



SECURITIES INDUSTRY PRACTICE

ALERT

SERIES LLCs AND THEIR USE IN THE SECURITIES INDUSTRY

In response to a request by FINRA, the SEC provided interpretive guidance as to its financial responsibility rules' application to a broker-dealer that is formed and operated as a series limited liability company (LLC) under state law.

The SEC staff described a Series LLC structure as consisting of a Master LLC and a series of ownership classes within that Master LLC. The structure of this entity operates as the Master LLC being the only formal legal entity to be registered as a broker-dealer. Other than the registration, the entity would have no business operations while the various Series LLC, under the aegis of the Master LLC, would operate the broker-dealer operations as well as other institutional activities. There would be separate assets and liabilities for each of the entities but all would be reported in a consolidated financial statement when filing financial reports with the SEC.

When assessing FINRA's request, the SEC reviewed three sets of its rules: the Net Capital Rules, Exchange Act Rule 15c3-1; the Financial Reporting Rules, Exchange Act Rule 17a-5; and the Customer Protection Rules, Exchange Act Rule 15c3-3. For example, the SEC stated that the Net Capital Rules required any capital contribution to be "subject to the risks of the business." Essentially, these risks could not be transferred between the entities. Further, all the liabilities would be recognized when computing the broker-dealer's net capital, and thus the assets would not be available for treatment as non-allowable. Additionally, all liabilities would be

deducted from allowable assets when computing the firm's net capital.

Additionally, the SEC staff reviewed the effect of the Series LLCs on the Financial Reporting Rules. The SEC staff stated that, if these Series LLCs reported financial positions on a consolidated basis, the ability to effectively supervise its financial position would be greatly diminished. The SEC staff would not be able to determine the controlling series specific assets or obligations to pay specific liabilities.

The SEC staff also said that the Series LLCs would not be able to comply with the requirements of the Consumer Protection Rules since those Rules require the broker-dealer to carry the customer account positions and customer reserves. The SEC staff believes Series LLCs would make it difficult because the assets and liabilities of each series would be in separate entities. Finally, the SEC staff also determined that, under the Securities Investor Protection Act, if there were to be a liquidation, it would be difficult to find the entities that actually controlled the assets.

In sum, although the SEC and FINRA appear unwilling to agree to the use of Series LLCs for broker-dealer entities, the Securities Industry Group of Fox Rothschild LLP is prepared to assist those entities with organizational and operational issues.

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