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Key Points to Remember on Fund Fees

By Sean Collins and Bob Grohowski

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Over the past two decades, investors have paid less and less to own shares of mutual funds. That's because investors demand low-cost funds, and because the fund industry is one characterized by competition, innovation, and economies of scale.

These favorable trends on fees, however, don't stop some pundits from taking shots at the fund industry. “Fund fees are outrageously high,” writes commentator John Wasik in a recent Forbes.com blog post criticizing the “$27 trillion U.S. mutual fund colossus.”

For the record, U.S. mutual funds have $14 trillion in assets under management, not $27 trillion.

But that's not the only thing Wasik has gotten wrong. Let's look at a few key points that investors should be aware of regarding fees. These points indicate that Wasik's outrage is misplaced.

Mutual fund expense ratios have fallen dramatically.

Across each of the major asset categories, average expenses paid by mutual fund investors have dropped significantly, on an asset-weighted basis, since the early 1990s.

Twenty years ago, for instance, investors incurred expenses of 1.07% (or $1.07 for every $100 in assets) to invest in equity funds, on average. By contrast, expenses averaged 0.77% for equity fund investors in 2012-nearly 30% lower than in 1993.

401(k) mutual fund investors tend to pay lower-than-average expenses.

Wasik's commentary leaves the reader with the impression that 401(k) investors are paying above-average expenses for investing in mutual funds. “You shouldn't be charged more for being in a 401(k),” he exclaims. “You should be charged less!”

Well, in fact, you are. The data show that 401(k) plan participants do pay lower fees, on average-and, consistent with patterns across the mutual fund industry, those fees have trended down for the last 15 years. For example, retirement savers in 401(k) plans, on average, incurred expenses of 0.63% on equity funds-down 15% from 1998 and well below the 0.77% for all equity fund investors in 2012.

Loads paid by investors have declined substantially.

Funds with load fees are sold through financial professionals, such as brokers and registered investment advisors. These professionals, who help investors define their investment goals and select appropriate funds, as well as providing ongoing services, are compensated through some combination of front- and back-end loads and 12b-1 fees. Alternatively, investors may pay directly out of their pockets, rather than indirectly through fund fees, for the services that financial professionals provide.

Wasik berates these fees as “plaguing investors” while failing to point out that load fees also have been on a downward slide.

For example, Investment Company Institute's recent study of this issue shows that the average front-end sales load that investors might have to pay on equity funds offered in 2012 was 5.3%. But the average sales load that investors actually paid was only 1%-due to load fee discounts on large purchases, as well as fee waivers (such as those on purchases through 401(k) plans).

Investors value financial advice.

Wasik argues that charges like sales loads “all need to go.” With the decline in front-end load fees paid by investors over the past 20 years, the market already has gone largely in this direction.

Nevertheless, it is important to note that investors have paid-and likely will continue to pay in one way or another-for financial advice because they find it valuable. Investors in nearly 30 million U.S. households own funds purchased with the help of financial professionals. ICI surveys show that fund shareholders with ongoing advisor relationships receive help from these professionals in a number of areas, including taxes, retirement, college savings, and more.

Investors and their advisors are fee-conscious.

Wasik paints a world where financial professionals and the fund industry are in cahoots to peddle “bad funds and terrible investment advice.” Presumably, this means driving investors toward high-cost funds.

But the evidence suggests just the opposite. For example, assets in equity funds tend to be concentrated in the least costly funds: in 2012, 72% of equity fund assets were in equity funds with expense ratios in the lowest quartile. Among actively managed equity funds, 69% of assets were in those equity funds with expense ratios in the lowest quartile.

Compare apples to apples.

Commentators often seek to compare the expense ratios of mutual funds to the fees that institutions-such as corporations, defined benefit pension plans, state and local governments, and foundations-pay for investment management. This comparison, however, is inapt.

As discussed in this paper, mutual funds are primarily retail products, providing services to thousands and sometimes millions of investors who may often initially invest $1,000 or even less. Institutional separate accounts gather assets from a limited number of clients who may initially invest millions to billions in a single account.

Mutual funds and institutional separate accounts are sold differently, operate under different legal and regulatory structures, and have different business risks. In addition, the fees that institutions pay for investing in separate accounts often cover portfolio management but little else, while the expense ratios of mutual funds cover portfolio management as well as the broad range of services that retail mutual funds provide, including fund websites, 24/7 access to telephone representatives, tax reporting, and the ability to exchange money among funds in the same complex.

Sean Collins is the senior director of industry and financial analysis at ICI. Bob Grohowski is a senior counsel at ICI.

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