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ICI VIEWPOINTS

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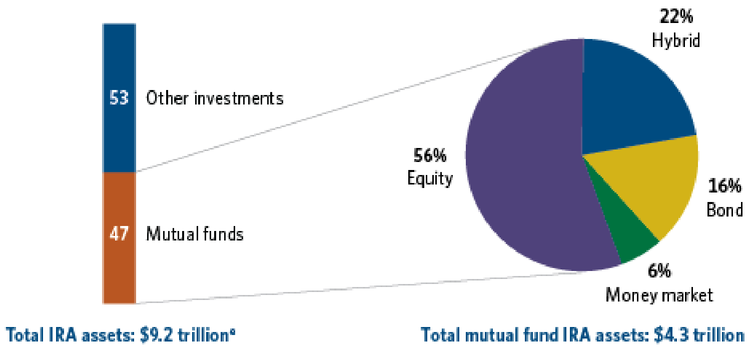
IRA Investors Are Concentrated in Lower-Cost Mutual Funds

By James Duvall

Individual retirement accounts (IRAs) represent the largest share of assets in theUS retirement market, with assets totaling $9.2 trillion at year-end 2017 (Figure 1). Forty-seven percent of this total is held in mutual funds, with IRA mutual fund investors primarily invested in equity funds.

Figure 1

Nearly Half of IRA Assets Are Invested in Mutual Funds
Percentage of assets, year-end 2017



[e] Data are estimated.

Sources: Investment Company Institute and Federal Reserve Board

As part of ICI's ongoing efforts to shed light on important insights into IRA investing, ICI is offering an updated analysis of expense ratios that investors pay on mutual funds in their IRAs.

Like other mutual fund investors, IRA mutual fund investors incur expenses and fees that cover the costs of investing in mutual funds. ICI uses asset-weighted average expense ratios to measure the expense ratios that mutual fund investors actually incur for investing in mutual funds. A fund's expense ratio is the fund's total annual expenses expressed as a percentage of its total net assets. In 2017, average expense ratios for IRA investors continued similar trends that have been observed over the past few years, which include:

- average expense ratios paid by IRA mutual fund investors continue to trend downward,
- equity and bond mutual fund investors in IRAs pay average expense ratios similar to those paid by all mutual fund investors (i.e., industrywide), and
- IRA investors, like those in 401(k) plans and industrywide, concentrate their assets in lower-cost mutual funds.

And although 401(k) plan investors pay lower average expense ratios when compared with investors in IRAs and industrywide, the differences can be explained, in part, by economies of scale and use of financial professionals by IRA and retail investors.

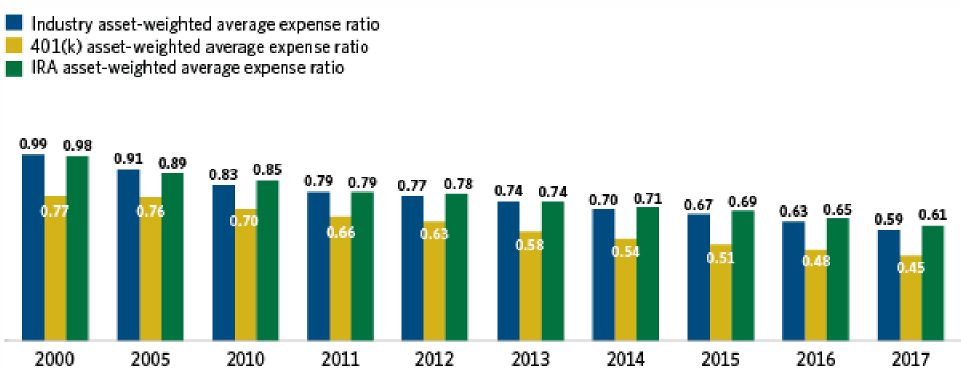
Average Expense Ratios Paid by IRA Mutual Fund Investors Continues to Decline

IRA equity mutual fund assets represented 56 percent of IRA mutual fund assets in 2017, and 2017 marks the eighth consecutive year that average expense ratios have fallen for equity mutual funds held by IRA investors. Moreover, the average expense ratio is down 38 percent from its level in 2000. The average expense ratio paid by equity mutual fund investors in IRAs fell to 0.61 percent, down from 0.65 percent in 2016 and 0.98 percent in 2000 (Figure 2).

Figure 2

Equity Mutual Fund Expense Ratios

Percent, selected years



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

Sources: Investment Company Institute, Lipper, and Morningstar

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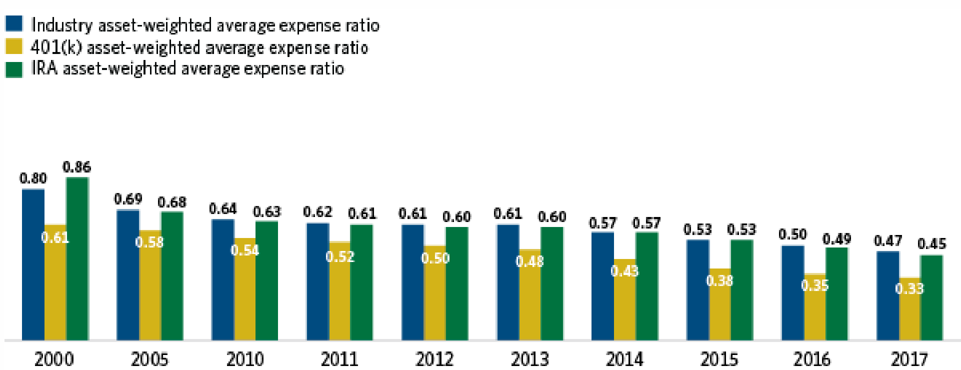
IRA bond mutual fund assets were 16 percent of IRA mutual fund assets in 2017. Average expense ratios for bond mutual funds held by IRA investors have decreased sharply over the past four years and are down 48 percent from their level in 2000. The average expense ratio paid by bond mutual fund investors in IRAs fell to 0.45 percent, down from 0.49 percent in 2016 and 0.86 percent in 2000 (Figure 3).

Figure 3

Bond Mutual Fund Expense Ratios

Percent, selected years



Note: Data exclude mutual funds available as investment choices in variable annuities and tax-exempt mutual funds.

Sources: Investment Company Institute, Lipper, and Morningstar

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Twenty-two percent of IRA mutual fund assets were invested in hybrid mutual funds in 2017. Similar to equity mutual funds, average expense ratios for hybrid mutual funds held by IRA investors have fallen for eight consecutive years and are down 30 percent from their level in 2000. The average expense ratio paid by hybrid mutual fund investors in IRAs fell to 0.62 percent, down from 0.65 percent in 2016 and 0.89 percent in 2000 (Figure 4).

Average Expense Ratios Industrywide and for IRA Investors Tend to Be Similar, but Not for Hybrid Mutual Funds

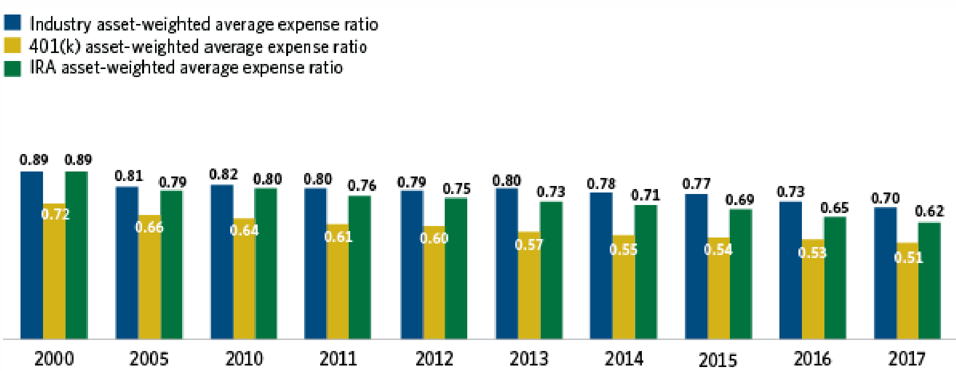
Average expense ratios paid by IRA investors in equity and bond mutual funds are about equal to those paid industrywide. The same is not true, however, for hybrid mutual funds—the average expense ratios paid by IRA investors in hybrid mutual funds have fallen noticeably below the average expense ratios for hybrid mutual funds industrywide. The primary reason for this is that demand for alternative strategies funds has grown more rapidly for assets in nonretirement accounts (i.e., outside of IRAs and 401(k) plans).

This is important because most of the total net assets of alternative strategy mutual funds fall into ICI's "hybrid mutual fund" category. These funds can offer investors exposure to a wide range of asset classes, protection against market downturns or volatility, or a lower correlation with the equity market, but such strategies can be costly to manage. Thus, the increased demand outside of retirement-related accounts helps explain why the average expense ratios of hybrid mutual funds industrywide are now higher than the average expense ratios of hybrid mutual funds weighted by assets in IRAs.

Figure 4

Hybrid Mutual Fund Expense Ratios

Percent, selected years



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

Sources: Investment Company Institute, Lipper, and Morningstar

A Comparison with 401(k) Mutual Fund Investors

The data show that 401(k) investors incur lower expense ratios in their mutual fund holdings than IRA mutual fund investors. One reason for this is economies of scale, as many employer plans aggregate the savings of hundreds or thousands of workers, and often carry large average account balances, which are more cost-effective to service. In addition, employers that sponsor 401(k) plans may defray some of the costs of running the plan, enabling the sponsor to select lower-cost funds (or fund share classes) for the plan.

Another difference? IRA investors often pay for the assistance of a financial professional when investing, and sometimes cover the cost of this service by investing in a fund (or fund share class) that has a 12b-1 fee. This fee, which the fund collects and passes to the financial professional assisting the IRA investor, is included in the fund's expense ratio. 401(k) plan participants have generally had more limited access to professional financial advice, and so 401(k) plans commonly select funds (or fund share classes) that provide no compensation for financial professionals and thus have somewhat lower expense ratios.

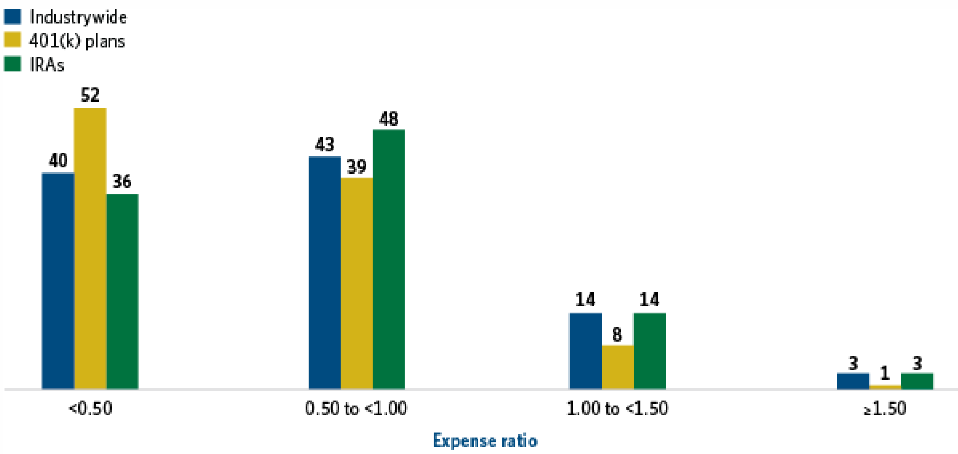
IRA Investors Concentrate Their Assets in Lower-Cost Funds

Like mutual fund assets in 401(k) plans and across the industry, IRA mutual fund assets tend to be concentrated in lower-cost mutual funds. At year-end 2017, 84 percent of equity mutual fund assets held by IRAs were invested in mutual funds with expense ratios of less than 1.00 percent, with 36 percent invested in equity mutual funds with expense ratios of less than 0.50 percent (Figure 5).

Figure 5

Equity Mutual Fund Assets Held in IRAs Are Concentrated in Lower-Cost Funds

Percentage of industrywide, 401(k) plan, and IRA equity mutual fund assets, 2017



Note: Data exclude mutual funds available as investment choices in variable annuities. Components may not add to 100 percent because of rounding.

Sources: Investment Company Institute and Morningstar

ICI Methodology

ICI evaluates fee trends using asset-weighted averages to summarize the expenses that shareholders actually pay through funds. To compute the average, ICI weights each fund's expense ratio by that fund's end-of-year total net assets. Simple averages (counting each fund's expense ratio equally) overstate the impact of the expenses of funds in which investors hold few dollars.

Find data on all figures in this report, including additional data on expense ratios between 2000 and 2017, here. For more information about IRAs, visit our Individual Retirement Account Resource Center.

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