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ICI VIEWPOINTS

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Average Expense Ratios for Long-Term Mutual Funds Continued to Decrease in 2016

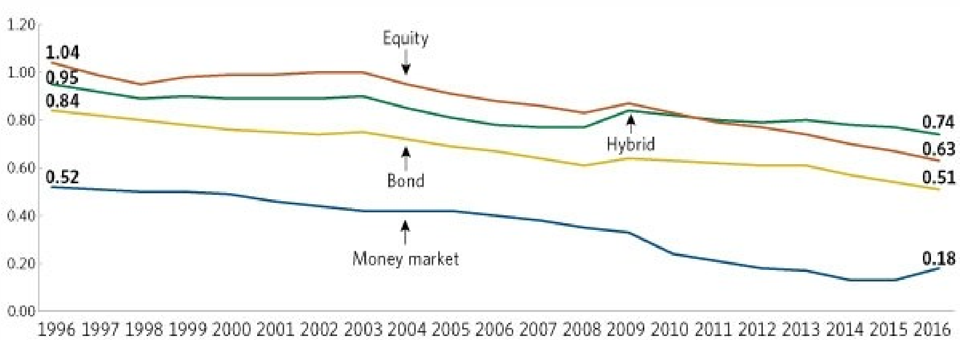
By Morris Mitler and Sean Collins

ICI recently released its report on the expense ratios of mutual funds: "Trends in the Expenses and Fees of Funds, 2016." This is ICI's first report that also summarizes expense ratios for exchange-traded funds (ETFs).

The report shows that the asset-weighted average expense ratios for equity, bond, and hybrid mutual funds fell in 2016 to their lowest levels in at least 20 years. For example, in 2016, the expense ratios that fund shareholders paid for holding equity mutual funds were, on average, 39 percent lower than in 1996.

Many factors can affect a mutual fund's expense ratio, including its investment objective, the amount of assets it holds, and the range of services it offers. As the report describes, the long downward trend in the expense ratios of mutual funds has been driven in large measure by three factors: investor interest in lower-cost funds, industry competition, and economies of scale resulting from asset growth.

Mutual Fund Expense Ratios Have Declined Substantially Since 1996
Percent, 1996–2016

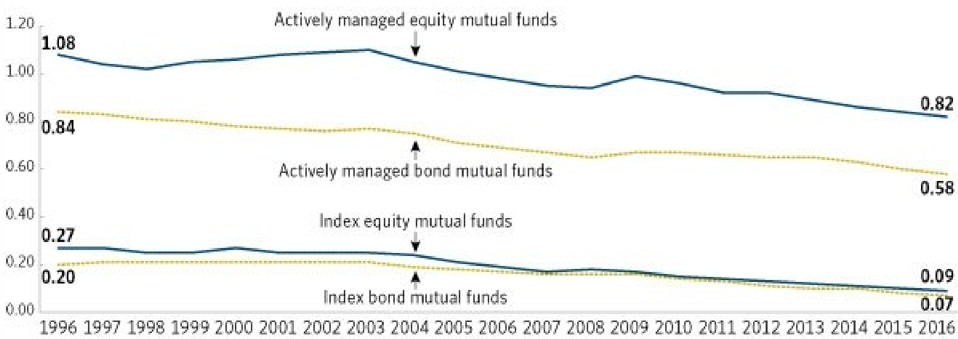


Note: Expense ratios are measured as asset-weighted averages. Average expense ratios calculated on an asset-weighted basis give more weight to funds with greater assets, reflecting where investors are actually putting their assets and better reflecting the actual expenses, fees, or performance experienced by investors than simple averages (which weight each fund or share class equally). 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

Long-term mutual funds. In 2016, expense ratios for equity mutual funds and bond mutual funds fell to 0.63 percent and 0.51 percent, respectively. Expense ratios for hybrid mutual funds (which invest in a mix of equities and bonds) fell to 0.74 percent—a decline of 22 percent since 1996.

Expense Ratios of Actively Managed and Index Mutual Funds

Percent, 1996–2016



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

Investors in actively managed mutual funds as well as investors in index mutual funds have benefited from the long decline in mutual fund expense ratios. For example, the average expense ratio of actively managed equity mutual funds in 2016 was 24 percent less than in 1996, while the average expense ratio for actively managed bond mutual funds fell by 31 percent during the same period. The average expense ratio for index equity and index bond mutual funds fell by 67 percent and 65 percent, respectively, between 1996 and 2016.

Target date mutual funds—whose portfolios typically adjust away from growth and more toward income as the fund approaches and passes its target date—have become increasingly popular with retirement savers. As assets in these funds have grown, their expense ratios also have fallen, to the benefit of fund investors. In 2016, investors in target date mutual funds incurred an average expense ratio of 0.51 percent, compared with 0.67 percent in 2008—a decline of 24 percent.

Money market funds. The average expense ratio for money market funds was 0.18 percent in 2016, an increase from 0.13 percent in the previous year. Though this increase reversed a trend during which expense ratios for money market funds declined or remained constant every year since 1996, it was not a surprise, given recent Federal Reserve decisions to increase interest rates. This ultimately led to the paring back of expense waivers that money market funds had adopted to ensure that net yields did not fall below zero.

We will describe the report's key findings on the expense ratios of ETFs in a subsequent *ICI Viewpoints* post.

Morris Mitler is an economist in ICI Research.

Sean Collins is Chief Economist at ICI.