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New rule puts money fund price shifts on display

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Three words investors in money-market mutual funds never want to hear: "break the buck."

It refers to an event that's happened just twice in almost 40 years. Financial markets tanked, and managers weren't able to keep fund shares at the steady $1 price they're supposed to maintain to protect investors from losses.

It's not a guarantee. But there's an expectation that draws safety-minded investors to money funds: Invest a buck, get at least a buck back, on demand. The chief goals are safety and on-demand access to cash, rather than strong returns. The stable $1-a-share feature distinguishes money funds from other mutual funds whose share prices veer with the stock and bond markets.

Yet it's not unusual for money funds to fluctuate slightly above or below that $1 safety threshold, based on how the market values a fund's holdings from day to day. Fund managers have leeway so that the price at which investors buy or sell shares stays at $1, even when the current market value for the funds' holdings suggests a price of 99 and nine-tenths of a cent would be more accurate.

This happens mostly behind the scenes, and involves what the funds call their shadow prices. But starting Monday, this information will become public.

More than two years after a money fund's collapse prompted new safety rules, the Securities and Exchange Commission will begin publishing shadow prices.

The industry and investor advocates alike say disclosures about shadow prices dipping below a dollar shouldn't be a cause for alarm.

"You are going to have some very risk-averse investors who will be uncomfortable about finding this out," says Niels Holch, executive director of the Coalition of Mutual Fund Investors. "But if investors are properly educated, I don't think there will be a mass of people rushing to sell. I think it's a matter of the industry telling individual investors how this works."

Price variations between shadow prices and published share prices are typically small -- usually a few hundredths or tenths of a cent.

The shifts are often triggered by a rise in short-term interest rates. A spike can briefly erode the value of short-term bonds, until the portfolio is rolled over into newly issued bonds reflecting higher rates. Meanwhile, a fund can round up as much as half a penny so the published share price remains a dollar.

The fund industry is aware that the new shadow price disclosures could scare some away from money funds, which hold about $2.8 trillion. Last week the Investment Company Institute published a study it conducted, showing that tiny shifts in shadow prices are the norm, yet haven't led to investor losses.

The disclosure requirement comes as the industry continues damage-control after the Reserve Primary Fund debacle. That fund's shares fell to 97 cents after its managers disclosed that a $785 million bond investment in Lehman Brothers had become worthless when the investment bank went bankrupt. Fearful clients, mostly institutional investors, demanded cash back, and managers were forced to sell holdings at steep discounts as the market plunged.

Although nearly all shareholder cash has since been returned, it was the first time individual investors got stuck in a money fund that broke the buck. A fund catering to institutional clients broke the buck in 1994, the first time that happened since money funds came into existence in 1971.

The new disclosure requirement is the latest in a series of rules -- some already in place, some still being debated -- to make money funds safer and better inform investors.

Here are five things investors need to know about the new disclosure:

-- Where to find the data: The SEC will publish shadow prices on its data page, searchable by fund ticker symbol or other methods, at: http://www.sec.gov/edgar/searchedgar/webusers.htm. The information will be filed on a document called Form N-MFP. The SEC has also posted an investor Q&A at: http://www.sec.gov/divisions/investment/guidance/formn-mfpqa-info.htm.

-- What it shows: Data will be posted monthly, but won't reflect current prices. Instead, there will be a two-month lag -- data published Monday will list share prices from Nov. 30. That way, a fund whose market price slipped below $1 isn't likely to be susceptible to a rush of scared investors pulling out; they'd be responding to out-of-date information.

-- What it means: The ICI's study found it's extremely rare for rapid market shifts to put a fund at risk of breaking the buck. The ICI found only one instance in almost 30 years when interest rates jumped one percentage point in a single-day -- on Feb. 1, 1982. The organization concluded that it would take a daily rise of more than three points to trigger a half-cent drop in a fund's shadow price, absent other changes in the market.

That's significant because fund managers are required to consider re-pricing a fund's published shares below $1 -- triggering an instance of breaking the buck -- when the shadow price slips below 99.5 cents. In the week after the Lehman bankruptcy, 93 percent of relatively high-yielding prime money funds had shadow prices greater than 99 and three-quarters cents.

-- Backup protection exists: Even when money funds risk breaking the buck, fund companies usually step in to protect investors. Moody's Investors Service recently found at least three-dozen money funds were at risk of breaking the buck during the financial crisis. Fund companies responded by spending billions to prop up their funds, including purchasing the soured investments that put the funds at risk.

-- New rules make money funds safer: Rules adopted last year strengthened requirements that funds invest only in top-quality securities. The aim is to reduce the chance of a blowup from speculative investments. Also, funds must hold a larger proportion of their portfolio in cash, so investors can get money back on demand. Also, bond investments must have an average maturity of no more than 60 days.

Money funds "are even better-positioned today than they were two years ago to handle stressful markets," ICI President Paul Schott Stevens says. "But they're not risk-free products. We hope that the public release of shadow pricing data will remind the public of that fact."

Online:

http://www.sec.gov/edgar/searchedgar/webusers.htm

http://www.sec.gov/divisions/investment/guidance/formn-mfpqa-info.htm