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Expense Ratios of Actively Managed and Index Mutual Funds Have Declined for More Than Two Decades

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ICI Adds Analysis on Flow Data That Shows Demand for Lower-Cost Funds

Washington, DC, April 30, 2018—The average expense ratios of equity, hybrid, and bond mutual funds—including both actively managed and index mutual funds in these asset classes—have trended downward for more than two decades, according to a new research report from the Investment Company Institute (ICI).

In 2017, the expense ratios of the three major asset classes of mutual funds continued to decline. Investors paid, on average, 43 percent less for equity mutual fund expense ratios in 2017 than in 1996. The trend reflects investor interest in lower-cost funds, as well as industry competition and economies of scale driven by asset growth, ICI says. A fund's expense ratio is the fund's total annual expenses expressed as a percentage of its total net assets.

"This research shows an overall decline in the expense ratios of actively managed and index mutual funds for more than two decades," says Shelly Antoniewicz, ICI's senior director of industry and financial analysis. "Industry competition continues to push down the expense ratios of mutual funds and exchange-traded funds, as the fund industry meets cost-conscious investors' demand for lower cost funds. This demand is driven by a major shift in the industry's business model, as increasingly investors pay directly for investment advice and assistance from investment professionals, rather than through fund fees."

For the first time, the report, "Trends in the Expenses and Fees of Funds, 2017," examines the net new cash flow to mutual funds and net share issuance of exchange-traded funds (ETFs) by expense ratio ranges, for both actively managed and index funds. In 2017, inflows to these funds were concentrated in relatively low-cost funds. Data for all figures in the report are accessible here.

Low-Cost Domestic Equity Funds Receive Majority of Inflows
Mutual funds and ETFs ranked from lowest to highest expense ratios, net flow in billions of dollars, 2017

Percentile of expense ratios Type of fund
< 5th

≥ 5th to < 25th

≥ 25th to < 50th

≥ 50th

Actively managed

Expense ratio

< 0.56%

≥ 0.56% to < 0.87%

≥ 0.87% to < 1.15%

≥ 1.15%

Net flow

$3

-$117

-$80

-$78

Index

Expense ratio

< 0.06%

≥ 0.06% to < 0.20%

≥ 0.20% to < 0.42%

≥ 0.42%

Net flow

$115

$93

$13

$8

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

Sources: Investment Company Institute and Morningstar

Inflows to Actively Managed and Index Funds Are Concentrated in Lower-Cost Funds

Fund investors showed strong demand for lower-cost funds, in both actively managed and index funds, in 2017 (see pages 22 and 23, including Figure 19, in the report). ICI reports that the 5 percent of actively managed domestic equity funds with the lowest expense ratios received a total of $3 billion in inflows. For index domestic equity funds, the report finds that more than 90 percent of net inflows were concentrated in funds with expense ratios below the 25th percentile.

Although overall flows between actively managed and index domestic equity funds contrasted starkly in 2017, it is important to note that investors continued to purchase, on net, actively managed domestic equity funds with the lowest expense ratios.

Actively Managed Mutual Fund Expense Ratios Continued Long Decline in 2017

The report shows an overall decline in the average expense ratios of equity, hybrid, and bond mutual funds since 1996, and finds the same trend for actively managed and index equity and bond mutual funds (Figure 14 in the report). For example, from 1996 to 2017, the average expense ratio of actively managed equity mutual funds fell by 28 percent. During the same period, the average expense ratio for index equity mutual funds fell 67 percent.

In 2017, the average expense ratio of actively managed equity mutual funds fell to 0.78 percent, from 0.82 percent in 2016, and the average expense ratio for actively managed bond mutual funds fell to 0.55 percent, from 0.58 percent. Over the same period, the average expense ratios for index equity mutual funds and for index bond mutual funds remained unchanged at 0.09 percent and 0.07 percent, respectively.

Investors in target date mutual funds, which usually invest through a fund-of-funds structure, paid an average expense ratio of 0.44 percent in 2017, compared with 0.50 percent in 2016 and 0.67 percent in 2008 (Figure 11 in the report).

Index ETF Expense Ratios Declined in 2017

In 2017, the average expense ratio of index equity ETFs fell to 0.21 percent, down from 0.22 percent in 2016, and the average bond ETF expense ratio was 0.18 percent in 2017, down from 0.20 in 2016. The declining expense ratios in index ETFs are largely attributable to a maturing ETF industry, as vigorous competition and economies of scale continue to put downward pressure on their expense ratios (Figure 17 in the report).

ICI's report also explains why index ETF average expense ratios are somewhat higher than those of index mutual funds—largely because of the difference in the composition of assets and relative size between the two products (see page 21 of the report).

Average Money Market Fund Expense Ratios Rose in 2017

Average money market fund expense ratios rose to 0.25 percent in 2017, from 0.20 percent in 2016. The increase was indirectly related to the Federal Reserve raising short-term interest rates three times in 2017. These actions prompted fund advisers to continue paring expense waivers that most money market funds offered during the period of prolonged, near-zero short-term interest rates (Figure 6 in the report).

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.