structure of mutual funds has been this shift toward asset-based fees, which are assessed as a percentage of the assets that the financial professional helps an investor manage. Increasingly, these fees compensate brokers and other financial professionals who sell mutual funds. An investor may pay an asset-based fee indirectly through a fund's 12b-1 fee, which is included in the fund's expense ratio, or directly (out of pocket) to the financial professional, in which case it is not included in the fund's expense ratio.

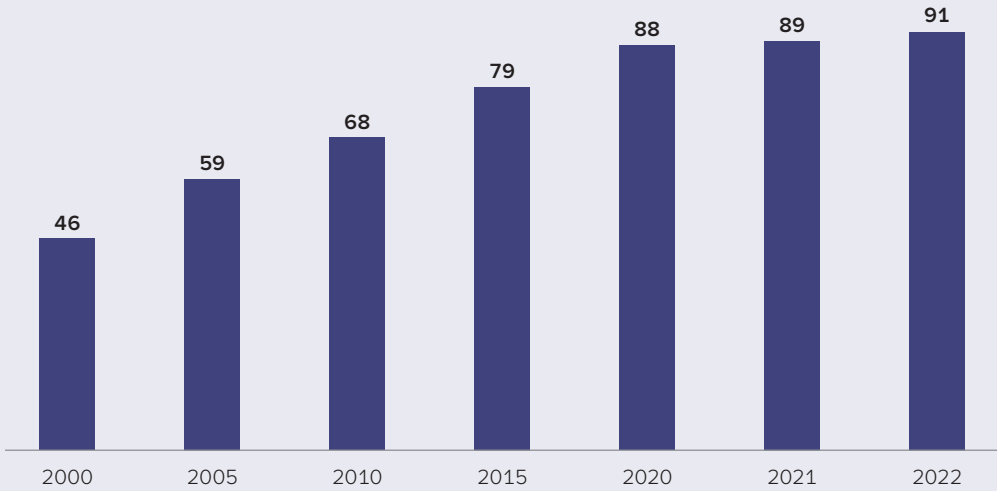
The shift toward no-load share classes has been an important force in driving down the average expense ratio of mutual funds. Some movement toward no-load funds can be attributed to “do-it-yourself” investors who invest through discount brokers or directly with fund companies. Another factor is an ongoing shift to compensate financial professionals with asset-based fees outside of mutual funds (for example, through fee-based professionals and full-service brokerage platforms). Additionally, assets and flows to no-load share classes have been bolstered by 401(k) plans and other retirement accounts. Gross sales to no-load mutual funds without 12b-1 fees have grown substantially since 2000 and were 91 percent of total gross sales to long-term mutual funds in 2022 (Figure 6.3).

CONTINUED ON THE NEXT PAGE

FIGURE 6.3

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, annual



Sources: Investment Company Institute, Lipper, and Morningstar. See *ICI Research Perspective*, "Trends in the Expenses and Fees of Funds, 2022."

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Mutual fund expense ratios also have fallen because of economies of scale and competition. Investor demand for mutual fund services has increased dramatically in the past few decades. From 1990 to 2022, the number of households owning mutual funds nearly tripled—from 23.4 million to 68.6 million (see Figure 7.1). All else being equal, this sharp increase in demand would tend to boost mutual fund expense ratios. Any such tendency, however, was mitigated by downward pressure on expense ratios—from competition among existing mutual fund sponsors, new mutual fund sponsors entering the industry, competition from products such as exchange-traded funds (ETFs) (see chapter 4, Figure 3.10, and page 82 of this chapter), competition from collective investment trusts (CITs) in retirement plans (see Figure 3.12), and economies of scale resulting from the growth in fund assets.

Finally, shareholders indicate that they typically reviewed the fund's fees and expenses when selecting their mutual funds (see Figure 7.7) and tend to invest in mutual funds with below-average expense ratios (Figure 6.1). The simple average expense ratio of equity mutual funds (the average for all equity mutual funds offered for sale) was 1.12 percent in 2022. The asset-weighted average expense ratio for equity mutual funds (the average shareholders actually paid) was far lower, at 0.44 percent. Another way to illustrate the tendency for investors to gravitate to lower-cost funds is to examine how the allocation of their assets across funds varies by expense ratio. At year-end 2022, equity mutual funds with expense ratios in the lowest quartile held most (79 percent) of equity mutual funds' total net assets, and this pattern holds for both actively managed and index equity mutual funds.

Differences in Mutual Fund Expense Ratios

Like the prices of most goods and services, the expense ratios of individual mutual funds differ considerably across the array of available products. The expense ratios of individual funds depend on many factors, including investment objective, fund assets, whether the fund is actively managed or tracks an index, and payments to financial intermediaries.

Mutual Fund Investment Objective

Mutual fund expense ratios vary by investment objective. For example, bond and money market mutual funds tend to have lower expense ratios than equity 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 such funds tend to cost more 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 0.61 percent or less, while another 10 percent have expense ratios of 1.78 percent or more (Figure 6.4). Among other things, this variation reflects the fact that some growth funds focus 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 since information about these types of stocks is less readily available, which means that active portfolio managers must spend more time doing research.

FIGURE 6.4

Mutual Fund Expense Ratios Vary Across Investment Objectives

Percent, 2022



Note: Each fund's share class is weighted equally for the simple average and the median, 10th, and 90th percentiles. Data exclude mutual funds available as investment choices in variable annuities.

Sources: Investment Company Institute and Morningstar

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Expense Ratios of Index Mutual Funds and Index ETFs

An index fund generally seeks to replicate the return on a specified 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 both index mutual funds and index 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 stocks or bonds, 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, underweighting or overweighting 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.

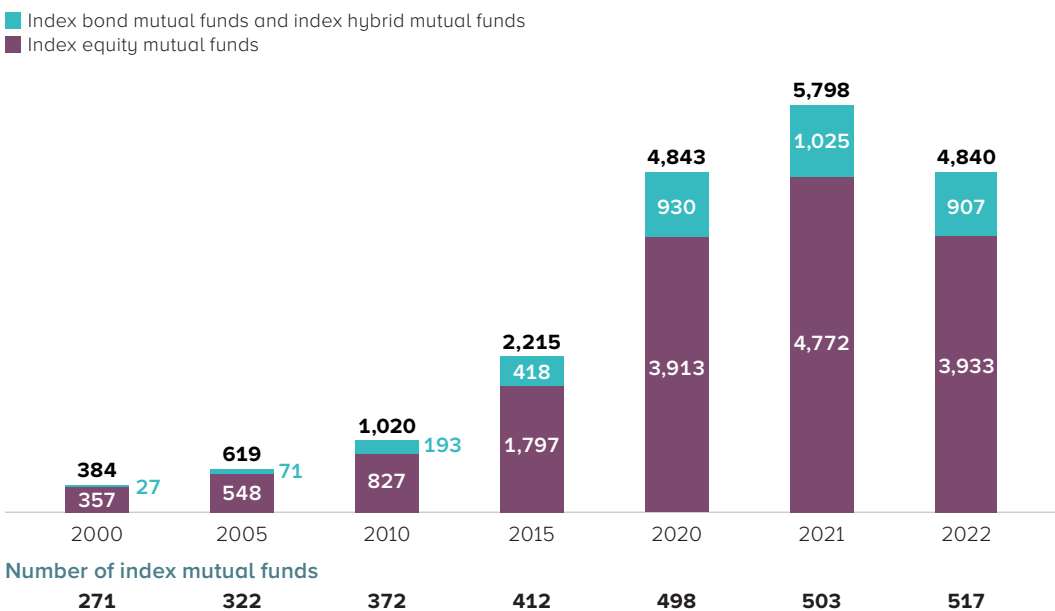
Index Mutual Funds

Growth in index mutual funds has contributed to the decline in asset-weighted average expense ratios of equity, hybrid, and bond mutual funds. From 2000 to 2022, index mutual fund total net assets grew significantly, from \$384 billion to \$4.8 trillion (Figure 6.5). Consequently, over the same period, index mutual funds’ share of long-term mutual fund net assets more than tripled, from 7.5 percent at year-end 2000 to 27.9 percent at year-end 2022. Within index mutual funds, index equity mutual funds accounted for the bulk (81 percent) of index mutual fund total net assets at year-end 2022.

FIGURE 6.5

Total Net Assets of Index Mutual Funds Fell in 2022

Billions of dollars, year-end



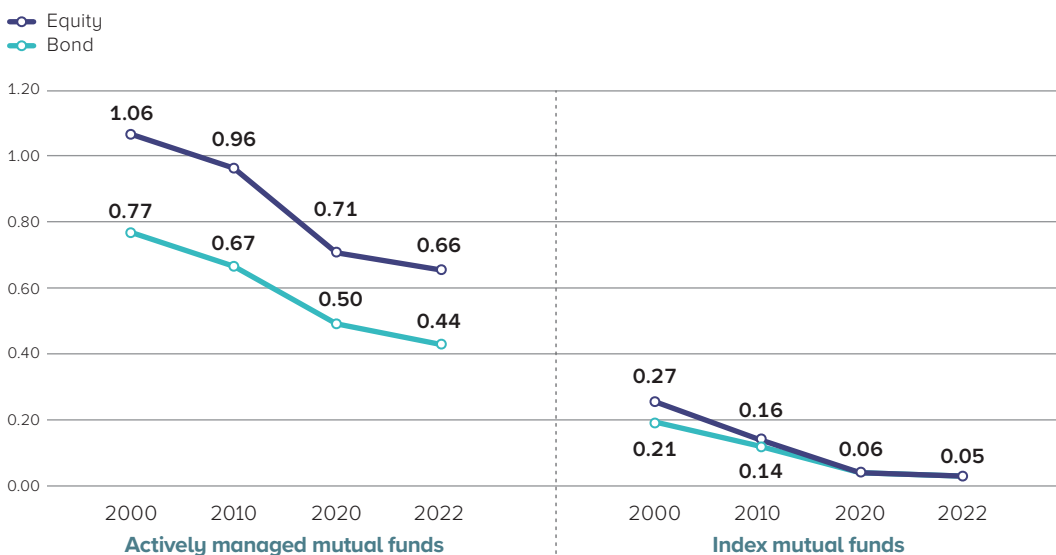
Index mutual funds tend to have below-average expense ratios for several reasons. First, their approach to portfolio management lends itself to being less costly. This is because index funds' portfolios tend not to change frequently, and therefore, have low turnover rates.

Second, index mutual funds tend to have below-average expense ratios because of their investment focus. Net 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. Net assets of actively managed equity mutual funds, on the other hand, are more widely distributed across stocks of varying capitalizations, international regions, or specialized business sectors. Managing portfolios of small- or mid-cap, international, or sector stocks is generally acknowledged to be more expensive than managing portfolios of US large-cap stocks.

Finally, index mutual funds are larger on average than actively managed mutual funds, which, through economies of scale, helps reduce fund expense ratios. At year-end 2022, the average index equity mutual fund (\$9.1 billion) was significantly larger than the average actively managed equity mutual fund (\$1.9 billion).

These reasons, among others, help explain why index mutual funds generally have lower expense ratios than actively managed mutual funds. However, 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 6.6).

FIGURE 6.6
Expense Ratios of Actively Managed and Index Mutual Funds Have Fallen
 Percent



Note: Expense ratios are measured as asset-weighted averages. Data exclude mutual funds available as investment choices in variable annuities.

Sources: Investment Company Institute, Lipper, and Morningstar. See *ICI Research Perspective*, "Trends in the Expenses and Fees of Funds, 2022."

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. Index equity mutual funds with expense ratios in the lowest quartile held 85 percent of index equity mutual funds' net assets at year-end 2022. This phenomenon is not unique to index mutual funds, however; the proportion of assets in the lowest-cost actively managed mutual funds is also high.

Index ETFs

ETF total net assets have grown rapidly in recent years, from \$992 billion at year-end 2010 to \$6.5 trillion at year-end 2022 (see Figure 4.1). During this time, ETFs have become a significant market participant, with net assets accounting for 22 percent of total net assets managed by investment companies at year-end 2022 (see Figure 2.1). ETFs are largely index-based and generally registered with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940. Actively managed ETFs registered under the 1940 Act represented 5.2 percent of ETF total net assets at year-end 2022, and ETFs not registered under the 1940 Act represented 1.8 percent. Like index mutual funds, most of the net assets in ETFs are in funds that focus on equities. Equity ETFs accounted for 78 percent of the total net assets of ETFs at year-end 2022.

Part of the strong growth in ETFs is attributable to their distribution structure, in which the ETF generally charges an expense ratio that provides no compensation to financial professionals. Compensation to financial professionals for distribution or account servicing and maintenance is typically paid directly by the investor.* And because ETFs are generally index funds, they typically have lower expense ratios.

Like mutual fund investors, ETF shareholders tend to invest in funds with below-average expense ratios (Figure 6.7). For example, the simple average expense ratio of index equity ETFs (the average for all index equity ETFs offered for sale) was 0.46 percent in 2022. The asset-weighted average expense ratio for index equity ETFs (the average shareholders actually paid) was much less than that, 0.16 percent.

* Some ETFs bundle distribution fees in the expense ratio to cover marketing and distribution expenses. These fees are usually small, typically no more than 0.04 percent.

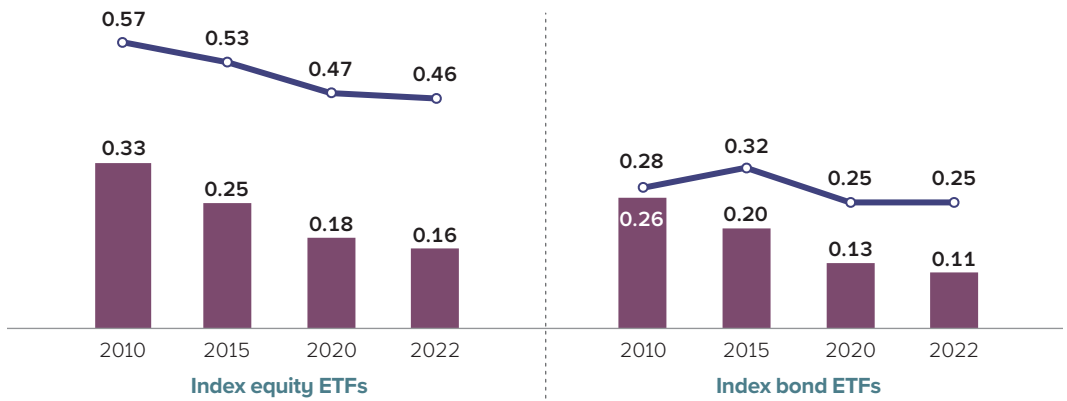
FIGURE 6.7

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

Percent

○ Simple average

■ Asset-weighted average



Note: Data exclude ETFs not registered under the Investment Company Act of 1940.

Sources: Investment Company Institute and Morningstar. See *ICI Research Perspective*, "Trends in the Expenses and Fees of Funds, 2022."

Additionally, like mutual funds, index ETF expense ratios differ both across and within investment objectives. Within specific investment objectives, expense ratios vary between actively managed and index ETFs and even among index ETFs for a range of reasons. For example, expense ratios may differ because not all index ETFs in a given investment objective rely on the same index, and licensing fees that ETFs pay to index providers may vary.

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