



Series 99

Operations Professional

Learning Guide / Workbook

How to Use This Learning Guide

As the instructor presents the material through the On-Demand lecture, use this Learning Guide to take notes, answer questions, and complete activities. Once the On-Demand program is complete, this Learning Guide can be used as an ongoing resource.

About the Series 99 Exam

<p>1</p> <p>50 Multiple-Choice Questions</p>	<p>2</p> <p>5 Experimental Questions Included (55 Total Questions)</p>	<p>3</p> <p>One and a Half Hours (90 Minutes) Allotted</p>	<p>4</p> <p>Minimum Required Passing Score is 68%</p>
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Sections	# of Questions
Basic Broker-Dealer Operations Knowledge and Broker-Dealer Operations	35
Professional Conduct and Ethical Considerations	15
Total	50

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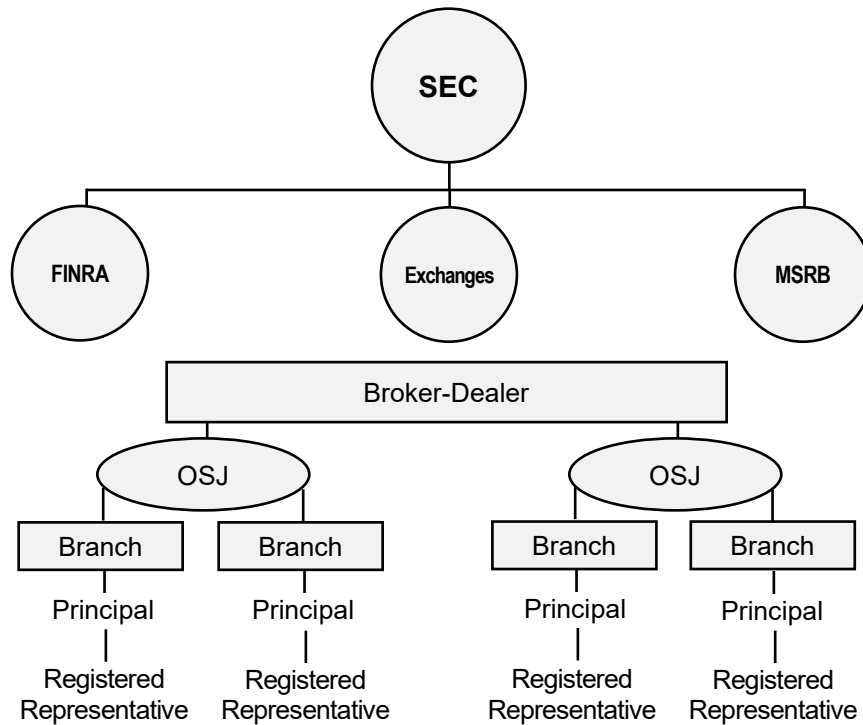
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Chapter 1 – Customer Accounts

Regulatory/Supervisory Overview



Financial Industry Regulatory Authority (FINRA)

The primary self-regulatory organization (SRO) for the securities industry

Conduct Rules	Uniform Practice Code (UPC)	Code of Procedure (COP)	Code of Arbitration
<ul style="list-style-type: none"> Governs the interaction between customers and firms 	<ul style="list-style-type: none"> Standardizes the procedures for doing business in financial markets 	<ul style="list-style-type: none"> Establishes the process used to discipline any person who violates FINRA rules 	<ul style="list-style-type: none"> Provides the method for resolving disputes (typically monetary) between members, including those that involve public customers

FINRA Rules for Customer Account Information

Required Information:

- Name of customer
 - Numbered or coded account is acceptable
- Address
 - Cannot open with P.O. box only (military P.O. box is acceptable)
- Whether of legal age
- Registered representative(s) of record
- Signature of supervising principal

Customers are NOT required to sign their new account forms

Copy of the above information must be provided to clients *at least every 36 months*

Additional Information

Prior to settlement of the initial transaction, a reasonable effort must be made to obtain the following customer information (this does not apply to institutional accounts):

Tax I.D./ Social Security number	Occupation, as well as name and address of employer	Whether associated with another member firm
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If a client refuses to provide any requested information, the RR should document the refusal

FINRA's Suitability Rules

Under FINRA's three main suitability obligations, a member firm and its registered representatives must have a reasonable basis to believe that:

The Reasonable Basis Obligation	The Customer-Specific Obligation	The Quantitative Obligation
A recommendation is suitable for at least some investors	A recommendation is suitable for a particular customer based on the customer's investment profile (this provision does not apply to institutional customers)	A series of recommended transactions, even if suitable for a customer, are not excessive when the customer's investment profile is taken into consideration

Individual Account

- Opened by, and for, one person
- Only the account owner can dictate trades
 - Third party authorization may be granted to another person
- Numbered or Nominee accounts are permitted
 - The account may be opened under a number or code name
 - Provides privacy for the individual
 - Customer Identification Program (CIP) requires firms to maintain records of the beneficial owners

Red Flag Issue

A client asks to open a numbered account. Is this practice acceptable?

If so, what are the areas of concern?

- Proper _____ of the beneficial owner
- Protection of the beneficial owner's _____
 - Examples: _____

Joint Accounts

- New account information is obtained for each owner
- Any owner may initiate activity
- When signatures are required, all owners must sign
- Checks are made payable to all parties

JOINT TENANTS WITH RIGHTS OF SURVIVORSHIP	JOINT TENANCY IN COMMON (JTIC)
<ul style="list-style-type: none"> ▪ Common for spouses ▪ Each tenant has equal ownership ▪ If one owner dies, ownership passes equally to surviving tenant(s) without probate 	<ul style="list-style-type: none"> ▪ Common for business partners ▪ Each tenant owns a specified amount ▪ If one owner dies, decedent's portion is transferred to her estate

Accounts for Minors – UGMA/UTMA

Custodial Account – Uses a standard new account form titled “custodian for minor”

ONE MINOR (Legal Owner)	<ul style="list-style-type: none"> ▪ Responsible for taxes; minor's Social Security number ▪ If child dies without a will, state law determines asset distribution
ONE CUSTODIAN (Any Adult)	<ul style="list-style-type: none"> ▪ Has authority to initiate activity (prudent investments) ▪ Under the Uniform Prudent Investor Act (UPIA), a custodian may delegate investment functions to a third party
GIFTS	<ul style="list-style-type: none"> ▪ Irrevocable; may be cash and/or securities ▪ Covered options and penny stock transactions may be permitted ▪ No margin (i.e., no uncovered options, short sales, commodities) ▪ No limit on number of donors or on the value of gifts ▪ Taxes may be due from donors if gifts exceed \$18,000 per year

Discretionary Accounts

If a client authorizes another person to make investment decisions in her account or deposit and/or withdraw funds, the following forms/steps are required:

- An authorization form signed by the client and the person granted authorization (Power of Attorney)
 - Principal must approve the account in writing prior to its opening
 - Each order must be reviewed and approved promptly by a principal (not in advance)
 - Activity must be monitored for potential churning

Limited Trading Authorization

- Allows for execution of trades

Full Trading Authorization

- Allows for execution of trades, withdrawal of cash and securities, check writing privileges

Power of Attorney

Grants a person other than the account owner with the authority to act on the owner's behalf without the owner's prior knowledge.

Not Held Orders

- Allows client to provide oral authorization for trade execution
- Avoids the need for discretionary authority if RR decisions are limited to *time and/or price of execution*
- Client specifies whether to buy or sell, the quantity, and the security
 - “Sell 1,000 shares of XYZ whenever you think the time and price is right”
- Not held orders are only good for one day; if longer, written authorization is required

The Three “A”s

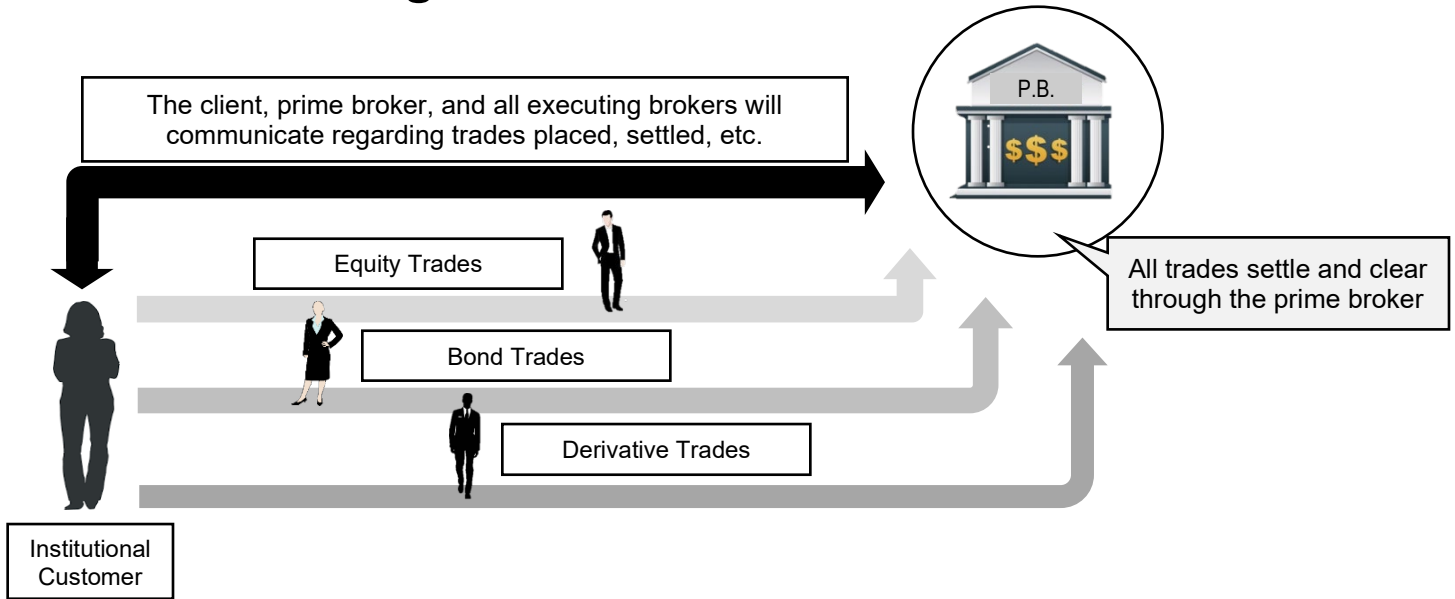
For Not Held orders, the customer specifies the **A**ction, the **A**mount, and the **A**sset.

Prime Brokerage Accounts

Prime Brokerage

- When a primary B/D provides a large client (e.g., hedge fund) with the ability to clear all trades through a centralized firm with executions occurring with multiple B/Ds
 - Prevents a single firm from determining the client's strategy
- The prime broker offers specialized services such as custody, securities lending, margin financing, clearing processing, operational support, research and customized reporting

Prime Brokerage



COD/DVP/RVP

These acronyms are used to describe situations in which a client (usually an institution) uses a bank to settle trades with one or more B/Ds

DVP or COD	Delivery Versus Payment (DVP) or Collect On Delivery (COD) <ul style="list-style-type: none"> ▪ Client is buying securities ▪ B/D delivers securities to client's bank and is paid by bank
RVP	Receipt Versus Payment (RVP) <ul style="list-style-type: none"> ▪ Client is selling securities ▪ Client's bank delivers securities to B/D; B/D makes payment to bank

- Before accepting a DVP/RVP account, the B/D must obtain the customer's account number and the name of its agent bank (i.e., an institutional identifier)
- Since DVP/RVP trades are settled with the customer's agent, account statements from B/Ds generally do not reflect any cash balance or security position at the quarter's end

Options Disclosure Document

The current options disclosure document (*Characteristics and Risks of Standardized Options*) must be delivered to each customer either prior to or at the time the account is opened.

Additional rules for options communications include:

- A warning that options are not suitable for all investors
- Must be clear and balanced as to the risks and potential benefits of investing in options

Penny Stocks

Defined as over-the-counter (unlisted) stocks that have a bid price below \$5 per share

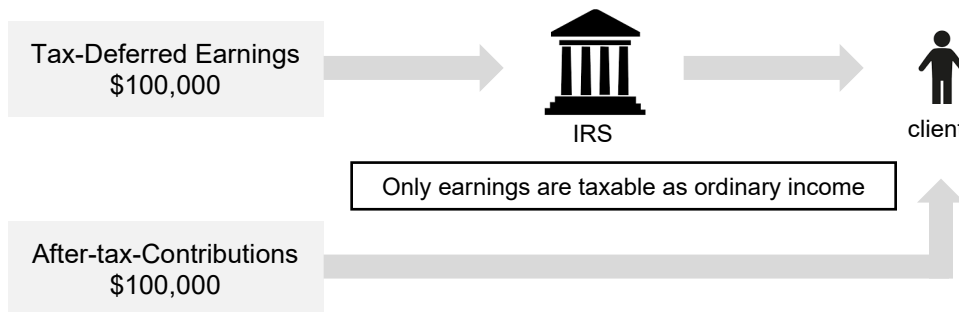
- Clients must be approved for penny stock trading and receive risk disclosure document
- Required disclosures for **solicited sales** include:
 - Current quote of penny stock
 - Compensation received by B/D and RR
 - Doesn't apply to unsolicited transactions
- Special suitability rules apply for new clients, but not established clients
- Established clients are those who have:
 - Been clients of the firm for more than one year, or
 - Made three separate purchases of three different penny stocks on three different days

Traditional and Roth IRAs

	Traditional	Roth
Similarities	100% of earned income, up to a maximum of \$7,000 (6% penalty for overfunding)	100% of earned income, up to a maximum of \$7,000
	Spousal option: extra \$7,000	Spousal option: extra \$7,000
	Age 50 or older: extra \$1,000	Age 50 or older: extra \$1,000
Differences	May be a deductible contribution	Contribution is NEVER deductible
	Contribution is always allowed	Higher income individuals may not contribute
	Required Minimum Distribution (RMD) by Apr. 1 the year after owner reaches age 73 (tax penalty for failure)	No withdrawal requirement
	Withdrawals are subject to tax	Qualifying withdrawals are tax-free

Taxation of Traditional IRAs

(Funded with after-tax contributions)



Traditional and Roth IRAs

For both Traditional and Roth:

- Early withdrawal penalty:
 - Before age 59 ½ and 10% of taxable amount
 - In a Roth IRA, the first contribution must have been made at least five years prior
 - Exceptions: death, disability, qualified higher education expenses, up to \$5,000 for expenses associated with birth or adoption of a child, or qualified first-time homebuyer distributions (\$10,000 lifetime limit)

- Rollovers and Transfers (no penalty)
 - Rollover:
 - Owner receives proceeds
 - Once per year (rolling 12 months); completed within 60 days
 - Trustee-to-Trustee Transfer:
 - Owner does not have access to the funds
 - May be more than one per year

ERISA

Employee Retirement Income Security Act of 1974 was created to prevent misuse and mismanagement of pension plan funds

- Rules apply to private sector defined benefit and defined contribution plans
- Determines qualified status
 - Employer and employee contributions are tax-deductible
 - Earnings are typically tax-deferred
- Plans must not be discriminatory and offered to all employees who:
 - Are age 21 or older
 - Have at least one year of full-time service (1,000 hours)
- An approved vesting schedule must be followed
 - Specifies the percentage of the employer's contributions to which the employee is entitled when withdrawing from the plan
 - Employees are 100% vested in their own contributions

Updating Client Information

Failure to update client information on a timely basis may result in the execution of unsuitable transactions or regulatory issues

- If a client moves to a new state, both the firm and the RR must be registered in that state in order to continue conducting business with the client
- Changes in the financial background of a client (for better or worse) must be documented
 - A different pattern of transactions may indicate a change
- Objectives are typically adjusted as customers age

FINRA rules require firms to send a copy of updated changes to a customer within 30 days or at the time the next statement is mailed.

SEC requires the updating of customer information at least every three years.

Red Flag Issue

An RR asks you to change an account mailing address to a P.O. box for the next several months since the client will be traveling abroad. What safeguards should be taken prior to making this change?

Registration Changes and Internal Transfers

Account Registration Changes:

- For persons who are married or divorced:
 - Requires marriage certificate, divorce decree, or court document
- To add a person to or remove a person from an account
 - Birth date, Social Security number, and contact information for the person being added are required
 - Typically both parties must sign and submit forms
- A registered principal must approve the change
 - Change must be documented and approved before transactions are executed in the account

Internal Transfers:

- All parties on the account must provide approval of the transfer
- If transferring stock to another person, a stock transfer form must be completed
- This process is different than transfers of accounts between brokerage firms

Escheatment

The process of turning over a client's unclaimed or abandoned property to a state authority, but not to the federal government

Escheatment occurs when a client:

- Dies without a will (intestate) or
- Cannot be located

Customer Identification Program

Required Identifying Information	<ul style="list-style-type: none"> ▪ Name ▪ Legal address (residence or business) ▪ Date of birth ▪ Identification number (which may be different for U.S. persons compared to non-U.S. persons)
Identification Number for U.S. Persons	<ul style="list-style-type: none"> ▪ Taxpayer ID or ▪ Social Security number
Identification Number for Non-U.S. Persons	<ul style="list-style-type: none"> ▪ One or more of the following: <ul style="list-style-type: none"> • Taxpayer ID • Passport number • Alien ID Card number • Any other government-issued document establishing residence and identity
Office of Foreign Assets Control (OFAC)	<ul style="list-style-type: none"> ▪ An OFAC list is maintained to identify the names of terrorists and/or criminals ▪ If a client's name appears on the OFAC List, transactions are blocked and law enforcement is notified

Red Flag Issue

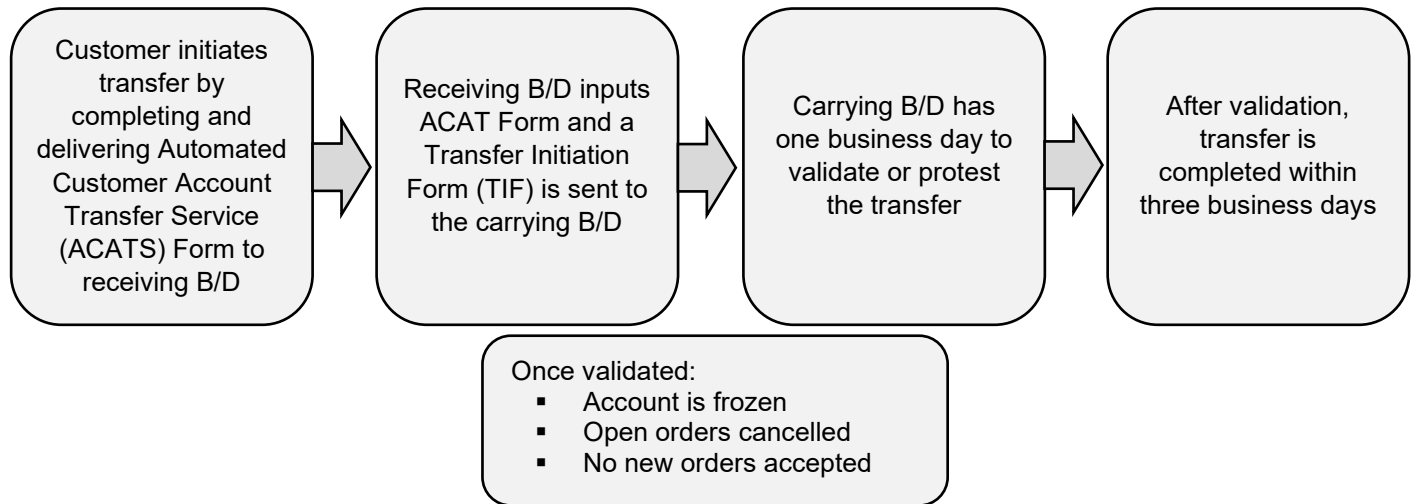
If a potential new client has provided you with all of the documentation required under your firm's CIP, should you go ahead and open the account?

Outside Brokerage Accounts

Employee Requirements	<p>Before a member firm employee can open an account with another firm, the employee must:</p> <ul style="list-style-type: none"> ▪ Obtain employer's prior written consent ▪ Provide written notification of his association to the executing firm ▪ Satisfy the previous two provisions within 30 days of employment if opened prior to employment
Executing Broker-Dealer Requirements	<ul style="list-style-type: none"> ▪ The executing firm must send duplicate confirmations and statements if requested by the employing firm. ▪ This applies to accounts for the employee's spouse, dependent children, or an account in which the person controls or has a beneficial interest.
Exemptions	<ul style="list-style-type: none"> ▪ Requirements of this rule do not apply to transactions involving mutual funds, variable contracts, unit investment trusts, or 529 plans.

Chapter 2 – Clearing and Account Transfers

Account Transfer Process



Account Transfer

Reasons to protest transfer request:

- Additional documentation is required (e.g., death certificate)
- Account is flat; reflects no assets
- Invalid account number
- Social Security number or account title does not match
- Existing court order or tax liens
- *Written* instructions to rescind the transfer are received from the client

If discrepancy claim occurs after transfer, carrying B/D must resolve it within five business days

But NOT due a dispute over securities positions or money balances

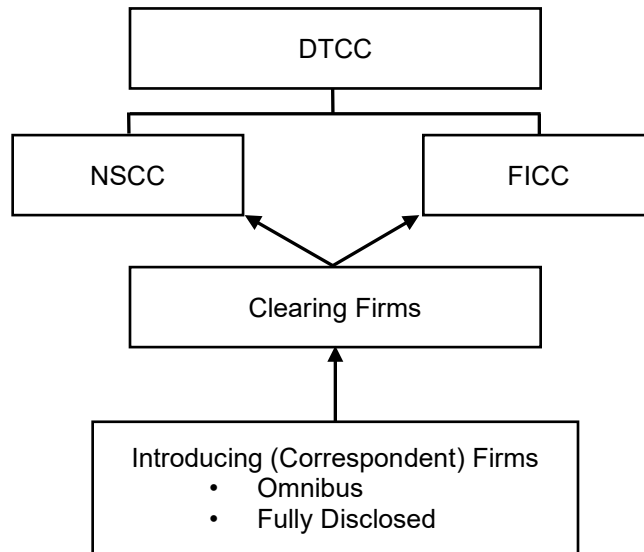
FinCEN's Reports

Under the Bank Secrecy Act (BSA), certain reports are sent to the Financial Crimes Enforcement Network (FinCEN), which is a bureau of the U.S. Department of Treasury

B	Bank Secrecy Act Currency Transaction Report (BCTR)
C	– Filed for all cash transactions executed by a single customer during
T	one business day that exceed \$10,000 (also filed for structured transactions)
R	– Filed within 15 business days
<hr/>	
S Suspicious Activity Report (SAR)	
A	– Filed whenever a transaction (or group of transactions) equals or exceeds
R	\$5,000 and the firm is suspicious
	– Filed within 30 business days
	– Suspicious activity should also be reported to a principal

A violation could result in a 20-year prison term and the greater of a \$500,000 fine per transaction or twice the amount of the funds involved.

Clearing and Settlement



Depository Trust & Clearing Corporation

The DTCC provides clearing, settlement, and information services for *depository-eligible securities* through its subsidiaries, including:

- National Securities Clearing Corporation (NSCC) – central counterparty for clearing, settling, and guaranteeing U.S. equity trades
- Depository Trust Company (DTC) – provides custody and safekeeping services for securities

Transactions among members are completed through computerized bookkeeping entries

- Referred to as *book-entry settlement*
- No physical delivery of securities

Fully Disclosed versus Omnibus

Introducing firms process trades through clearing firms in one of two ways:

<p>1. Fully Disclosed Accounts</p> <ul style="list-style-type: none"> ▪ Specific information about each individual client is given to the clearing firm ▪ Clearing firm is responsible for: <ul style="list-style-type: none"> • Maintaining client assets • Establishing a separate account for each client • Sending confirmations, statements, and checks <ul style="list-style-type: none"> – Contact information for introducing firm is included 	<p>2. Omnibus Accounts</p> <ul style="list-style-type: none"> ▪ A single account is set up at the clearing firm ▪ Specific client information is maintained by the introducing firm ▪ Recordkeeping responsibilities rest with the introducing firm
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Clearing Agreement

The agreement delineates the responsibilities of the introducing and clearing firm regarding the opening/approval of accounts, sending confirms/statements, and receipt/delivery of funds and securities (clients receive written notification of the agreement)

If the clearing firm receives a complaint from a client of the introducing (correspondent) firm, it must:

- Forward the complaint to the introducing firm and the introducing firm's primary SRO
- Provide acknowledgement of receipt to the client

Red Flag Issue

Several days after settlement, a trader at a correspondent firm is habitually moving trades in and out of its error account. As a senior operations professional at the clearing firm, what are your concerns?

Chapter 3 – Trade Reporting and Corrections

The Life of a Trade



1. **Order entry** – Order ticket details regarding how a trade is to be executed
2. **Execution** – Occurrence of a trade in a market center
3. **Clearing** – Executing firms agree to the details of a trade
4. **Settlement** – The process of the buyer and seller transferring monies and securities
5. **Custody** – Safeguarding of client and firm assets

The Order Audit Trail System (OATS) is a system that tracks the life of both customer and internal firm orders in Nasdaq and OTC equities from beginning to end and provides daily reports.

How Broker-Dealers Function

BROKER	<ul style="list-style-type: none"> ▪ Firm acts as a conduit or agent by finding another party willing to take the other side of the trade ▪ Sells to a bid or buys from an offer ▪ Collects commission for the service ▪ No risk to the firm
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A _____
 B _____
 C _____

How Broker-Dealers Function

P _____
 D _____
 M _____

DEALER	<ul style="list-style-type: none"> ▪ Firm acts as a principal ▪ Firm takes the other side of the trade ▪ Entitled to markup/markdown (discussed shortly) ▪ Inventory/risk
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Types of Transactions

When an order is placed, it must be identified as either a:

Purchase	Trade may be paid in full or purchased on margin
Long Sale	Sale of securities that are owned by the customer
Short Position Created By:	<p>Sale of securities that are not owned by the customer</p> <ul style="list-style-type: none"> ▪ Customer borrows securities from the B/D and sells them with the agreement to repurchase and deliver on a future date ▪ The appropriate amount of margin must be deposited to borrow securities ▪ Risk is on the upside and unlimited

Components of an Order Ticket

Created at the time an order is received and includes:

- Branch identifier
- RR responsible for account and person accepting the order
- Whether a purchase or sale
- Sales must be marked long or short
- Symbol or description of security and quantity
- Account number/name and type (e.g., cash or margin)
- Time stamps – time of entry and execution (if filled)
- Whether discretionary, solicited, or unsolicited

Orders must be approved by a principal on the day of entry

Missing information: firm capacity, accrued interest, compensation, and CUSIP number are items found on a confirmation

A Market Maker's Quote

A market maker that publishes a quote is obligated to buy or sell at its stated bid or offer and up to the size quoted.

Bid	Ask
10.00	10.05

The market maker must buy at 10.00 and sell at 10.05

Failure to do so is considered *backing away* (a violation).

Markups and Markdowns

Market maker quotes are inter-dealer, but are adjusted when trading with retail customers

- Allows dealers to profit on trades with customers
- Price adjustments are built into the trade, but are generally disclosed on the confirmation

This quote shows the prices at which the market maker will buy from and sell to other dealers:

Bid	Ask
17.05	17.15

Factoring in a \$.05 markdown or markup, the prices to retail clients will be as follows:

Price for Selling Client	Price for Buying Client
17.00	17.20

Trading Reporting Overview

The following systems are used to report trade executions:

Trade Reporting Facility (TRF)	For Nasdaq and third-market securities, report as soon as practical, but no later than 10 seconds
OTC Reporting Facility (ORF)	For OTC equities (Pink Market), report as soon as practical, but no later than 10 seconds
Trade Reporting and Compliance Engine (TRACE)	Facilitates mandatory reporting for secondary market transactions in eligible fixed-income securities (not corporate money market, foreign government or municipal securities). <ul style="list-style-type: none"> ▪ Must be reported within 15 minutes of execution

Give-Up and Step-Out Arrangements

Give-up relationship

- When B/D 1 reports and locks in trades on behalf of B/D 2 and reports the trades to the Trade Reporting Facility (TRF)
- B/D 2 agrees to accept and honor trades reported on its behalf
- If not reported appropriately, both firms are responsible
- To establish the relationship, both B/Ds must file the appropriate forms with Nasdaq

Step-out relationship

- When a B/D, who has previously executed a trade, allocates all or part of the trade to another B/D for clearing purposes
- A clearing-only report is submitted to the TRF
- Used to transfer the customer's position, but not report the trade

Trade Corrections

Trade Corrections		
When is the Trade Correction?	Same day as Execution	Later Date than Execution
Which Function is Used?	No/Was	As/Of

The As/Of report would also be used to enter a trade after the reporting system is closed for the day

Red Flag Issue

You receive a Don't Know (DK) notice from a broker-dealer. After contacting the trader, he directs you to settle the trade with a different broker-dealer which results in another DK notice. Further communications with the trader result in redirected settlement notices and further DK notices. What is your primary concern?

The 5% Policy

The policy applies to proceeds transactions

- When a client directs a B/D to liquidate securities and use the proceeds to buy other securities
 - Markup is calculated based on one trade (as if done for cash)

The policy excludes:

- Trades involving securities sold by prospectus or offering circular (e.g., new issues, mutual funds, variable annuities)
- Exempt securities (e.g., U.S. government and municipal securities)

Prohibited Trading Practices

Order Protection Rule	<p>Prohibits the trading-through of a protected quote. A protected quote represents the highest bid and lowest offer (i.e., the inside market) in a market center that allows electronic quotations.</p> <p>A trade-through occurs with an execution of a buy order at a price that's above the lowest ask price, or the execution of a sell order at a price that's below the highest bid.</p>
Interpositioning	<p>Refers to the insertion of a third party between a customer and the best market.</p> <ul style="list-style-type: none"> ▪ Prohibited if detrimental to customer ▪ Acceptable if advantageous to customer
Trading Ahead of Research	<p>If a firm has knowledge of material, non-public information regarding the contents of a research report, it may NOT establish, increase, decrease, or liquidate an inventory position in a security or its derivative.</p> <ul style="list-style-type: none"> ▪ Information barriers must exist between trading and research departments

Prohibited Trading Practices

Market rumors	Front-Running	Breakpoint Sales	Quoting a Security in Multiple Mediums
<ul style="list-style-type: none"> Spreading false or misleading information to influence the price of stocks and/or bonds 	<ul style="list-style-type: none"> RRs executing trades for proprietary accounts (or those for which they have discretion) ahead of a customer's block order (a market-moving order) 	<ul style="list-style-type: none"> Soliciting sales of mutual fund shares just below a breakpoint A breakpoint on a mutual fund is a dollar level at which the sales charge is reduced. Letters of Intent and Rights of Accumulation 	<ul style="list-style-type: none"> Refers to displaying quotes on the same security in multiple markets Permitted if quotes are at the same price

Red Flag Issue

A trader at your firm has a consistently winning record in several options trades placed over the last month. You notice that many of these derivative trades are in the same stocks that are being accumulated by one of the firm's largest institutional accounts. Is the trader guilty of insider trading?

Red Flag Issue

A new client has recently deposited \$300,000 with your firm. You notice that the client's RR has purchased shares of different growth funds offered by various fund families. Each purchase is for an equal amount. What may be occurring here?

Chapter 4 – Cashiering and Settlement

Cashiering Department

Responsibilities include:

- Receipt and disbursement of checks and wires
- Receipt and delivery of securities
- Settlement of trades
- Money market sweeps

Essentially, the cashier's department of a broker-dealer handles its money and paperwork issues.

Red Flag Issue

An RR repeatedly asks to pick up checks from the cashiering department so that he's able to hand deliver the funds to an elderly customer. Is this an acceptable practice?

Firm-to-Firm Settlement Dates

Unless a specific exception is made, settlement (completion of the transaction between the firms involved) will occur as follows:

- Corporate and Municipal Securities
 - One business day after the trade date (T + 1)
- U.S. Government Securities and Option Trades
 - One business day after the trade date (T + 1)
- Cash Settlement for any security
 - Same day as the trade date (both sides must agree)
- Seller's Option
 - Negotiated settlement; not earlier than two business days after the trade
- When Issued
 - As determined by the National Uniform Practice Committee

Settlement versus Customer Payment

Payment date is set by the FRB under the provisions of Regulation T

- Reg. T applies to transactions involving corporate securities

Transaction	Settlement	Payment Date
Corporate securities in either a cash or margin account	One business day (T + 1)	Three business days (T + 3 or S + 2)
Municipal securities	One business day (T + 1)	Exempt from Reg. T (generally settlement)
U.S. Government securities	One business day (T + 1)	Exempt from Reg. T (generally settlement)
Option Trades	One business day (T + 1)	Three business days (T + 3)

Holding Customer Securities

Three options:

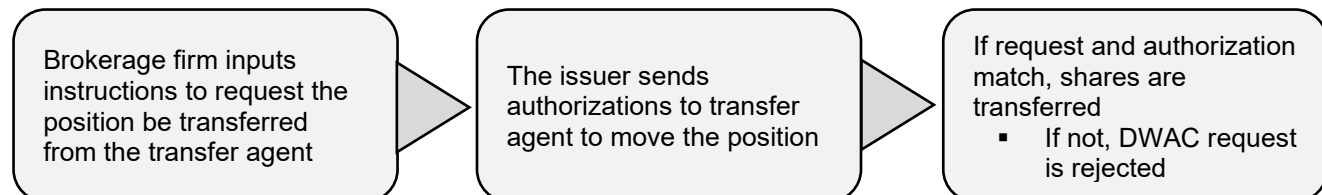
Physical Certificates	Street Name	Direct Registration
<ul style="list-style-type: none"> Shares are registered in client's name and delivered to client in certificate form (a fee may be charged) Shares are registered in client's name, but held at the B/D in certificate form (still segregated) 	<ul style="list-style-type: none"> Shares are registered in the B/D's name, but segregated in bulk from proprietary positions Street name doesn't automatically mean book entry 	<ul style="list-style-type: none"> If the Direct Registration System (DRS) is offered by the company, the transfer agent will hold shares directly in client's name (in electronic form)

Deposit or Withdrawal at Custodian (DWAC)

The DWAC Transaction System is run by DTCC and used to move shares electronically between the issuer's transfer agent and broker's/custodian banks

- Often used to transfer employee stock options and/or company-issued shares

The Process:



The DWAC process requires a Medallion Signature Guarantee

- A medallion signature guarantee verifies that the transferring B/D assumes liability in the event of forgery. The guarantee protects customers against unauthorized transfers and also limits the transfer agent's liability.

Physical or Electronic Ownership

The following are different methods that a client may hold a bond position:

Bearer	In certificate form, with no owner name noted on the physical security (interest coupons physically attached)
Registered to Principal Only	In certificate form, with name of owner evidenced (interest coupons physically attached)
Fully Registered	In certificate form, with name of owner evidenced (interest payments automatically mailed or paid electronically)
Book Entry	Position is held electronically at a depository

Good Delivery

A member firm's transfer agent makes the final determination as to whether a security is in good deliverable form and is transferable to the new owner

Good Delivery Requirements	Units of Delivery
<ul style="list-style-type: none"> ▪ Properly registered ▪ Properly endorsed certificate ▪ Signed stock power if the stock certificate is sent unsigned ▪ CUSIP numbers may be used to identify and clear ▪ Medallion Signature Guarantee Program (not the same as a notary public) 	<ul style="list-style-type: none"> ▪ Stock transactions must be delivered in multiples of 100 shares ▪ Bond transactions must be in \$1,000 units or multiples thereof <ul style="list-style-type: none"> – \$100 units adding to \$1,000 are permissible

Rejection versus Reclamation

Delivery Issues with Physical Securities

<ul style="list-style-type: none"> ▪ Stock is restricted (bears a legend) ▪ Security is not endorsed ▪ Endorsement does not match registration (if a joint account, both must sign) ▪ Security is mutilated/illegible ▪ Bond is missing coupons ▪ Missing documentation due to death of owner ▪ Stock has been reported lost, missing, or stolen

Restricted Securities and Rule 144

- Restricted securities bear a legend and have stop transfer instructions
- Removal requires an opinion letter from the legal counsel of the issuer
- The transfer agent removes the legend
- May be sold to the public only if registered or conducted under Rule 144

	Holding Period	Paperwork Required	Time Limit
Restricted	Six months and no volume limitations for non-affiliates after one year	File Form 144	90 days to execute sale
Control	No mandatory holding period	Same	Same

Rule 144 places a limitation on the amount of stock that may be sold over any 90-day period

- For exchange-listed, the maximum is the greater of 1% of the total shares outstanding or the average weekly trading volume of the past four weeks

Buy-In and Sell-Out

Buy-In: Occurs when a selling B/D fails to deliver securities to the buying B/D

Sell-Out: Occurs when a buying B/D fails to accept delivery of securities on the settlement date

	Buy-In	Sell-Out
B/D-to-B/D	Settlement + 3 business days (possible 7-day wait)	Settlement + 1 business day
B/D-to-Customer	Settlement + 10 business days (close-out occurs immediately thereafter)	Settlement + 3 business days

Chapter 5 – Margin and Regulation SHO

Opening a Margin Account

<p>Margin Basics</p>	<ul style="list-style-type: none"> ▪ Use of margin increases customer purchasing power ▪ However, potential losses are also increased due to adverse market changes ▪ Subject to the FRB's Regulation T 50% deposit requirement, which can be met by depositing: <ul style="list-style-type: none"> • Cash equaling 100% of Reg T call • Fully-paid marginable securities equaling 2 x the Reg T call ▪ Selling short and uncovered option positions must be executed in a margin account
<p>Credit Agreement</p>	<ul style="list-style-type: none"> ▪ This document discloses the terms of the loan <ul style="list-style-type: none"> • Interest amount, how computed, and when charged
<p>Hypothecation (Pledge) Agreement</p>	<ul style="list-style-type: none"> ▪ Customer hypothecates securities to B/D as collateral ▪ B/D borrows money from a bank to replace the loan that was made to the customer <ul style="list-style-type: none"> • What amount of cash can the B/D borrow from a bank? _____ • What amount of the customer's securities can be rehypothecated to the bank as collateral? _____

Additional Margin Documents

Loan Consent Agreement (generally used for short sales)

- *Not mandatory for opening account*
- If signed, B/D is able to lend the customer's securities to others

Margin Disclosure Document – must be provided to all customers opening a margin account and indicates:

- A customer can lose more money than deposited
- The firm can force the sale of securities or assets in the account
- The firm can sell securities from the account without notifying the customer
- The customer has no control over which assets are sold to meet a margin call
- The in-house maintenance requirement can be changed without prior written notification to the client
- The client is not entitled to an extension for a maintenance call

Margin Terminology

Marginable Securities	Non-Marginable Securities
<ul style="list-style-type: none"> Determined by the FRB; includes all listed securities 	<ul style="list-style-type: none"> OTC equities, standard options, and new issues
Long Market Value (LMV)	Credit Balance
<ul style="list-style-type: none"> The current value in the long margin account 	<ul style="list-style-type: none"> The amount of money generated by the initial short sale plus the Reg. T deposit
Debit Balance	Short Market Value
<ul style="list-style-type: none"> The amount of money borrowed from the firm to create a long position 	<ul style="list-style-type: none"> The current value in the short margin account
Equity	Equity
<ul style="list-style-type: none"> An investor's ownership interest in an account - For long account: $LMV - Debit = Equity$ 	<ul style="list-style-type: none"> An investor's ownership interest in an account - For short account: $Credit - SMV = Equity$
Maintenance Call	
<ul style="list-style-type: none"> Required deposit if equity falls below 25% of LMV in a long account, or below 30% of SMV in a short account 	

Initial Margin Requirement

For Long Positions: The lesser of \$2,000 or 100% of the market value	
Purchase:	Deposit:
Below \$2,000	100% of purchase
Between \$2,000 and \$4,000	\$2,000
Above \$4,000	50% (Reg. T)

Buy \$1,500 of ABC

Buy \$3,000 of ABC

Buy \$5,000 of ABC

For Short Positions: \$2,000	
Short Sale:	Deposit:
Below \$4,000	\$2,000
Above \$4,000	50% (Reg. T)

Short \$1,500 of XYZ

Short \$3,000 of XYZ

Short \$5,000 of XYZ

Restricting Activity in an Account

According to the FRB, the Regulation T payment must be obtained for purchases that are made in either cash or margin accounts within two business days of settlement (S + 2 or T + 3)	Payment extension may be granted by the firm's SRO	If no payment is made and no extension is granted, the position is closed out (securities sold) on the third business day following settlement	The result of non-payment is that the account is frozen for 90 days (all payments must be made in advance)
---	--	--	--

An investor who buys a stock and subsequently sells it, but fails to meet the Regulation T requirement, is guilty of *freeriding*.

Pattern Day Trading

Definitions	<ul style="list-style-type: none"> ▪ Day Trading <ul style="list-style-type: none"> • The purchase and sale (or short sale and purchase) of the same security, on the same day, in a margin account ▪ Pattern Day Trader <ul style="list-style-type: none"> • A client who executes four or more day trades within a five-day period
Risk Disclosure Statement	<ul style="list-style-type: none"> ▪ Prior to opening a day trading account for a non-institutional customer, a firm must provide a <i>Risk Disclosure Statement</i> which indicates: <ul style="list-style-type: none"> • Day trading can be extremely risky • Be wary of claims of large profits from day trading • Day trading requires knowledge of the securities markets and the firm's operations • Day trading will generate substantial commissions • Day trading on margin or short selling may result in losses beyond your initial investments
Approval Procedures	<ul style="list-style-type: none"> ▪ Firm must have reasonable grounds to believe that day trading is appropriate for the customer ▪ If the customer has provided written notice that the account will not be used for day trading, but the firm has evidence of the occurrence of day trading, the account must be approved for day trading within 10 days

Additional Margin Considerations

Portfolio Margin	<p>Also referred to as risk-based margin</p> <ul style="list-style-type: none"> ▪ Margin requirement is based on net risk in the portfolio <ul style="list-style-type: none"> • E.g., risk of a long stock position being offset by a put on that stock ▪ Eligibility limited to customers approved for uncovered options writing and certain firms
Leveraged ETFs	Minimum maintenance for these products equals the leverage factor times 25% (long) or 30% (short)
Pattern Day Trading	<ul style="list-style-type: none"> ▪ Minimum equity requirement of \$25,000 ▪ Buying power is four times the traders maintenance margin excess

Regulation SHO

Regulates the practice of selling short (i.e., the sale of a security that the seller does not own)

Order Marking Requirement: sell order tickets must be marked *long* or *short*

- Tickets may be marked long if:
 - Client or client's agent has title (e.g., DTCC or prime broker)
 - Customer has unconditional contract, but the trade has not yet settled
 - Convertibles have been tendered
 - Options, warrants, or rights have been exercised

And B/D believes the security will be delivered promptly

Locate Requirement – applies if sell order ticket is marked *short*

- B/Ds must use an *Easy-to-Borrow* list that is less than 24-hours old

Threshold Security

Defined as an equity security of a reporting issuer with substantial fail-to-deliver positions that have existed for **five** consecutive business days

A mandatory close-out for fail-to-deliver positions is required if the position has been open for **13** consecutive settlement (business) days

- The close-out occurs *immediately thereafter*

Threshold securities are included on an SRO published list

Regulation SHO – Rule 204

Designed to further reduce “naked” short selling

Broker-dealers are required to either:

1. Deliver the security by settlement date (T + 1) or
2. Immediately purchase or borrow the security to close out the fail by no later than the beginning of regular trading hours on the next settlement date following the fail (T + 2)

Exemptions exist under certain conditions

- 35 days for transactions in which the client is long, but cannot deliver (Rule 144 transactions and converting bonds)
- Two extra settlement days (T + 4) for market makers and long sales (in other words, three settlement days from the settlement date)

Chapter 6 – Custody and Control of Securities

Customer Protection Rule

On a daily basis, broker-dealers are required to obtain and maintain physical possession or control of all fully paid and excess margin securities belonging to customers

Control	Excess Margin Securities	Customers
<ul style="list-style-type: none"> Good control locations include an SEC-approved depository (domestic or foreign) such as the DTC or in-transit between the offices of a broker-dealer 	<ul style="list-style-type: none"> The value of margined securities that exceeds 140% of a customer's debit balance 	<ul style="list-style-type: none"> Any person for whom the B/D holds funds or securities or any omnibus account that's maintained by a B/D on behalf of its customers Excludes B/Ds, general partners, directors, principal officers, or subordinated lenders

Customer Protection Rule

Special Reserve Bank Account

- Kept separate from all other B/D accounts and established for exclusive benefit of customers
- Contains 100% of the difference between customer-related credits and debits
- Calculation is generally conducted weekly (Friday) with necessary deposit made on the second business day (Tuesday) following the calculation
- Deposit must be made in *cash* or *qualifying U.S. government securities*

Customer Free Credit Balances

A free credit balance represents customer proceeds resulting from sales, dividends, or interest payments that have not been withdrawn or invested

- A statement must be sent to customers at least quarterly
- The statement must indicate the total amount due and that it's payable on demand
- If statements are sent more frequently than quarterly, a notice of free credit balance must be included

The Securities (Box) Count

Conducted on a quarterly basis

- Not less than two months, or more than four months, from the previous count

Completed or supervised by a person who is not responsible for the care and handling of securities

Firms must account for all of the securities in its possession as well as those in transfer or transit, pledged, or borrowed

A short securities difference that's unresolved for seven business days is subject to a net capital adjustment

SIC Reporting

	If securities are:			If thereafter:
	Stolen or counterfeit	Lost/missing	Lost/missing from a box count	Recovered
Report to whom:	FBI, SIC, and transfer agent	SIC and transfer agent	SIC and transfer agent	SIC and transfer agent (possibly FBI)
When to notify:	One business day of discovery	One business day after a Two-day search	No later than 10 business days after the count	One business day of recovery

Cash Dividend

The ex-dividend date is the same business day as the record date

Ex-Dividend	Buyers must have settled their trades on or before record date to be entitled to a cash or stock dividend
Due Bill	If a security is sold before it trades "ex-dividend" (or "ex-rights") and is delivered too late to be transferred on or before the record date, it will be accompanied by a due-bill. The due bill is evidence of a seller's obligation to deliver the dividend (or right) to the buyer.
Due Bill Check	A due bill in the form of a check payable on the date of payment of a cash dividend, interest on registered bonds, or interest on unit investment trust securities.

Chapter 7 – Account Statements and Confirmations

Customer Account Statements

Broker-dealers must send customer statements *at least quarterly*

- For active accounts, they are sent *monthly*

Information includes:

- Summary of the total value of investments and cash
 - Unrealized and realized gains and/or losses
- Detailed information on the specific investments in the portfolio
- Income generated from investment for the statement period and year-to-date
- Daily activity for the statement period
- Required disclosures

Holding Customer Mail

For a broker-dealer to be permitted to hold customer mail:

- Firm must receive written customer instructions
- Instructions must include the time period during which the mail will be held
 - If the requested time *exceeds three consecutive months*, customer instructions must include a valid reason
- At reasonable intervals, firms must verify whether the customer's instructions still apply

After-Market Prospectus Requirements

Distribution participants that sell securities in the after-market must provide purchasers with a copy of the prospectus for a specific period from the effective date.

For a non-listed IPO	90 Days
For a non-listed, follow-on offering	40 Days
For an IPO of a security to be exchange-listed (NYSE or Nasdaq)	25 Days
For an exchange-listed, follow-on offering	No Requirement

The more public information available about the company, the shorter the period.

Red Flag Issue

An RR tells you that a customer who is buying an IPO is not required to be sent a final prospectus. The reason the RR gives is that the customer has already received the preliminary prospectus and she does not want the final version. What should you do?

Trade Confirmations

Sent on, or before, settlement of the transaction

Confirmation Information
<ul style="list-style-type: none"> ▪ Execution details: <ul style="list-style-type: none"> • Name of customer • Buy/sell • Price and quantity ▪ Trade and settlement dates ▪ Firm capacity (agent or principal) ▪ For bonds, dollar price and yield information ▪ Name of contra party or a statement of the availability of the information upon written request

Handling Errors

Error Account	Failing to Follow Instructions	Client Errors
<ul style="list-style-type: none"> ▪ Maintained by all B/Ds; used <u>if the firm or an RR executes a trade in error</u> (wrong security/ quantity or wrong side of market) ▪ To place trades in the account, principal authorization is required ▪ If execution was for the wrong customer, the <i>cancel and rebill</i> process must go through the error account 	<ul style="list-style-type: none"> ▪ Clients may refuse trades if their instructions were not followed (e.g., failing to execute at the client's limit price or better; buying more shares than ordered) <ul style="list-style-type: none"> • To correct the error, a principal must be consulted 	<ul style="list-style-type: none"> ▪ B/Ds are not responsible for errors that are caused by the client (e.g., client placed order for wrong stock or failed to cancel an order)

Note: If client receives an erroneous trade report, the actual price is binding.

Customer Tax Records

Broker-dealers must provide a report to customers regarding their tax information, including:

- Form 1099 for cash dividends, interest, and sales proceeds
- Stock Dividend and Stock Splits
- Cost Basis and Sales Proceeds
 - Identifying shares sold
- Mutual fund tax reporting
 - Income and gains are taxable to investors and reported on Form 1099-DIV
- Limited partnership tax reporting
 - Form K1 reports passive income and losses

Chapter 8 – Recordkeeping and Financial Responsibility

Retention of Books and Records

Lifetime	Six Years	Three Years
Corporate and partnership documents	Blotters (records of original entry), ledgers, new account forms, powers of attorney, municipal complaints*	Order tickets, confirmations, statements, Forms U4 and U5, employee records, all forms of communication, trial balances

* FINRA requires complaints to be maintained for four years

All records must be maintained in an easily accessible place *for the first two years*

Recordkeeping Formats

Fully Disclosed Broker-Dealer – Records are maintained by clearing firm

Omnibus Account – Records are maintained by introducing firm

Prior to utilizing any form of electronic storage media, a B/D must notify its SRO

- If the electronic storage media to be used is other than CD-ROM, the B/D must give its SRO 90-day advance notice
- Electronic storage media must have:
 - *Tamper-evident* features OR
 - The ability to record all changes made to its contents

Even in today's increasingly paperless world, it's still a good idea to keep hard copies of key investment records.

Minimum Net Capital Requirements

Prime Brokers	= \$1,500,000
Qualified Block Positioners or Executing Firms in a Prime Brokerage Arrangement	= \$1,000,000
Carrying Brokers	= \$250,000
Underwriters and Market Makers	= \$100,000
Introducing Brokers on a fully disclosed basis and receives, but doesn't hold, funds/securities	= \$50,000
Other B/Ds on a fully disclosed basis that don't accept funds/securities	= \$5,000

Financial Reports

A firm's principal (chief) executive officer, principal (chief) financial officer, and principal (chief) operations officer are all required to sign a FOCUS report

FOCUS reports are sent to the SEC and the firm's primary regulator

For Carrying B/Ds	
FOCUS Part I	Monthly
FOCUS Part II	Quarterly
For Introducing (Non-Carrying) B/Ds	
FOCUS Part I	Not required
FOCUS Part IIA	Quarterly

Chapter 9 – Communication and Customer Privacy

Definitions of Communications

Correspondence	Retail Communication	Institutional Communication
<ul style="list-style-type: none"> ▪ Written or electronic communication that a member firm distributes or makes available to <u>25 or fewer retail investors</u> (prospective or existing) within any 30-calendar-day period ▪ Subject to review and supervision 	<ul style="list-style-type: none"> ▪ Written or electronic communication that a member firm distributes or makes available to <u>more than 25 retail investors</u> within any 30-calendar-day period ▪ Often subject to preapproval and filing 	<ul style="list-style-type: none"> ▪ Written or electronic communication that a member firm distributes or makes available <i>only to institutional investors</i> (NOT to any retail investors) ▪ Subject to review and supervision

Fee-Based Accounts

Advisory and custodial fees, along with transaction costs, are wrapped into one comprehensive annual fee

- Fee-based accounts roll all of the costs for services into one fee
 - Wrap accounts are a type of fee-based account

Suitability considerations:

- Are the services appropriate given client's needs?
- Are the fees reasonable given the client's trading history?
 - Unsuitable for clients who trade infrequently (Buy and Hold)
 - Designed primarily for active traders

- Traditional accounts charge on a per transaction basis and assess a commission on each trade

Soft-Dollar Arrangements

This practice involves an investment adviser (IA) receiving research or other services from a B/D in exchange for order flow

- The services received from the B/D must benefit its clients.

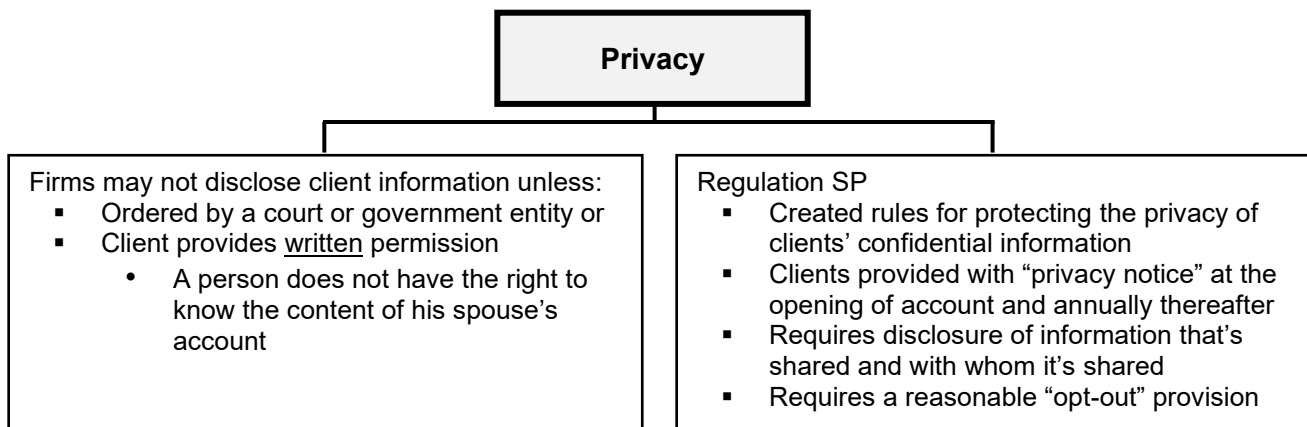
Acceptable	Unacceptable
<ul style="list-style-type: none"> Research reports (in-house and third-party) Access to analysts Portfolio analysis software Subscription to industry trade publications Attendance cost for a securities conference or seminar IA Software 	<ul style="list-style-type: none"> Office space Accounting fees Advertising/marketing expenses Travel reimbursement Professional licensing fees Subscription to mass-marketed publications (e.g., WSJ) Bloomberg hardware

Non-Registered Persons

Customer contact is limited to	<ul style="list-style-type: none"> Extending invitations to firm-sponsored events Inquiring as to whether a prospective customer wants to speak with a registered person Inquiring as to whether a customer is interested in receiving investment literature
Customer orders cannot be accepted	<ul style="list-style-type: none"> Orders can only be accepted and entered by registered persons If an RR is unavailable, a non-registered person can transcribe an order as long as an RR confirms the order with the customer before it's entered

Commissions or finder's fees cannot be paid to non-registered persons

Protecting Client Information



Identity Theft Protection

Federal Trade Commission's (FTC) Red Flag Rules

- Financial institutions must create and implement policies and procedures to detect and address identity theft
- The program should enable a firm to:
 - Identify relevant patterns, practices, and specific forms of activity ("red flags") that signal possible identity theft
 - Incorporate business practices to detect red flags
 - Detail appropriate responses to any red flags that are detected to prevent and mitigate identity theft

Use of Stockholder Information for Solicitation

- Firms are prohibited from using client information for solicitation purposes
- Permitted if specifically directed to do so and it is for the benefit of the corporation

Red Flag Issue

An associated person notices that an online customer has begun to liquidate some long-held positions and is uncharacteristically moving the sales proceeds into penny stocks. What's the primary concern?

Forwarding Official Communications

Beneficial Owners – Investors whose securities are held in their name and recorded on the firm's books

Non-Objecting Beneficial Owner (NOBO)	Objecting Beneficial Owner (OBO)
<ul style="list-style-type: none"> ▪ Owners who allow issuers to contact and send communications to them directly 	<ul style="list-style-type: none"> ▪ Owners who will not release personal information to issuers ▪ Instead, all communications must be sent through the OBO's broker-dealer

Proxies

- A voting power of attorney; must be immediately forwarded to customers
- By signing, the beneficial owner allows another person to vote on his behalf

Forms 10-K (annual) and 10-Q (quarterly)

- Comprehensive overview of a company's business and financial condition; filed with the SEC

Chapter 10 – Broker-Dealer Supervision and Customer Complaints

Written Supervisory Procedures

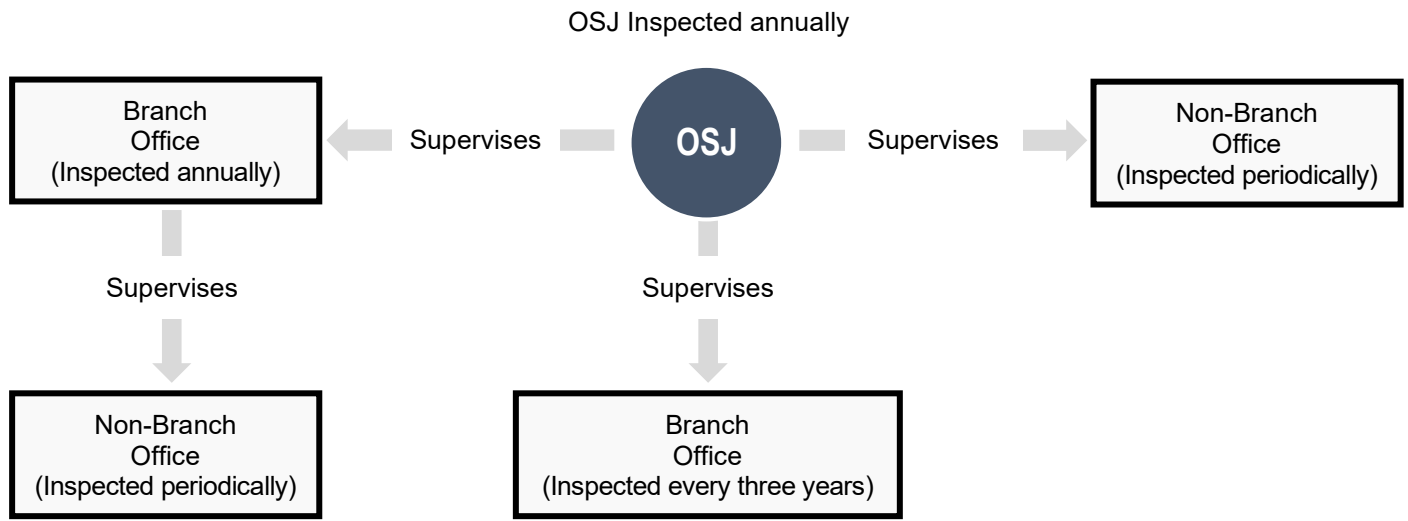
To provide adequate supervision, a firm must establish, maintain, and enforce written supervisory procedures, which include the following:

- Clear identification of a person’s supervisory responsibilities and the date assigned
- Procedures for each business line and applicable securities laws for which each supervisor is responsible
- Approving customer accounts and reviewing them periodically in an effort to detect and prevent abuses
- Verifying the good character, qualifications, and experience of all persons being certified for registration and monitor their good standing on a continuing basis

A firm’s WSP must be created to ensure oversight of its representatives' activities in handling customer accounts.

Each registered representative is assigned to a specific supervisor/principal

Supervisory Structure



Inspections must be performed in-person (not remotely) and may be delegated to home office compliance personnel.

Office of Supervisory Jurisdiction (OSJ)

OSJ activities include:

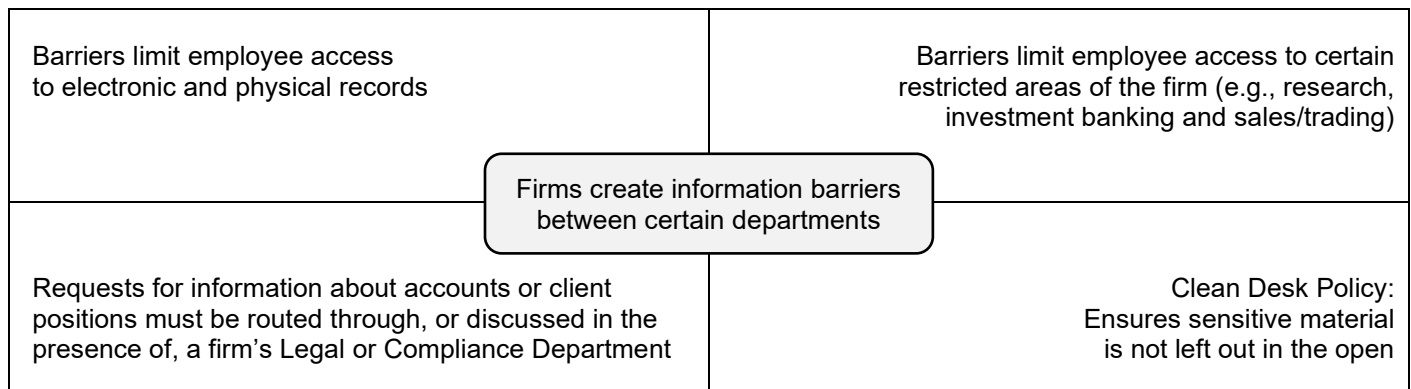
- Order execution (solicitation may be done by branches)
- Market making
- Structuring investment banking transactions
- Maintaining custody of customer assets
- Final approval for opening new accounts
- Review and approval of customer orders
- Final approval of retail communications (preparation may be done by branches)
- Supervising one or more branch offices

A registered principal must be present at this location to supervise the activities of all personnel and a copy of the firm's WSP must be maintained

Branch versus Non-Branch Offices

Branch Office	Non-Branch Office
<p>Defined as a location from which a member firm effects or attempts to effect securities transactions</p> <ul style="list-style-type: none"> ▪ If a branch subsequently moves, Form BR must be filed within 30 days 	<ul style="list-style-type: none"> ▪ Operations office (non-sales office) ▪ Office of convenience – used occasionally, and exclusively by appointment, to meet with clients (no signage allowed) ▪ Location used less than 30 business days per year (e.g., vacation or 2nd home) ▪ Office where fewer than 25 securities transactions are effected annually (non-securities business office) ▪ Office whose sole function is to <i>solicit</i> investment banking services ▪ Registered representatives' primary residence (under certain conditions)

Information Barriers



Red Flag Issues

An RR asks you for a list of all new accounts that have been opened in the last six months and the positions they hold. What's your next course of action?

Red Flag Issues

A member of the sales and trading group needs to attend a meeting in the investment banking area of your firm. Is this allowed?

Firm Supervision – Principals

Principals are the individuals who are responsible for managing specific areas of a member firm

Focus/Activity	Required Registration
General Securities Principal	Series 24
Registered Options Principal /Options	Series 4
Financial and Operations Principal/ <ul style="list-style-type: none"> ▪ Prepares FOCUS Reports ▪ Verifies accuracy of books and records 	Series 27

FINRA Rule 3130 requires a broker-dealer to notify FINRA of the designation of a principal who will serve as chief compliance officer for the firm

- Annually, a firm's chief executive officer must certify that the firm has in place policies and procedures to achieve compliance with all applicable industry rules and regulations.

Customer Complaint

Defined as a grievance that's delivered in any written form, including letters, e-mails, IMs, or text messages

- Complaints must be forwarded to a supervisor for review/investigation
- Complaint files, including copies, are maintained in an OSJ along with a report to indicate the action taken to resolve the complaint
- Records are retained for four years
- Quarterly reports are sent to FINRA (not the SEC) to provide statistical and summary complaint information

Red Flag Issue

A newly established firm has received no complaints for the time it's been in business. What's the procedure regarding the complaint file?

Reporting Requirements

FINRA requires firms to file information relating to certain customer complaints and other incidents involving RRs *by no later than within 30 days of discovery*. These events include:

<ul style="list-style-type: none"> Being subject to a customer complaint involving allegations of theft, misappropriation of funds or securities, or forgery 	<ul style="list-style-type: none"> Having been indicted or convicted of, or pleaded guilty or no contest to, any felony or misdemeanor involving securities violations
<ul style="list-style-type: none"> Violating securities laws or regulations of the government, SRO, financial business or professional organization 	<ul style="list-style-type: none"> Being the subject of a suspension, termination, withholding of commissions, or fines in excess of \$2,500
<ul style="list-style-type: none"> Having been named as a defendant by a regulator alleging violation of any securities, insurance, or commodities regulation 	<ul style="list-style-type: none"> Being a defendant or respondent in an award or settlement of more than \$15,000

Business Continuity Plan (BCP)

A written plan which identifies procedures to be followed due to an emergency or significant business disruption must be made available to FINRA promptly on request

Regulatory reporting	Communication with regulators (e.g., SEC and FINRA)	Communications between firms and clients and between firms and employees
A BCP must address each of these points		
Emergency contact information of two persons (one must be a member of senior management and a registered principal)	Alternative locations for employees to continue working	Ensuring that mission-critical systems (computers) continue to process transactions promptly

Red Flags

Red Flags	SEC rules emphasize that firms must exhibit reasonable supervision and require supervisors to look for <i>red flag</i> situations <ul style="list-style-type: none"> ▪ A Red Flag situation arises if there is any indication of real or potential violations of securities rules
Red Flag Discovery	If an issue is discovered, the following steps must be taken: <ol style="list-style-type: none"> 1. <i>Investigate the situation</i> – make a reasonable effort to ascertain all relevant facts 2. <i>Document the investigation</i> – records must be written 3. <i>Pursue the investigation to a conclusion</i> – the matter should be brought to some resolution, which may be that no violation occurred

Red Flag Issue

You receive a letter from a customer alleging that an RR has made a series of unauthorized trades. The RR contests that the trades were placed in the wrong account and have already been cancelled and re-billed. The RR instructs you to disregard the correspondence since the error has been corrected. What should you do?

Red Flag Indicators

Client inquiries about the following items may be indicators of potential fraud:	
No specified statement period, or a statement period that does not follow a consistent pattern	Income that appears on a statement, but has not been deposited in the account
Account number, firm of record, or registered representative does not match previous statements	Fees, including commissions, handling charges or other costs, that seem excessive or are unfamiliar
Performance that seems unrealistic (e.g., return is always positive)	Trading activity that does not match or is not reflected on account statements
Positions that do not match from one statement to another	Trade confirmation indicates a trade is unsolicited, but customer states the RR recommended the trade