
This 50-page report covers a wide range of issues relating to the evolution of the U.S. mutual fund marketplace.

It also offers perspective and potential lessons, based on the U.S. experience, to fund managers, distributors, and regulators of mutual funds outside the U.S. – in particular with regard to considerations around the cost and structure of payments for financial advice.

The following offers an introduction to the report, as well as the table of contents. To request a copy of the full study, please contact us at research@sionline.com.
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An Introduction: The U.S. Mutual Fund Marketplace –
Evolution, Distribution Structure, Fees and Financial Advisor
Compensation Trends, and Lessons Learned

The mutual fund vehicle continues to expand in importance as a key savings tool for an increasing number of investors around the world. Today, mutual funds (including ETFs) oversee close to $30 trillion in assets globally, including roughly $14 trillion in the U.S. As the growing acceptance of mutual funds across a widening range of countries and regions persists, the worldwide fund marketplace continues to become ever-more interconnected in a variety of ways – from the synergies of a truly global economy to the widening focus of fund firms’ global fund distribution efforts to match the expanding range of investor demand around the world.

This 50-page report covers a wide range of issues relating to the evolution of the U.S. mutual fund marketplace, as well as important emerging considerations outside the U.S. As we enter 2013 and plan ahead – following a remarkable year of growth for the U.S. and the global mutual fund industry – we see this report serving as a valuable resource to both U.S. and global industry participants in a number of ways, including:

- Providing important foundational context for mutual fund executives, strategists, and analysts around the evolution and inter-connected complexities of the U.S. fund marketplace with regard to investor demand, product proliferation, distribution, pricing, and more.

- In detailing the evolution of the U.S. fund marketplace, presenting a holistic examination of the power of market-driven forces in creating effective environments for fund industries, distribution landscapes, investor experience, shareholder costs and more. This perspective can offer value for both future U.S. industry deliberations, as well as non-U.S. fund marketplace considerations.

- Offering perspective and potential lessons based on the U.S. experience to managers, distributors, observers, and regulators of mutual funds outside the U.S. with regard to considerations around the cost and structure of payments for financial advice and shareholders’ total cost of fund ownership.

We encourage you to share this study broadly within your organization – from the sales division to the investment product management teams, as well as your funds’ board of trustees if appropriate, executives building fund operations outside the U.S., and other senior management executives.

The report is organized in the following chapters:

I. Executive Summary
II. History, Structure, and Evolution of the U.S. Mutual Fund Industry
III. U.S. Fund Distribution
V. U.S. Mutual Fund Expenses
Perspectives on the Evolution of the U.S. Mutual Fund Marketplace


This U.S. mutual fund-centered study may offer lessons to managers, distributors, observers, and regulators of mutual funds outside the U.S. As global acceptance and usage of mutual funds continues to expand, the perception, focus and policymaking initiatives of fund regulatory bodies around the world also continue to increasingly converge – with many fund rule-makers often looking to the experiences of the mature U.S. marketplace to guide their efforts.

One area of particular focus for regulators around the globe recently has been the issue of shareholders’ total cost of fund ownership and the structure and cost of professional financial advice. As mutual fund usage has expanded, a common thread linking many diverse jurisdictions and marketplaces has been the demand for professional advice among fund investors.

In the U.S., marketplace evolution (not regulatory guidance) over the past two decades has shifted the payment of fees for advice from occurring primarily at the point-of-sale (associated with ‘commissions,’ ‘loads’, etc.) toward almost exclusively being paid over time as long as the investments are held – with such fees for financial advisors’ services unbundled from fees for investment management and largely charged directly to the investor outside the fund’s total expense ratio. Outside the U.S., investors’ payments for advice remain largely embedded within the mutual fund expense structure (and are paid to advisors via ‘retrocession’) or are made at the point of fund purchase.

In recent years, debates around the structure and cost of professional financial advice have spurred regulatory initiatives such as the “Retail Distribution Review” (RDR) in the U.K., as well as steps to ban commissions on fund sales in India, Australia and the Netherlands. In addition, similar deliberations around shareholder cost and pricing structures persist in Europe, Canada and elsewhere.

In this report, Strategic Insight provides perspective on the evolution in structure, distribution, pricing, and the resultant impact on shareholders’ total costs of mutual fund ownership in the U.S. The market-driven U.S. fund industry evolution captured in this study may offer lessons and key considerations for fund industries around the world.

This analysis includes data and discussion of total shareholder costs in the U.S. and a breakdown of the components of such costs, as well as an examination of key marketplace forces impacting their shifting structure. The U.S. experience may provide valuable lessons to global market participants – investment managers, fund distributors, and regulators. Such market participants are collaboratively searching for ways to expand the use and acceptance of mutual funds and to improve transparency and disclosure of fees charged to shareholders – both for investment management, as well as for professional advice around selection, asset allocation, and monitoring. How should local best practices develop? What should be driven by marketplace forces, competition and disclosure, and what should be dictated by regulatory mandates? What are the unintended consequences to avoid?
Among Strategic Insight’s findings are a number of conclusions around common questions surrounding the movement toward an unbundled fee-for-advice compensation model (some answers to which, in SI’s view, are at times misconceived), including:

- **Does unbundling payments for advice from the mutual fund expense structure create higher or lower total costs of fund ownership for investors?**
  - Based on the U.S. experience, Strategic Insight believes that for many “buy-and-hold” inclined U.S. mutual fund investors, total shareholder costs over the lifetime of an investment have increased as a result of the transition to a fee-for-advice model – as many investors no longer have the benefit of paying commissions just once or taking advantage of discounts of such commissions available to U.S. fund investors based on aggregate investments held within one distributor or across funds of the same investment manager.

- **Does the unbundled fee-for-advice structure increase or decrease transparency of total investment costs for fund shareholders?**
  - It is Strategic Insight’s view that when total shareholder costs are unbundled – with fees-for-advice ratios reported by each distribution company separately, and to each investor individually – the transparency of total shareholder cost is generally reduced. Mutual fund expense ratios in the U.S. are publically reported in a consistent manner by each fund and captured by numerous companies tracking the fund industry – thus making them easily benchmarked. With unbundled and externalized payments for advice, the ability to compare total shareholder costs across different distribution organizations is lessened.

- **Does the unbundled fee-for-advice model reduce or increase imprudent trading into or out of funds, thus harming shareholders’ wealth creation and investment results? How does this fee-based model impact the velocity of advisors’ purchases and redemptions of funds?**
  - While the shift to an asset allocation-based portfolio of funds, wrapped with a fee-for-advice, undoubtedly created more balanced and prudent investment strategies and also eliminated some instances of opportunistic and thus ill-timed transactions due to selling “one-fund-at-a-time”, Strategic Insight actually observes higher-than-average asset velocity within fee-for-advice account structures. This higher asset turnover typical within fee-for-advice accounts raises concerns about resultant investment outcomes, as compared to lower turnover “buy-and-hold” strategies.

- **Does removing payments for advice from the mutual fund expense structure increase or decrease the availability of funds to smaller investors?**
  - It is Strategic Insight’s view that the variable fees of unbundled fees-for-advice (versus the fixed ratios of internalized fund expenses for all investors) ultimately may limit opportunities for lower wealth investors to receive advice. With unbundled fees-for-advice typically rising as investor account sizes decrease (due to the lack of economies of scale in servicing such smaller accounts), many middle-income mutual fund investors are faced with the reality...
of significantly higher ongoing costs for financial advice – or even the complete lack of an advice option – within the continued transition to a fee-for-advice culture in the U.S.

Overall, the desire for professional financial advice in an increasingly uncertain global financial market continues to gain in emphasis among U.S. fund shareholders and many investors around the world. Given the growing demand for such guidance (and the acceptance of its cost), the U.S. mutual fund marketplace exemplifies how naturally occurring marketplace forces and other factors can serve as powerful conduits in creating an effective environment for both investment managers and investors. The evolution of investment strategies, advisory services and pricing mechanisms to compensate financial advisors across many distribution channels, costs efficiencies due to scale, regulatory guidance, and transparency of key cost comparison variables all combine to enable access to advice across varying investor wealth and sophistication levels in the U.S.

Strategic Insight’s observations in this report are based on a number of sources, including SI’s proprietary database (Strategic Insight Simfund) which tracks the mutual fund industry and incorporates data based on mutual funds’ filings with the SEC, as well as data provided by Lipper, Morningstar, and SI’s own research. Also used for this study is data and findings published by the Washington D.C. based Investment Company Institute, the national association of U.S. investment companies.

Data based on the new version of SI’s U.S. fund database, which tracks ownership and flows for funds and ETFs within each of 900 U.S. fund distributors, is also included in this study.

This report includes commentary based on Strategic Insight’s past studies, SI’s proprietary surveys of U.S. fund managers, data sourced from other research firms, and our firm’s cumulative knowledge of the mutual fund marketplace acquired over the more than two decades since its founding. A number of previously published Strategic Insight studies also address the topic of mutual fund shareholder costs in the U.S. and globally and have in the past been shared with the fund management industry, industry observers, and regulators. The studies referenced below are available to Strategic Insight research subscribers on our web libraries, or upon request to Strategic Insight (e-mail research@sionline.com).

- **Mutual Fund Fees: Facts, Trends, Economies of Scale, and Market Forces**, 2004 (at the advice of the ICI, this study was shared with the U.S. Senate Banking Committee)


- **Fund Fees in Europe**, 2011 (commissioned by the European Fund and Asset Management Association - EFAMA), this report was shared with the EFAMA member firms and with the public.)
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