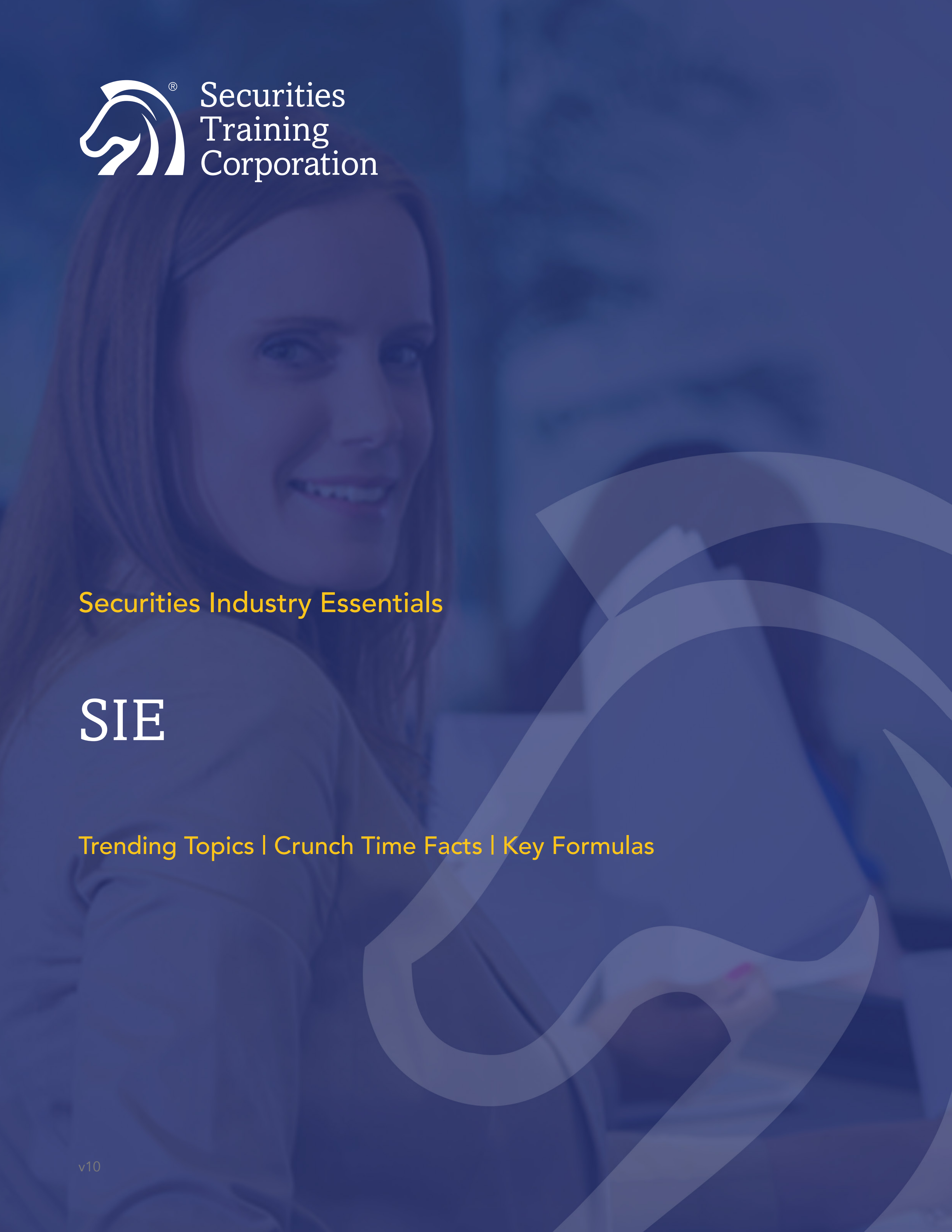

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SECURITIES TRAINING CORPORATION
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TRENDING TOPICS

Regulation Best Interest (Reg BI)

In June of 2019, the SEC adopted a package of rulemakings and interpretations that are designed to enhance the quality and transparency of **retail customers'** relationships with broker-dealers and investment advisers. These rules will bring the legal requirements and mandated disclosures in line with reasonable investor expectations, while preserving access (in terms of choice and cost) to a variety of investment services and products. Specifically, these actions include new Regulation Best Interest, the new Customer Relationship Summary (Form CRS), and separate interpretations under the Investment Advisers Act of 1940.

Regardless of whether a retail customer chooses a broker-dealer or an investment adviser (or both), the retail customer is entitled to a recommendation (from a broker-dealer) or advice (from an investment adviser) that's in the customer's best interest and that doesn't place the interests of the firm or the financial professional ahead of the customer's interests. In other words, any strategy or product that firms or individuals recommend to retail customers must be in the customers' best interest (not just suitable).

Who's a Retail Customer? Currently, Reg BI only applies to retail customers. According to the regulation, a retail customer is defined as a natural person, or this person's *non-professional legal representative*, who:

- Receives a recommendation of any securities transaction or investment strategy involving securities from a broker-dealer; and
- Uses the recommendation primarily for personal, family, or household purposes

Professional legal representatives (e.g., financial industry professionals) and other fiduciaries are not considered retail customers.

Client Relationship Summary (Form CRS) Along with the passage of Reg BI, the SEC adopted a new relationship summary disclosure document that broker-dealers must provide for retail customer—the *Client Relationship Summary (Form CRS)*. Form CRS must be no longer than two pages. The purpose of Form CRS is to provide retail investors with information about the nature of their relationship with their financial professional in a simple, easy-to-understand format.

- New retail investors must receive a copy of Form CRS by no later than the time they open a brokerage account, place an order, or receive a new recommendation for an account type, securities transaction, or investment strategy.
- All existing retail customers will receive Form CRS early in the summer of 2020.

Broker-dealers must file Form CRS with the Central Registration Depository (CRD), while registered investment advisers must file Form CRS with the Investment Adviser Registration Depository (IARD) as Part 3 of Form ADV.

General Obligations Brokerage firms must fulfill the following four specific obligations in order to satisfy their overall duty under Regulation BI:

1. Disclosure – Provide certain required disclosures regarding any recommendation made to a retail customer and the relationship between the firm and the customer before or at the time of the recommendation.
2. Care – Exercise reasonable diligence, care, and skill in making recommendations.

3. Conflicts of interest – Establish, maintain, and enforce written policies and procedures that are reasonably designed to address conflicts of interest.
4. Compliance – Establish, maintain, and enforce written policies and procedures that are reasonably designed to achieve compliance with Reg BI.

Broker-dealers are subject to Reg BI, whereas investment advisers are subject to the provisions of the Investment Advisors Act of 1940. Reg BI applies to any recommendations that are made to retail customers and extend beyond securities or portfolio recommendations, including whether an investor should roll over a 401(k) into an IRA or recommendations as to the type of account that a retail customer should open.

Suitability Since Reg BI serves to supplement FINRA's existing suitability rules, firms are required to comply with both rules. However, one change implemented by Reg BI applies to the difference between a "retail customer" (as used by Reg BI) and FINRA's use of the term "institutional customer." FINRA's definition of an institutional customer includes a natural person who has total assets of at least $50 million; however, Reg BI doesn't establish a dollar limit. In other words, for a natural person who has assets exceeding $50 million, the provisions of Reg BI will apply, while for other institutional investors (e.g., banks, IAs, investment companies), FINRA's suitability rules apply.

Titles Under Reg BI, unless a broker-dealer is also a registered investment adviser (i.e., the firm is dually registered as a broker-dealer and an adviser), the SEC has stated that it's a violation of the disclosure obligation to use either the term "adviser" or "advisor" in its title. From a practical standpoint, if an registered representative is neither Series 65 or Series 66 registered and currently uses either of these terms in her title, her firm must provide her with a different title that she can use on all of her marketing materials. To use either term, the representative must take and pass either the Series 65 or Series 66 Exam.

Sales Contests Regulation BI effectively bans all sales contests, quotas, bonuses, and other non-cash compensation that are tied to sales of specific securities or specific types of securities within a limited period. However, compensation that's based on other metrics, such as total sales, asset growth or accumulation, or customer satisfaction is still permitted. Training and education meetings are also permitted as long as attendance is not based on selling certain products within a limited period. Current SRO rules on non-cash compensation were updated to reflect that the rules must be consistent with Reg BI.

THE SECURE ACT

In December 2019, the Setting Every Community Up for Retirement Enhancement (SECURE) Act was passed. The SECURE Act is designed to enhance and increase access to retirement savings plans and its effective date is January 1, 2020. Listed below is a summary of the Act's potential impact to the exam:

Increase of Age for the Required Minimum Distribution (RMD)

- For individuals who turn age 70 ½ after December 31, 2019, the RMD is now set at age 72.
  - If an individual turned age 70 ½ in 2019, he must take his RMD for 2019 by April 1, 2020 and each year thereafter.

Contributions to a Traditional IRA After the Age of 70 ½

- Provided an individual has earned income, he's able to contribute to a Traditional IRA regardless of his age.

Penalty Free Withdrawals are Permitted for Birth or Adoption

- An individual is now able to take a penalty-free withdrawal of up to $5,000 from an IRA or employer-sponsored retirement plan for expenses associated with the birth or adoption of a child.
  - However, the individual is still required to pay tax on the amount withdrawn that was based on pre-tax contributions.

Section 529 College Savings Plans

- An individual is now permitted to withdraw up to $10,000 on a tax-free basis (a qualified withdrawal) to repay a qualified student loan as well as expenses for certain apprenticeship programs. This is a lifetime limit that applies to the beneficiary and each of the beneficiary's siblings. The law made the effective date retroactive to distributions that are made after December 31, 2018.

401(k) Plans for Part-Time Employees

- Employees who worked at least 500 hours per year for three consecutive years are now eligible for a company's 401(k) plan.
- This will now require employers that maintain 401(k) plans to have a dual eligibility requirement under which employees must be eligible if they complete either:
  1. A one-year of service requirement (with the existing 1,000-hour requirement) or
  2. Three consecutive years of service during which the employees complete at least 500 hours of service

PRODUCTS

- A common feature of both qualified and non-qualified annuities is *tax-deferred growth*.
- If an investor expects a sharp rise in a stock's price, *exercising rights is more profitable* than buying puts, selling calls, or selling puts.
- Warrants and rights are issued by the corporation, but call options are not.
- If an investor is concerned about a significant market decline to occur shortly, to protect her assets she should *move to cash and cash equivalents*.
- If an investor buys 2 STC July 40 calls at 5, the *breakeven point is 45*. The breakeven is per contract and not influenced by the number of contracts purchased or sold.
- If a bond is called at 103.75, the holder will receive *$1,037.50 plus accrued interest*.
- Qualified withdrawals from 529 plans, Roth IRAs, and Roth 401(k) plans are *tax-exempt*.
  - However, traditional IRAs allow for *tax-deferred growth*; while UGMA/UTMA accounts are *taxable*.

DISCLOSURES

- The disclosure document for a public offering is a *prospectus*.
- The disclosure document for a municipal offering is an *official statement*.
- The disclosure document for a private placement is an *offering memorandum*.
- On Form U4, an applicant must disclose *bankruptcy and felonies* which have occurred *within the last 10 years*, but NOT all misdemeanors (only those involving the securities industry).
- A customer account statement must indicate that the customer should *promptly notify her broker-dealer* if a discrepancy is noticed.

MISCELLANEOUS

- When an investor rolls $800,000 from a 401(k) plan to an IRA and is concerned that the market will fall dramatically, this is considered *systematic risk*.
- If a mother wants to make a gift to her son, but doesn't want him using the funds to pay living expenses, she should *establish a trust account*.
- An unregistered person cannot make securities recommendations.
- A C Corporation is NOT a pass-through entity (i.e., it's taxable).
- If a country runs a trade surplus (i.e., the value of its exports exceeds the cost of its imports), its currency will appreciate.
- A large appliance manufacturer is an example of a cyclical company.

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

CHAPTER 1 OVERVIEW OF MARKET PARTICIPANTS AND MARKET STRUCTURE

- Investment bankers assist businesses that seek to raise capital through the issuance of securities.
- The research department of a broker-dealer studies both the markets and individual issuers in order to issue recommendations.
- The trading department of a broker-dealer must be segregated from its investment banking department by information barriers.
- Buying a stock on one exchange and simultaneously selling it on another exchange is referred to as arbitrage.
- The reason for the creation of the DTC was to provide a book-entry system to handle the increase in volume of securities transactions.
- The quoted price of a non-listed stock can be found on the OTCBB or OTC Pink Marketplace.
- Broker-dealers that receive a commission are acting in an agency capacity.
- A firm that charges a markup on a stock transaction is acting in a dealer (principal) capacity.
- A broker-dealer sells a security to an investor at the ask price.
- A broker-dealer buys a security from an investor at the bid price.
- A market maker's quote is 7.10 – 7.15, 20 x 10. This quote indicates the firm's willingness to buy 2,000 shares at 7.10 and sell 1,000 shares at 7.15 (20 x 10 represents the number of 100-share round lots).
- A market maker is a member of a stock exchange (or a broker-dealer) that's responsible for providing liquidity by consistently buying and selling securities at its quoted prices.
- A married couple who has earned $300,000 of income in each of the last two years and reasonably expect this level to continue is considered an accredited investor.

CHAPTER 2 OVERVIEW OF REGULATION

- The North American Securities Administrators Association (NASAA) is an organization that consists of state regulators and is responsible for updating the states' securities laws (Blue Sky Laws).
- The Uniform Securities Act is the state model law that is sometimes referred to as "Blue Sky Laws."
- The reason that the Investment Company Act of 1940 requires mutual funds to have a significant percentage of its directors be disinterested is to protect shareholders against management impropriety.
- The purpose of information barriers is to limit the spread of non-public information within a broker-dealer.
- In arbitration proceedings involving customers, the arbitration panel can consist of both industry and non-industry arbitrators. (However, industry arbitration proceedings will utilize industry arbitrators only.)
- The SIPC protects the customers of a broker-dealer that is defunct (bankrupt).
- An SRO has the power to suspend an RR's registration after a hearing is held.

- For SIPC coverage purposes, a client with $250,000 in stocks and $50,000 in cash is fully covered. However, a client with $200,000 in stocks, $50,000 in cash, $100,000 in a CD, and $50,000 in futures is NOT fully covered since the SIPC doesn't cover commodity futures contracts.
- For coverage purposes, the SIPC considers CDs and money-market mutual funds as securities.
- The FDIC (NOT the SIPC) guarantees bank savings accounts, as well as CDs that are held in a bank account.

CHAPTER 3 EQUITY SECURITIES

- Authorized shares are not required to be issued.
- Preferred stock has a fixed dividend, but the payment is not guaranteed and is determined by the company's earnings.
- Convertible preferred stock will change in value as the underlying common stock changes.
- A warrant is an instrument that allows the holder to buy stock at a predetermined price for a long period.
- A company will issue warrants in order to pay a lower interest rate on its bonds.
- When comparing rights, warrants, and options, warrants have the longest period to expiration from the time of issuance.
- Characteristics of rights include that they are provided to existing shareholders, they allow for the purchase of shares at a predetermined price, and they are transferable; however, they do NOT receive dividends.
- Restricted stock (unregistered stock that's acquired through a private placement) must be sold under the provisions of Rule 144.
- Under the provisions of Rule 144, the SEC notification requirement does not apply to the sale of registered securities being sold by non-affiliates.
- Cumulative preferred shares must receive all previously unpaid dividends (i.e., dividends in arrears) before common shares receive dividends.
- Preemptive rights give existing shareholders the ability to maintain their percentage of ownership and control of the company.
- A risk that's unique to ADRs as opposed to domestic stocks is political risk.
- A company makes a tender offer for 40,000 shares at $10. An investor who owns 1,000 shares will receive $10,000.
- Under the statutory voting method, the number of votes that a common stockholder has to cast for members of the board of directors is based on the number of shares owned.

CHAPTER 4 INTRODUCTION TO DEBT INSTRUMENTS

- For bonds, 1 basis point is equal to 1/100 of 1% (100 basis points equals 1%).
- If interest rates fall, long-term bonds and long-term bond funds will increase the most in value.
- Bonds with short-term maturities minimize interest-rate risk (i.e., they move less than long-term bonds).
- Stability in the value of a debt portfolio is the greatest when the debt securities have short maturities.
- If interest rates fall, a money-market fund will experience a stable value, but a decrease in yield.
- If bond prices are falling, it's because interest rates are rising (and vice versa).

- A call feature on a bond is most advantageous for the issuer (NOT the bondholders).
- Long-term bonds have a longer duration than short-term bonds.
- Call protection is most valuable for a bondholder if bond prices are rising (due to interest rates falling).
- The last transaction in ABC 4.75s 2028 was at 101 1/2. The bond trade was priced at a premium (i.e., 101 1/2). 4.75s is the bond's coupon of 4.75% and its maturity is in 2028.

CHAPTER 5 TYPES OF DEBT INSTRUMENTS

- FNMA securities are issued in book entry form and their interest is fully taxable.
- General obligation (GO) bonds are backed by the taxing authority of a state or local government entity (i.e., a municipality).
- Unsecured bonds that are not backed by specific assets are referred to as debentures.
- Regarding the tax treatment of a municipal bond mutual fund, it provides tax-free income and taxable capital gains.
- T-bills trade at a discount, while T-notes, T-bonds and TIPS can trade for a premium or discount.
- Treasury securities are issued in book entry form.
- T-bills have more liquidity than T-notes, T-bonds, TIPS, and STRIPS.
- An increase in property values is favorable to the credit rating of a municipal issuer.
- The interest received on a U. S. treasury security is taxable at the federal level, but exempt from state and local taxes.
- A bond has a face value of $1,000, a market price of 125, and is convertible at $25. If an investor exercises the conversion feature, he will receive: 40 shares of common stock ($1,000 ÷ $25).
- A sewer bond is paid for by an increase in property taxes.
- A corporation is the primary source that backs an industrial development bond (IDB).
- The payment on an IDB is guaranteed by the signatures of the issuing authority and the corporation.
- U.S. Treasury securities are direct obligations of the U.S. government, coupon-bearing bonds are quoted in price terms, and non-coupon-bearing bonds are quoted in yield terms; however, they are not redeemable by the issuer (i.e., they trade in the secondary market).
- Regular-way settlement for Treasuries is next business day (T + 1).
- Money-market securities mature in one year or less.
- A bankers' acceptance is a security that helps finance foreign trade.
- For accrued interest, corporate and municipal bonds use 30 days in every month and 360 days in the year, while U.S. Treasury notes and bonds use actual days in every month and 365 days in the year.

CHAPTER 6 INVESTMENT RETURNS

- If a stock is paying a \$0.50 quarterly dividend and its market price is \$40, the dividend yield is 5% (\$2.00 annual dividend ÷ \$40).
- An investor who buys mutual fund shares will not receive an impending dividend distribution if she purchases on the ex-date (the ex-date represents the date on which the shares will sell without the dividend).
- An investor who is buying shares will receive a dividend if her purchase is executed prior to the ex-date.
- For a cash dividend, a stock's price is reduced on the ex-dividend date.
- The formula for calculating the current yield on a municipal bond is annual interest divided by the market price.
- A 5% bond that's trading at 90 has a current yield of approximately 5.6% (\$50 ÷ 900).
- If an investor owns 1,000 shares of ABC at \$40 and ABC distributes a 25% stock dividend, after the distribution the investor will own 1,250 shares at \$32.
- The ex-date is typically one business day before the record date and is the date on which the stock's price is reduced by the amount of the dividend.
- For small stock dividends, the ex-date is the one business day before the record date.
- The formula for calculating Real Rate of Return is: Actual Return – Rate of Inflation.
- The S&P 500 is a broad-based index which includes large companies that are listed on U.S. exchanges.
- The Dow Jones Industrial Average (DJIA) is an index that's based on 30 of the leading blue-chip companies.

CHAPTER 7 PACKAGED PRODUCTS

- The custodian bank of a mutual fund holds its cash and securities, but doesn't manage the fund's portfolio.
- The formula for calculating a fund's Sales Charge % is: (POP – NAV) ÷ POP.
- If a back-end load decreases the longer an investor owns mutual fund shares, it's referred to as a contingent deferred sales charge (CDSC).
- A no-load mutual fund has no front-end sales charge, no deferred sales charge, and no 12b-1 fee that exceeds .25% per year.
- The 12b-1 fee is used to pay for promotion and advertising, but not commissions on portfolio transactions.
- In order to reduce the front-end load on a mutual fund, breakpoints are available based on the total amount invested in the fund (i.e., the more invested, the lower the sales charge).
- A sales charge reduction is available for an investor who signed a letter of intent (LOI), but NOT for a married couple that invests in different mutual funds through the same RR.
- Closed-end management company shares trade in the secondary market, can be sold short, and are marginable.
- Closed-end shares trade at prices that are determined by supply and demand on the exchange.
- A unit investment trust is a type of investment company; however, a REIT, private equity fund, and hedge fund are not.
- On a breakpoint chart, a discount is provided at \$101,000. If a sale of fund shares is executed with a value of \$99,000, it's considered a breakpoint sale.

- The redemption value of open-end investment company shares is based on the NAV that's computed after the redemption order is received.
- REITs and mutual funds are actively managed.
- ETF shares trade in the secondary market, while mutual fund shares remain in the primary market (they are redeemable).
- Index funds have lower management fees since they are passively managed.
- A letter of intent to invest a certain dollar amount in a mutual fund is generally valid for 13 months.

CHAPTER 8 VARIABLE CONTRACTS AND MUNICIPAL FUND SECURITIES

- In a 529 plan, a person can be both the donor and beneficiary as long as she's 18 or older.
- The withdrawals, but not contributions, from a 529 plan may be federally tax-free if they're used for qualified education expenses.
- The cash value of a variable life insurance policy will change due to the fluctuation in the market value of the securities in the subaccounts.
- One benefit of a variable annuity is the tax-deferral of investment income.
- When selling a variable annuity, disclosure must be provided of administrative fees, mortality fees, and surrender fees, but NOT probate fees.
- When recommending a 529 plan to a customer, a registered representative should consider the potential deductibility of contributions from state taxes.
- To avoid gift tax, investors can contribute a maximum of $15,000 into a 529 plan (per person, per year). Investors can also front-load 529 plans by giving a lump sum of $75,000, provided no other gifts are made over the next five years (this lump sum amount still avoids the gift tax).

CHAPTER 9 ALTERNATIVE INVESTMENTS

- If an investor is interested in income, a raw land investment is unsuitable.
- ETFs are exchange-traded products that represent an interest in a stock portfolio that tracks an index.
- ETFs distribute gains, dividends, and interest.
- Direct participation programs (DPPs) are businesses that pass-through both income and losses to their owners (i.e., they are flow-through investment vehicles which allow investors to "participate in earnings").
- Two risks that are specific to ETNs include credit risk and market risk.
- Since ETNs are unsecured and backed only by the issuing institution's full faith and credit, a downgrading of the issuer's credit rating will have a significant impact.

CHAPTER 10 OPTIONS

- The maximum loss for the buyer of a call or put is 100% of the premium paid.
- Being long 1 ABC Jan 50 call will provide coverage (protection) for an investor who has a 100-share short position in ABC stock.
- An investor who owns an American-style equity option can exercise his contract at any time up to the expiration date.
- The potential outcomes for covered call writing are a limited gain and a limited loss.
- A trade involving an option contract settles on the next business day (T + 1).
- If the writer of an option covers (offsets) the position by purchasing an option, the transaction is considered a closing purchase.
- At expiration, all S&P 500 Index calls that are in-the-money are settled by the delivery of cash (not specific shares of stock).
- When an index option is exercised, the seller can satisfy her obligation by depositing cash that's equal to the difference between the option's strike price and the index's closing value.
- Buying puts is a suitable hedge for a long stock position, while buying calls is a suitable hedge for a short stock position.
- Selling calls against a long stock position is a conservative strategy for generating income (this is referred to as writing a covered call).
- If a customer with a long option position notifies her broker-dealer that she wants to exercise it, the broker-dealer must then notify the Options Clearing Corporation (OCC).

CHAPTER 11 OFFERINGS

- The best source of information regarding a new municipal bond offering is the official statement which is created by the issuer and can be found in the Electronic Municipal Market Access (EMMA) system.
- During the cooling off period, a registered representative can provide potential investors with a preliminary prospectus (red herring).
- Accredited investors include officers, directors, and other executives of the issuer, but NOT a person whose net worth is $200,000 or a person whose annual income is $150,000.
- If a company intends to sell securities over the next two years, it may utilize a shelf registration (which is good for up to three years).
- Shelf registration allows an issuer to complete the registration process well in advance of a securities offering.
- For a new issue, a broker-dealer is permitted to accept payment from a customer after the security's registration is declared effective.
- For a partnership that's offered under Regulation D, the disclosure document is referred to as the offering memorandum.
- Under Rule 144A, restricted securities are permitted to sell to qualified institutional buyers (QIBs).

CHAPTER 12 ORDERS AND STRATEGIES

- Short sales must be executed in a margin account.
- If an investor buys ABC stock and sells short XYZ stock, the purchase may be executed in a cash account (or a margin account), but the short sale must be executed in a margin account.
- In a new margin account, if a client's initial transaction is to sell short 100 shares of ABC at $18, she must deposit $2,000.
- If the initial transaction in a customer's margin account is a short sale of 1,000 shares of ABC stock at $90, the customer must deposit $45,000.
- In a new margin account, if a client's initial transaction is to buy 100 shares of XYZ at $30, he must deposit $2,000 (for purchases, the initial equity requirement is the lesser of $2,000 or 100% of the purchase).
- If a customer wants to buy or sell securities immediately, she should enter a market order.
- In the secondary market, the spread represents the difference between a stock's bid and ask prices.

CHAPTER 13 SETTLEMENT AND CORPORATE ACTIONS

- An investor owns 375 shares at $17 per share. If the stock splits 5:3, the investor will then own 625 shares (375 x 5/3) at $10.20 per share ($17 x 3/5).
- A tender offer is made with a 100,000 share minimum and a 1 million share maximum; however, only 80,000 shares were tendered. In this case, none of the shares that were tendered by the investors will be purchased.
- If an investor sells shares of preferred stock, delivery must be made by T + 2.
- In a joint account, good delivery of a stock certificate is made if the stock power is signed by both of the owners.
- A proxy may be used by a customer to vote for members of the board of directors.
- A customer owns 1,000 shares of XYZ at $2.00 per share. If XYZ executes a 1:20 stock split, his position is now 50 shares at $40 per share (1,000 x 1/20 and $2.00 x 20/1).
- If a company executes a stock split, the transfer agent is responsible for maintaining a record of the shareholders who are eligible to receive the additional shares.

CHAPTER 14 CUSTOMER ACCOUNTS

- In a margin account, the hypothecation agreement permits a broker-dealer to pledge a customer's securities as collateral for a loan and must be signed by the customer.
- The $2,000 maximum non-deductible contribution to a Coverdell Education Savings Accounts (ESA) is gradually phased out as income rises (if married, filing jointly, no contribution is allowed if income exceeds $220,000).
- IRAs are retirement accounts that allow individuals to contribute the lesser of 100% of earned income or $6,000 per year.
- If a 55-year-old has $55,000 of pension income and $1,500 of earned income, she can contribute a maximum of $1,500 to an IRA.

- Numbered accounts are acceptable if the firm has a signed statement on file from the customer which "attests" to ownership of the account.
- For numbered accounts, the firm must know the identity of the beneficial owner.
- Along with name, accounts can be identified by number or symbol.
- If a customer is invested in a 401(k) plan, she must begin withdrawing funds by April 1 of the first year after the year in which she turns age 72.
- Selling a stock based on access to material, non-public information is considered insider trading.
- Buying a stock based on knowledge of a large order that's not yet been executed is considered front-running.
- If a mutual fund is performing poorly and an RR sells a customer's shares prior to speaking with the customer, this is considered unauthorized trading and the RR may be subject to penalties.
- A fee-based account is generally more suitable for individuals who trade their portfolios actively (i.e., a portfolio that's rebalanced rather than one that's buy-and-hold).
- A Coverdell ESA must be established for a person who is under the age of 18 and the funds must be used by her 30th birthday.
- A person who is 54 years old is able to contribute a maximum of $7,000 to a Traditional or Roth IRA.

CHAPTER 15 COMPLIANCE CONSIDERATIONS

- According to Regulation SP, the privacy statement is NOT required to include the names of the third parties with which information is shared (instead, it includes the categories of third parties).
- Regulation SP requires broker-dealers to send a privacy notice at the time an account is opened and annually thereafter.
- The most suitable investment for a customer seeking aggressive growth is stock, not bonds.
- Customers who buy technology stocks accept significant capital risk.
- Telemarketing (cold) calls can only be made between 8:00 a.m. and 9:00 p.m. of the person being called, unless the client has an established business relationship with the firm.
- Firms that conduct telemarketing must create and maintain their own Do Not Call Lists. The list is not created by the firms' registered representatives.
- Customer account records must be maintained for six years after the account is closed.
- A broker-dealer can hold a customer's mail if it receives a written request from the customer.
- FINRA's suitability rules state that member firms and RRs must have a reasonable basis for believing that a transaction is suitable based on information they've obtained from the customers.
- An important aspect of a broker-dealer's anti-money laundering (AML) policy is appointing an AML compliance officer.
- If a broker-dealer receives cash **exceeding** $10,000 from one customer in one business day, it must file a CTR.
- To safeguard the financial system from the abuses of financial crime, including terrorist financing and money laundering, FinCEN enforces the Bank Secrecy Act (BSA).

CHAPTER 16 PROHIBITED ACTIVITIES

- Believing that a thinly traded security has significant upside potential, an RR buys shares for his own account. The RR also convinced many of his large high net worth clients to do the same. The stock subsequently rises and the RR cashes out his position for a large gain. Thereafter, he suggests that his clients do the same. This activity is unethical and prohibited.
- If RR's father-in-law establishes a trust account at a financial institution and makes the RR the trustee, this must be reported to the RR's broker-dealer since the RR has a beneficial interest in the account.
- An RR is prohibited from agreeing to buy back mutual fund shares from a customer if they don't perform in accordance with a benchmark.
- A sale of mutual fund shares at $99,999 will most likely represent a breakpoint sale.
- An RR placing trades for herself or for her firm just before the placement of a large order from a customer of which she was aware is prohibited (i.e., front-running).
- An RR is prohibited from buying or selling stock for herself or her firm just before the release of a research report (i.e., referred to as trading ahead of research).
- Another prohibited form of trading ahead involves a firm executing a trade for its own account at a price that would have filled a customer's order that it's holding.
- Falsely inflating the value of a stock in order to sell at a higher price is prohibited and referred to as *pump and dump.*
- An RR effects a series of large trades of a thinly traded stock during the last minutes of trading on an exchange. These trades resulted in the price rising overnight. At the beginning of the next day, the RR sold the securities at a profit. This prohibited activity is considered marking-the-close.
- If a customer buys ABC stock and sells short XYZ stock, he's prohibited from using the proceeds from the short sale to pay for the purchase.
- FINRA member firms, member firm employees, and the immediate family members of the employees who are materially supported by, or share a household with, the employee are restricted from buying equity IPOs. For purposes of the rule, immediate family includes in-laws, but not grandparents.
- Registered representatives can only borrow from or lend to clients that are immediate family members and financial institutions that are in the business of providing funds, without permission of their firms. However, if the borrowing/lending is with persons registered at the same firm or persons with whom they have a pre-existing personal/business relationship, their firms' permission is required.
- The Exploitation of Specified Adults Rule is designed to prevent the abuse of any persons who are over the age of 65 and any persons who are over the age of 18 who has a mental or physical impairment that renders the person unable to protect his own interest.
- If the niece of an elderly client is involved in making suspicious withdrawals/disbursements of cash from her uncle's account, the best course of action is to halt/suspend the withdrawals (assuming the owner has not provided a trusted contact person).

CHAPTER 17 SRO REQUIREMENTS FOR ASSOCIATED PERSONS

- An individual who is employed by a broker-dealer is required to be fingerprinted if he processes trades in the back office, is a clerical person who has access to books and records, or handles client funds in the back office, but not if he simply provides capital to the firm.
- If a registered representative has been terminated, she can still receive trailing commissions as long as she entered into a contract while she was appropriately registered.
- A registered person is required to attend a compliance meeting on an annual basis.
- If an RR receives a felony conviction for driving under the influence (DUI), it's grounds for statutory disqualification.

CHAPTER 18 EMPLOYEE CONDUCT AND REPORTABLE EVENTS

- Within 60 days, a registered representative must report on Form U4 that she satisfied a tax lien.
- If a person's association with a member firm was terminated more than 24 months ago, the person must requalify through examination to re-enter the securities industry.
- A link to BrokerCheck must be on the first page of a firm's website so that it's available to the public.
- FINRA members and associated persons are not allowed to give gifts that exceed $100 per year to employees of other member firms.
- To be exempt from the Gift Limit Rule, a promotional gift with a firm's logo must be valued at less than $100. A gift of a golf bag or putter with the firm's logo is likely to be valued in excess of $100 and therefore prohibited.
- Business and entertainment expenses do not violate the gift limit rule as long as the person giving the gift also attends the event/function.
- A registered person is not permitted to receive non-cash compensation (sales contest) directly from the distributor of a securities product (mutual funds).
- A Municipal Finance Professional (MFP) can contribute $250 per candidate, per election, provided the MFP is able to vote for the candidate.
- Due to an RR's inability to make mortgage payments on a second property, she decides to sell the property short and use the proceeds to cover the mortgage. This is referred to as a "compromise with creditors" and FINRA must be notified.
- Based on sales that are executed by registered representatives, if the sponsor of a mutual fund is offering a trip, this is considered a form of non-cash compensation.
- In relation to the sale of variable products, non-cash compensation includes meals, lodging, and gifts, but NOT commissions.
- Under FINRA's non-cash compensation rules, an all-expenses paid trip that's covered by a mutual fund wholesaler is prohibited.
- If an MPF makes a $500 contribution (in excess of $250) to her neighbor who is running for local office, the MPF's firm is prohibited from engaging in negotiated underwriting business with the municipality for two years.

- Selling away is a prohibited practice which involves an RR engaging in private securities transactions without the prior written consent of her broker-dealer.
- An RR must provide written notification to his employing broker-dealer to engage in outside business activities (even bartending, driving part-time for a transportation network company, or being involved in fixed insurance product sales). However, notification is NOT required if he coaches little league, is a member of a fraternal organization, or serves as a PTA treasurer.

CHAPTER 19 ECONOMIC FACTORS

- The economic policy that utilizes taxation and government spending programs to influence the economy is considered Keynesian.
- During an economic slow-down, the FRB will lower interest rates to stimulate economic activity.
- The FRB determines whether unlisted equity securities are marginable.
- Inflation is characterized by a rise in price levels.
- In periods of high inflation, stocks typically perform better than bonds.
- Coincident economic indicators include industrial production.
- Cyclical stocks tend to follow the business cycle (i.e., they rise during expansion, but fall during contraction).
- If inflation increases by 5% and the distribution that's received by an investor increases by 5%, the investor's purchasing power remains the same.
- If a country imports more than it exports, its GDP will decrease.
- If a country exports more than it imports, its GDP will increase.
- One likely reason for the FRB to pursue an easy money policy is an increase in unemployment.
- A recession is considered a decline in gross domestic product (GDP) for two successive quarters.

CHAPTER 20 INVESTMENT RISKS

- Interest-rate risk (most for long-term bonds) and inflation risk (most for bonds in general) are forms of systematic risk.
- Political risk is a form of unsystematic risk.
- A Ginnie Mae security is impacted by all of the following risks – prepayment risk, reinvestment risk, and fluctuations in the principal value of underlying mortgages.
- If an investor wants a hedge against inflation, common stock is an appropriate investment.
- If an investor wants to preserve capital, an appropriate investment is short-term U.S. government bonds.
- Political risk, repayment risk, and interest-rate risk applies to both domestic and foreign bond investments; however, exchange risk applies to foreign bond investments only.
- To create a downside risk hedge, an investor who owns 100 shares of ABC at $40 buys 1 ABC July 40 put at 3. To breakeven, the investor needs ABC stock to be trading at $43 ($40 cost of the stock plus the $3 premium paid).

KEY FORMULAS

CHAPTER 3 EQUITY SECURITIES

- Outstanding Stock = *Issued Stock – Treasury Stock*
- For cumulative preferred stock all dividends in arrears must be paid before any common stock dividends.
  - A 6% cumulative preferred stock pays a maximum dividend of 6% of 100, or $6.00. If this amount is not paid for two successive years, the issuer will owe $18 ($12 from the missing years plus $6.00 for the current year.
- Market Capitalization = *Market Value Per Share x Outstanding Shares*
- To calculate the conversion ratio of a convertible preferred stock:

$$\text{Conversion Ratio} = \frac{\text{Par Value of Preferred Stock (\$100)}}{\text{Conversion Price}}$$

  - For example, if the conversion price is $20, then the conversion ratio is 5-for-1 ($100 par value ÷ $20).

CHAPTER 4 AN INTRODUCTION TO DEBT INSTRUMENTS

- To determine the amount of interest received annually, a bond's par value ($1,000) is multiplied by its stated interest (coupon) rate. For example, if a client purchases a 7% corporate bond, she will receive $70 per year ($1,000 x 7%). Since bonds typically pay interest twice per year (semiannually), the investor will receive two $35 payments every year ($70 ÷ 2).
- For a bond, each point is equal to 1% of its par value. Therefore, each point is equal to $10 ($1,000 x 1%).
  - Each 1/8 of a point is $1.25
  - If a bond is trading at 92 5/8, the fraction should be converted to a decimal and will become 92.625% of par, or $926.25
- Treasury Bonds are quoted in 1/32 of a point. Therefore, if a T-note is quoted at 95.16, it's equal to 95 16/32. The fraction should be converted to a decimal and will become 95.50, or $955 (assuming a par value of $1,000).
- To calculate the conversion ratio of a convertible bond:

$$\text{Conversion Ratio} = \frac{\text{Par Value of Bond}}{\text{Conversion Price}}$$

CHAPTER 6 INVESTMENT RETURNS

- To determine a stock's adjusted after ex-dividend = *Old Stock Price – Dividend*
- To determine the number of additional shares received from a stock dividend
  = *Shares owned x stock dividend percentage*
  - These additional shares are added to an investor's existing shares to determine the total number of shares owned
- To determine an investor's adjusted price after a stock dividend
  = *Original dollar amount ÷ new total number of shares owned*
- Basis points are used to track changes in rates (One basis point is .01%)
  - If a bond's yield goes from 5.30% to 5.50%, it has increased by 20 basis points
- Current yield of stock:

$$\text{Current Yield} = \frac{\text{Annual Dividend}}{\text{Current Market Price}}$$

- Current yield on a bond:

$$\text{Current Yield} = \frac{\text{Annual Interest}}{\text{Current Market Price}}$$

- Total Return on an investment:

$$\text{Total Return} = \frac{(\text{Ending Value} - \text{Beginning Value}) + \text{Investment Income}}{\text{Beginning Value}}$$

- Inflation-Adjusted Return = Actual Return – Rate of Inflation

CHAPTER 7 PACKAGED PRODUCTS

- Net Asset Value + Sales Charge = Public Offering Price
- To determine the sales charge percentage:

$$\text{Sales Charge \%} = \frac{(\text{POP} - \text{NAV})}{\text{POP}}$$

- To calculate the POP:

$$\text{POP} = \frac{\text{NAV}}{(100\% - \text{Sales Charge \%})}$$

CHAPTER 10 OPTIONS

- Option Premium = Intrinsic Value + Time Value
- Time Value = Option Premium – Intrinsic Value
- Intrinsic value equals the in the money amount of an option (see below)
  - Calls are IN-THE-MONEY if the stock's market price is above the option's strike price
  - Puts are IN-THE-MONEY if the stock's market price is below the option's strike price
  - Calls are AT-THE-MONEY if the stock's market price is equal to the option's strike price
  - Puts are AT-THE-MONEY if the stock's market price is equal to the option's strike price
  - Calls are OUT-OF-THE-MONEY if the stock's market price is below the option's strike price
  - Puts are OUT-OF-THE-MONEY if the stock's market price is above the option's strike price
- To calculate the breakeven for the buyer of a call: *Strike price + premium*
- To calculate the breakeven for the buyer of a put: *Strike price – premium*
- To calculate the breakeven for the seller of a call: *Strike price + premium*
- To calculate the breakeven for the seller of a put: *Strike price – premium*
- To calculate the breakeven for a covered call (own stock and sell a call):
  Original cost of stock – premium
- To calculate the breakeven for a protective put (own stock and buy a put):
  Original cost of stock + premium

CHAPTER 11 OFFERINGS

- The volume limitation of shares sold under Rule 144:
  - The *greater of* 1% of the total shares outstanding or the stock's average weekly trading volume over the past four weeks
- Difference between the amount that an investor pays and an issuer receives
  = underwriting spread

CHAPTER 12 ORDERS AND TRADING STRATEGIES

- If a firm is quoting a stock at $20.10 – $20.20, 10 x 5
  - The firm will buy 1,000 shares at its bid of $20.10 (10 round lots of 100 shares)
  - The firm will sell 500 shares at its offer of $20.20 (5 round lots of 100 shares)
  - The spread represents the difference between the bid and offer

CHAPTER 13 SETTLEMENT AND CORPORATE ACTIONS

- If a company executes a forward stock split:
  - To determine the new number of shares =
    Number of Shares Owned x Stock Split Ratio
  - To determine the new price per share =
    Current Market Price x Inverse of Split Ratio

CHAPTER 14 CUSTOMER ACCOUNTS

- Reg T Margin Requirement = Security's purchase price x Reg T of 50%

- Minimum dollar amount deposited to buy on margin = $2,000
  - In a new margin account, an investor buys 100 shares at $18 = Required deposit of $1,800 (no lending of funds)
  - In a new margin account, an investor buys 100 shares at $30 = Required deposit of $2,000

- Minimum amount deposited to sell short (can only be executed in a margin account; always borrowing stock) = $2,000
  - In a new margin account, an investor sells short 100 shares at $18 = $2,000

CHAPTER 19 ECONOMIC FACTORS

- Total Assets = Total liabilities + Shareholders' Equity

- Shareholders' Equity = Total Assets – Total Liabilities

