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Study Finds Significant Drop in Total Cost of Fund Ownership Since 1980

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Washington, DC, February 16, 1999 - The total cost of investing in bond funds decreased by 25 percent between 1980 and 1997, according to a study published by the Investment Company Institute, the national association of the American investment company industry. The cost of investing in money market mutual funds also declined significantly, dropping 15 percent during the same 18-year period.

"This study confirmed that the cost of investing in mutual funds has fallen across-the-board during the past 18 years: in stock funds, as last year's Institute study demonstrated, and in bond and money market funds," Institute President Matthew P. Fink said. "Competition in the fund industry is fierce. That means more efficient operations for companies and lower costs for investors."

The new study, Total Shareholder Cost of Bond and Money Market Mutual Funds, by the Institute's chief economist John Rea and senior economist Brian Reid, determined that from 1980 to 1997 the average cost of investing in bond funds decreased nearly 25 percent to 1.16 percent of each dollar invested from 1.54 percent. The average cost of money market funds decreased over the same 18-year period, declining 15 percent to 0.46 percent in 1997 from 0.54 percent in 1980. Previous Institute research, Trends in the Ownership Cost of Equity Mutual Funds, found the average cost of investing in equity funds decreased more than 33 percent in the same period (see graph below).

Cost of Investing in Mutual Funds Declines Significantly Since 1980

Source: Investment Company Institute

"For all three groups of funds, an important source of the decrease in total shareholder cost was increased purchases by investors of mutual funds that have relatively lower costs," Rea said. "Investors generally have tended to purchase and hold funds that fall in the lower half of the range of available choices."

Economists Rea and Reid determined that several other factors contributed to the decline in total costs for all three categories of mutual funds. For equity funds, lower costs came in the form of declining distribution costs. Bond funds posted both lower distribution costs and operating expenses. The overall decline in total shareholder costs for money market funds occurred in operating expenses.

Rea and Reid evaluated fee trends using a comprehensive measure called total shareholder cost. This measure represents the cost that an investor would expect to incur in purchasing and holding mutual fund shares. It accounts for all major fees, expenses, and sales charges relevant to decisionmaking, and is based upon the same considerations underlying the fee information required by the U.S. Securities and Exchange Commission in every mutual fund prospectus.

The actual fees and expenses included in total shareholder cost consist of fund operating expenses, 12b-1 fees, and sales loads. In contrast, most other measures used to analyze mutual fund ownership cost ignore sales loads and therefore do not accurately reflect the total cost to shareholders.

"Many discussions of mutual fund fees and expenses rely on the expense ratio to determine pricing trends and to measure the cost of investing in mutual funds," Rea said. "Expense ratios do not include the sales load. This is a critical omission, especially because the substantial majority of all individual fund investors purchase fund shares through sources offering load funds. Looking only at the expense ratio can lead to erroneous conclusions about trends in the cost of investing in mutual funds. Total shareholder cost comes closest to capturing all costs of purchasing fund shares."

The Investment Company Institute is the national association of the American investment company industry. Its members include mutual funds, closed-end funds, and unit investment trusts.