UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
TRADING AND MARKETS

September 1, 2009

Ms. Susan M. DeMando
Associate Vice President
Financial Industry Regulatory Authority
1735 K Street, N.W.
Washington, DC 20006

RE: Broker-dealers Operating Under a Series LLC Structure

Dear Ms. DeMando:

On behalf of the Financial Industry Regulatory Authority ("FINRA"), you have asked for interpretive guidance as to how the Securities and Exchange Commission's ("Commission") financial responsibility rules would apply to an entity formed and operated as a Series Limited Liability Company ("Series LLC") under state law.

A Series LLC consists of a Master LLC and "series" of ownership classes within the Master LLC itself. The Master LLC is the only formal legal entity and is the only entity created under applicable state statutes. Generally, under state law a Series LLC may create any number of series that may operate in many respects as independent entities. For example, each series may have separate assets and separate liabilities. Under state law each series is not required to absorb the financial obligations of any other series or the Master LLC, and liabilities of the Master LLC and each series are not enforceable against any other series or the Master LLC.

Series LLCs were first introduced in Delaware in 1996 but the concept has since spread to other states – for example, Illinois, Iowa, Nevada, Oklahoma, Tennessee, and Utah now have laws similar to the Delaware Series LLC law. You have informed us that in recent years, broker-dealers have approached the Financial Industry Regulatory Authority asking to use this structure. As one example of how a broker-dealer may wish to use the Series LLC structure you have described to us the following construct: the broker-dealer would structure the Series LLC such that the Master LLC would have no business operations, Series A would operate a retail broker-dealer and Series B would handle institutional activities. Series A and B would each have separate assets and liabilities and liabilities of one series would not be enforceable against the other series. The Master LLC would be the only Commission registrant. Prospective FINRA members seeking to use this structure have informed FINRA that they would report the assets and liabilities of the two series in one consolidated financial statement when filing financial reports with the Commission.

The Commission's financial responsibility rules include the net capital rule,[1] the customer protection rule,[2] and the financial reporting rule.[3] The net capital rule requires, among other things, different minimum levels of capital based upon the nature of the firm's business and whether the broker-dealer handles customer funds or securities.[4] The main purpose of the net capital rule is "to protect customers and other market participants from broker-dealer failures and to enable those firms that fall below the minimum net capital requirements to liquidate in an orderly fashion without the need for a formal proceeding for financial assistance from the Securities Investor Protection Corporation."[5]

Generally, under the net capital rule, assets that are not available to meet any and all of the firm's obligations are not allowable. The Commission staff has previously taken a no-action position that if a capital contribution to a broker-dealer is to be included in the net capital of the firm, it must be available, without limitation, for the company to use for any purpose.[6] Specifically, the capital needs to be "subject to the risks of the business" in order to be included in the firm's net capital.[7] Further, the rule requires that all liabilities of a company be recognized when computing the net capital of a broker dealer. Under a Series LLC structure, assets that are not available to all creditors would not be subject to the risks of the broker-dealer's business and would be treated as non-allowable when computing net capital. Similarly, the net capital rule also requires that liabilities be deducted when computing net capital; therefore, all liabilities, whether the liability of a Master LLC or a series, would be deducted from allowable assets when computing net capital.

Rule 17a-5 requires broker-dealers to regularly file certain financial information with the Commission and the self regulatory organizations for which the broker-dealer is a member. You note that if a Series LLC reported its financial position on a consolidated basis, SRO and Commission examiners would not be able to determine the financial position and operating results of the registrant and each series without substantial effort. Indeed, a user of the financial statements would be unable to determine which of the series controlled specific assets or was obligated to satisfy specific liabilities. Therefore, the Commission's and the SRO's ability to effectively supervise the financial position of the firm would be greatly diminished.

In addition, the customer protection rule, Rule 15c3-3, imposes requirements on broker-dealers for the protection of customer property. Generally, Rule 15c3-3 requires a broker-dealer that carries customer accounts to compute on a daily basis its possession or control obligations, and perform a weekly computation regarding the amount required to

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[1] 17 CFR 240.15c3-1.
[2] 17 CFR 240.15c3-3.
[3] 17 CFR 240.17a-5.
[4] *See, e.g.,* Alternative Net Capital Requirements for Broker-Dealers that are Part of Consolidated Supervised Entities, Exchange Act Release 49830, 69 F.R. 34,430 (June 21, 2004).
[5] *See* 69 FR 34,428, 34,430.
[6] *See* SEC No-Action Letter, Net Capital Treatment of Temporary Capital Contributions, March 6, 2000.
[7] *See, e.g.,* 17 CFR 240.15c3-1d(b)(4) (as to proceeds of subordinated loan agreements).

be on deposit in a special reserve bank account for the exclusive benefit of customers. Performing this possession and control requirement or a customer reserve requirement for a Series LLC would be difficult, if not impossible, because the assets and liabilities of each series would be in separate entities. For example, the amount required to be held in the customer reserve account must be calculated across and be available to all customers of the firm. However, under the Series LLC laws, if the amount calculated for the special reserve account for customers included credits from one series and debits from another series the account could be underfunded. Therefore, a Series LLC that receives customer cash or securities would not be able to comply with the requirements of Rule 15c3-3.

We also note that the Series LLC structure could be problematic for purposes of a liquidation proceeding under the Securities Investor Protection Act ("SIPA"). Within specified limits, SIPA contemplates equal treatment of customers, and a trustee liquidating a broker-dealer must comply with these requirements. Thus, if customer assets are missing, all customers share the pool of customer property at the firm on a *pro rata* basis. In contrast, if each series is treated as a separate entity it could give preferred treatment to some customers at the expense of others. To illustrate, if assets of only Series A customers are missing, only Series A customers would be subject to the risk of the loss. Series B customers would be made whole. Moreover, unsecured general creditors of Series B would be paid before customers of Series A, an outcome that is inconsistent with SIPA.

This is a staff position on Series LLCs only and does not purport to state any legal conclusion to this issue. Any material change in circumstances may warrant a different conclusion and should be brought immediately to the Division of Trading and Market's attention. Furthermore, this position may be withdrawn or modified if the staff determines that such action is necessary in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the securities laws.

Sincerely,

Michael Macchiaroli
Associate Director