

# SECURITIES TRAINING CORPORATION

## Series 66

### Crunch Time Facts

*The Crunch Time Facts are a collection of statements we believe are valuable as you engage in the final preparation to sit for your examination. These facts are not designed to raise questions, but instead to be part of your final review used with any notes created during your studies.*

#### Chapter

#### Facts

- 1** The definition of a person does not include a minor or someone who is mentally incompetent.
  - An agent of an issuer who is compensated for sales to the public must register.
  - An agent of an issuer of exempt securities is not subject to registration. An agent of a broker-dealer who is involved in the purchase or sale of an exempt security is subject to registration.
- 2** A soon-to-be agent can sell fixed annuities while his registration is pending since fixed annuities are not securities.
  - Federal covered securities are exempt from state registration.
  - Universal life insurance is not a security.
  - The Howey Test is used to define whether an investment is a security.
  - Fixed annuities are not subject to the USA because they are not securities.
  - Viatical investments are securities.
  - Investment company shares and securities issued under Rule 506 of Reg. D are subject to Notice Filing.
  - Registration by Filing is not used for IPOs, and is not used by all states.
  - Registration by Coordination is used for interstate offerings.
  - Registration by Qualification is used for intrastate offerings and requires the most documentation.
  - Securities issued by an insurance company are exempt from registration, but variable annuities are not exempt.
- 3** If an IA ceases operations, it must maintain a surety bond for 3 years.
  - An agent's assistant who takes phone messages to buy or sell securities is not an agent.
  - A person does not need to be registered as an agent to provide a quote.
  - Custody includes holding third-party checks for more than 3 business days.
  - A broker-dealer must register in every state where it has an office.
  - Limited registration is granted to Canadian broker-dealers and their agents, but not to Mexican broker-dealers or their agents.
  - A broker-dealer is not required to register in a state if it has no place of business within the state and deals only with institutional clients or existing retail clients who are nonresidents.
  - A broker-dealer would need to register if it has no place of business within a state and deals with wealthy retail clients who are accredited investors. Retail investors are not institutional clients.
  - A Consent to Service of Process is filed by broker-dealers, agents, IAs, and IARs.
  - Agents may split commissions with other agents of the same broker-dealer if the agents and broker-dealer are both registered in the same state.

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- Agents and IARs register by filing Form U4.
  - An agent may transact business with existing clients who are temporarily in another state without registration in that state.
- 4** An IA with full power of attorney may pay a client's bills.
- Lawyers, accountants, teachers, and engineers are excluded from the definition of an IA if advice is incidental and there are no fees for investment advice.
  - An IAR of a state-registered adviser must register in all states in which the adviser has a place of business or more than 5 noninstitutional clients.
  - An adviser's net worth does not include his home, furnishings, or automobiles—only business assets.
  - Form ADV-E is filed by the auditor of an IA who has custody of client funds or securities. It is filed within 120 days of the audit.
  - According to the IA Act of 1940, advisory clients must receive a brochure no later than the time of entering a contract.
  - Per the USA, advisory clients must receive a brochure at least 48 hours before signing a contract, or at the time of signing if it can be cancelled without a penalty within 5 days.
  - A brochure is not required if advising registered investment companies, or providing impersonal advice for less than \$500 per year.
- 5** The stock of a bank holding company is subject to registration, but stock issued by a bank is not.
- Federal covered securities include those sold to qualified clients (those who own at least \$5 million of securities).
  - Performance fees may be charged to qualified purchasers (those with at least \$1 million under management, or more than \$2 million in net worth).
  - If an IA established as a partnership changes partners, it must notify the Administrator and clients.
  - An IAR of a federal covered adviser must register only in a state in which it has a place of business.
  - IAs who manage less than \$100 million in assets must register with the state.
  - IAs who manage between \$100-\$110 million in assets may register with the SEC or state.
  - IAs who manage more than \$110 million in assets must register with the SEC.
  - IAs register by filing Form ADV.
  - Advisers to investment companies must register with the SEC regardless of the amount of assets under management.
  - A broker-dealer that sponsors a wrap program must register as an investment adviser.
  - If an IAR leaves an advisory firm, there is no assignment of client's contracts.
- 6** Soft dollars may be used only to acquire services that benefit advisory clients.
- The Uniform Prudent Investor Act (UPIA) is a key feature of modern portfolio theory with emphasis on the trade-off between a portfolio's risk and reward.

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- Soft dollars may be used to acquire research and analysis, not advertising, travel, meals, or entertainment.
- A wrap account with very little trading suggests the possibility of reverse churning.
- UPIA does not categorically restrict an investment within a portfolio.
- 7** ○ A broker-dealer may use testimonials. An IA may not.
- Agents may not solicit orders for unregistered, nonexempt securities. They may accept unsolicited orders.
- When executing an agency cross transaction, one side of the trade must be unsolicited.
- Front-running is entering a trade based on the knowledge of a pending large order. Insider trading is trading in advance of material, nonpublic information about an issuer of securities.
- A sign of churning is frequency of trades.
- An agent may not effect personal trades in a security prior to her firm releasing a research report (trading ahead).
- It is prohibited to state that a security has been approved by a regulator.
- Broker-dealers may commingle customer cash, but must segregate customer securities from its own.
- In a principal transaction, an IA may be buying or selling securities for its own account at its own risk.
- An order memorandum contains the name of the security, the agent, if solicited, or if discretionary, the type of order.
- An agent may share in a client's account. An IAR may not.
- 8** ○ The Administrator may issue a cease-and-desist order, not an injunction.
- A gift of assessable stock is considered both an offer and a sale.
- The Administrator may not impose civil or criminal penalties.
- The Administrator has jurisdiction over an offer to buy or sell a security that is made or accepted in the state.
- An offer is made in a state if the offer originated in, or was directed to and received in, the state.
- Registration can be denied if an individual has been convicted of a securities violation in a foreign country within the past 5 years.
- The Administrator can subpoena witnesses both inside and outside the state.
- The Administrator can cancel a registration without a hearing if the registrant is deceased, missing, out of business, or mentally incompetent.
- A letter of rescission is good for 30 days, after which a client cannot bring civil action.
- Willful violations of the USA are subject to criminal penalties of up to 3 years in prison and/or a \$5,000 fine.

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- For civil liabilities, a client must bring suit within 2 years of discovery of the violation, or within 3 years from the date of the violation, whichever comes first.
- 9**
- A closed-end fund is priced independently of its NAV.
  - A mutual fund must pay shareholders within 7 calendar days of redemption.
  - Under the 1933 Act, a red herring may be given to potential investors during the cooling-off period. It contains a range of prices, but no final price or effective date.
  - Under Reg. D, securities may not be sold to more than 35 nonaccredited investors.
  - Under Reg. D, accredited investors include individuals with a net worth more than \$1 million, or an annual income of \$200,000 or more (\$300,000 for spouses).
  - A no-load mutual fund may have a 12b-1 fee that does not exceed .25% of average net fund assets per year.
  - Under the '33 Act, civil suits must be brought within one year of discovery of a violation, or within 3 years from the date of the violation, whichever is first.
  - Willful violations of the '33 Act may result in a fine of \$10,000 and/or imprisonment for 5 years.
  - Schedule 13D is filed by anyone who acquires more than 5% of the voting stock of a company.
  - Schedule 13F is filed quarterly by advisers who control more than \$100 million in equity securities as of the last day of any month.
- 10**
- Distributions from a 529 plan may pay for tuition at a foreign university.
  - Section 404(c) of ERISA requires a plan to offer at least 3 core investment options.
  - The trust of a decedent is distributed by branch if each branch of the family is to receive an equal share of an estate.
  - The trust of a decedent is distributed per capita if each beneficiary receives an equal percentage.
  - If a firm that is leveraged earns more on its debt than it pays in interest, it has positive financial leveraging.
  - Mutual fund dividends that are reinvested increase the investor's cost basis.
  - A 529 plan is also called a Qualified Tuition Plan (QTP).
  - A gift tax applies to gifts exceeding \$10,000 per person, per year, adjusted for inflation. (Currently, the maximum is \$14,000.)
  - Alimony is taxed as ordinary income and may be contributed to an IRA.
  - A Transfer on Death (TOD) account designation is used to avoid probate, not estate taxes.
  - In a qualified retirement plan, 100% of withdrawals are taxed as ordinary income.
  - In a nonqualified retirement plan, only the earnings are taxed as ordinary income upon withdrawal.
  - Upon the sale of a primary residence, \$250,000 of any gains are excluded from taxes if filing a single tax return, or \$500,000 is excluded if filing a joint tax return.
  - The custodian under the UGMA has custody of the assets, not the minor.

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- A SIMPLE 401(k) can be established by a small business with no more than 100 employees. The maximum annual contribution is \$12,500.
  - A Roth IRA may create a deductible loss when all Roth accounts are closed and the amount received is less than the investment, minus distributions.
  - Beneficiaries are taxed on income distributed by a trust, but not taxed on the principal remaining in the trust.
  - IRAs may be funded only by cash. They may not invest in collectibles, gold, or commodities (U.S. minted gold coins are allowed).
  - In a Per Capita Trust, beneficiaries receive an equal percentage of the trust, whereas in a Branching Trust, they receive an equal share.
  - A 529 plan is more effective in saving for college than a trust.
  - When inheriting assets, the recipient's basis is the value upon death of the donor. Any gains upon sale of the assets are treated as long-term capital gains.
- 11** The breakeven for a client who is long 100 shares of XYZ @ 60, who buys an XYZ 55 put @ 3, is 63 per share.
- A farmer may use a forward contract to lock in the price of corn if he believes the price of corn may decline.
  - Writing a call and a put on the same stock, with the same expiration and same strike price, is a short straddle. (Expect stability.)
  - If a client expects volatility in a stock but is unsure which direction the stock may move in, they could buy a straddle. (Expect volatility.)
  - A UIT is not a derivative.
  - A short stock position can be protected with a long call.
  - The cash value of a variable life insurance policy is determined by the performance of the subaccounts within the separate account.
  - A variable annuitant's payments are based on the AIR and the performance of the separate account.
  - An equity-indexed annuity's return may be based on point-to-point, which compares the index value on two particular dates.
  - An equity-indexed annuity has a floor of zero.
  - A real estate limited partnership passes through losses and gains to its partners. A REIT does not pass through losses to its shareholders.
  - Once a client has annuitized her annuity, it may not be rolled over into an IRA.
  - A form that is filed with the IRS on behalf of a limited partner is the K-1.
  - When a term life policy is extended, its premium will increase.
- 12** A stop order is a suspended market order. A stop-limit order becomes a limit order when activated.
- The simplest approach to investing is indexing.

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- A Form 8-K is filed with the SEC upon the occurrence of any event listed in Sections 1-6 and 9 of this form.
- A Form 8-K is filed with the SEC within four business days upon the occurrence of a material event.
- Highly regulated companies are subject to regulatory risk.
- Fixed assets and long-term debt are not used to determine working capital.
- Working capital = Current Assets - Current Liabilities
- A basic measure of risk is standard deviation.
- An efficient frontier is represented by a line graphing optimal portfolios.
- According to CAPM, there are two specific types of risk: diversifiable (nonsystematic risk) and nondiversifiable (systematic risk).
- High beta stocks are expected to outperform when the market is rising. Low beta stocks are expected to outperform when the market is falling.
- Tactical asset allocation may include sector rotation.
- Emerging markets are more prone to political risk.
- To determine present value, future value is discounted at a given rate. To determine future value, present value is compounded at a given rate.
- Net yield (after tax) = taxable yield x (100% - tax bracket %)
- A reporting company is required to file a Form 10-Q three times a year. A Form 10-K is filed annually.
- To calculate the amount needed to assure payments in perpetuity, take the annual income desired and divide by the rate of interest needed to produce the future income.
- A measure of profitability is earnings per share (EPS)
- A company's market capitalization is found by multiplying the current market value of its stock by the number of shares outstanding.
- Given the following numbers, 3, 3, 3, 4, and 7, the Median is the middle value (3), the Mode is the number that appears most often (3), the Mean is the average (4), and the range is the difference between the highest and lowest number (4).
- Value stocks have low P/Es and price-to-book ratios.
- Growth stocks have high P/Es and price-to-book ratios.
- Total Return = (ending market value – beginning market value) + (Dividends + Interest) divided by beginning market value.