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Revised Money Market Reform FAQs—Good News for Retail Funds

On August 4, the staff of the Division of Investment Management updated their [2014 Money Market Fund Reform Frequently Asked Questions](#) (the "FAQs"). I'll discuss these revisions in a series of posts, starting with an important question relating to beneficial ownership by natural persons. **Why Retail Funds Care about Beneficial Ownership** After October 14, 2016, only government and retail money market funds may continue to use the amortized cost and penny rounding methods to maintain a stable \$1.00 share price. Rule 2a-7 now defines a "retail money market fund" as "a money market fund that has policies and procedures reasonably designed to limit **all** beneficial owners of the fund to natural persons." Rule 2a-7 does not define a "beneficial owner." The [SEC release](#) adopting the reforms referred to two 1934 Act rules, [13d-3](#) and [16a-1\(a\)\(2\)](#), which had different definitions of "beneficial owner." In Question 16 (formerly 15) of the FAQs, the staff clarified that it would look to the definition of "beneficial owner" in Rule 13d-3 when interpreting the definition of a "retail money market fund." **Fitting a Broad Definition into a Narrow Exception** I emphasized "all" in the definition of a retail money market fund to highlight the stringent nature of the requirement. A retail fund must design procedures to exclude anyone other than a natural person from beneficially owning its shares. Rule 13d-3 defines "beneficial owner" broadly, however, to include:

any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or **shares**: (1) Voting power which includes the power to vote, or to direct the voting of, such security; and/or, (2) Investment power which includes the power to dispose, or to direct the disposition of, such security.

A natural person may share voting and/or investment power with an institution in many circumstances. This is commonly the case in tax-deferred retirement, health and college savings plans, all of which the SEC release said could invest in retail funds. Under Rule 13d-3, institutions would be, contrary to the definition of a retail fund, beneficial owners of retail fund shares held through these plans. **Tailoring the Definition of Beneficial Owner** Question 16 of the FAQs explained the rationale for incorporating the definition of "beneficial owner" from Rule 13d-3 as follows:

The Commission exempted retail money market funds ... from the floating NAV requirement because past experience demonstrated that retail investors are less likely to redeem quickly in times of market stress. The staff believes it is an exercise of an investor's investment power when such investor decides to redeem securities.

Rule 13d-3 uses voting, as well as investment, power to determine beneficial ownership. Voting power has nothing to do with the ability "to redeem quickly in times of market stress." Accordingly, the revised answer to Question 16 states that:

in the staff's view and notwithstanding Rule 13d-3, policies and procedures would be deemed 'reasonably designed to limit all beneficial owners of the fund to natural persons' even if they do not use voting power as a basis for identifying beneficial owners of the fund.

In addition, an institution may exercise investment power over the purchase rather than the redemption of shares, or share the right to redeem with a natural person. Rule 13d-3 treats these institutions as sharing investment power with the natural persons who would redeem shares in the normal course. The answer to Question 16 now states:

that such policies and procedures may also permit institutional decision makers to share investment power with a natural person.

What Retail Funds Must Do Putting Question 16 together with Rule 13d-3, it appears that a retail fund's

policies and procedures should be reasonably designed to confirm, for each shareholder's account, that at least one natural person has investment power (as defined in Rule 13d-3) to redeem the shares held in the account. None of the FAQs alters statements made in the SEC release permitting funds to look through omnibus accounts to the underlying shareholders to confirm that natural persons are the ultimate "beneficial owners" of shares held in the omnibus account. Nor do the FAQs change the SEC's expectation "that many funds will rely on social security numbers to confirm beneficial ownership by a natural person." 79 FR at 47797.

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