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General Securities Representative Qualification

Series 7 *Top Off*

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TRENDING TOPICS

OPTIONS

- An uneconomic trade is one in which the amount of premium paid is nearly equal to the maximum profit potential and, when fees or commissions are considered, the position doesn't make economic sense.
- The key to identifying whether a spread is economic is remembering that the investor's maximum gain plus the maximum loss is equal to the difference in the strike prices. For a debit spread, the net premium paid represents the investor's maximum loss, while the remainder represents the maximum gain. For a credit spread, the net premium received represents the investor's maximum gain, while the remainder represents the maximum loss.
  - Let's assume that an investor creates a debit spread (is the buyer) and pays a net premium of 2 for a spread that has a 5-point difference in the strike prices. In this case, her maximum loss is the 2-point net premium, while her maximum gain is the remaining difference of 3. On the other hand, let's assume that another investor creates a debit spread and pays a net premium of 4.75 on a spread that has a 5-point difference in the strikes. For this investor, his maximum loss is the 4.75 net premium, while his maximum gain is the remaining difference of .25. The first example is clearly more economic.
  - Now, let's assume that an investor creates a credit spread (is the seller) and receives a net premium of 6 on a spread that has a 10-point difference in the strike prices. In this case, his maximum gain is the 6-point net premium, while her maximum loss is the remaining difference of 4. On the other hand, let's assume that another investor creates a credit spread and receives a net premium of .75 on a spread that has a 10-point difference in the strike prices. For this investor, her maximum gain is the .75 net premium, while her maximum loss is the remaining difference of 9.25. Again, the first example is more economic.

SOCIAL MEDIA

- A principal must approve any social media site that an RR intends to use for business communication with clients (however, sites that are strictly for personal use don't need to be approved).
- **Static content** is material that's posted to social media for an extended period and is not interactive. This falls under the definition of retail communication and, unless an exception applies, it must be pre-approved by a principal.
- **Interactive communications** are typically real-time and involve interaction with third parties. These are also defined as retail communication; however, they're treated in the same manner as correspondence, which means that they only need to be supervised (reviewed) by the firm. They don't require pre-approval as long as the firm provides education and training to associated persons on the procedures and content standards of the communications rules.
- If interactive content is copied or forwarded to a static area of a social media site, it's now considered retail communication and, unless an exception applies, it must be approved by a principal and may need to be filed with FINRA.
- Firms are required to maintain records of any communication that its registered persons disseminate through social media for business purposes (not personal use). Since this rule applies to any type of device that's used by an RR (e.g., a smart phone or tablet), if a personal device is used for business communication, the recordkeeping rule applies.

- Firms are prohibited from using a social media site for business communication if it automatically erases or deletes content because this violates SEC recordkeeping rules.
- FINRA's suitability rules apply to any recommendations that are made through social media websites. In addition, if an RR uses social media to make a recommendation, a registered principal is required to preapprove the content (many firms don't permit such recommendations).
- If a customer of a broker-dealer or other third-party posts content to social media, this is generally not considered communication with the public (although recordkeeping rules still apply). However, it's considered communication with the public in the following two situations:
  1. If the broker-dealer is involved in the preparation of the content that was posted by the third-party. This is referred to as *Entanglement*.
  2. If the broker-dealer has explicitly or implicitly endorsed or approved the content. This is referred to as *Adoption*.
- Firms and their RRs are prohibited from linking to a third-party website using social media that it knows or has reason to know contains false or misleading content. If a firm adopts or becomes entangled with the third-party site, the firm is responsible for its content.
- RRs may use text messaging and chat services with their clients as long as their firm is able to review, supervise, and retain records.
- In personal communication, if an RR shares or links to content that her firm makes available and it doesn't relate to the firm's products and services, it's not considered communication with the public. In other words, an RR is permitted to distribute information regarding a charity event that her firm is sponsoring.
- If a firm allows an RR to use a social media site for business communication that it supervises, any unsolicited third-party opinion posts are not considered "testimonials."
  - If the RR "likes" or shares comments which are posted on social media, they're subject to FINRA's communication rules and may be considered testimonials to which all of the applicable rules apply.
  - In this situation, the firm may comply with the required testimonial disclosures by posting a clearly marked hyperlink that indicates "important testimonial information."
  - Any firms that are registered as investment advisers are prohibited from using testimonials.

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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 BUILDING AN INVESTOR PROFILE

- An excessive number of recommendations that result in trades, even if suitable, may be considered unreasonable.
- A typical asset allocation method is to subtract an individual's age from 100 to determine the percentage of the portfolio that should be invested in equities. The age represents the percentage invested in debt.
- Investments that result in a loss may still be suitable, while investments that result in a gain may actually be unsuitable.
- According to Regulation Best Interest (Reg BI), the most important factor when making a recommendation is whether it's in the client's best interest. A suitable investment may not necessarily be in the client's best interest.

CHAPTER 2 CUSTOMER ACCOUNTS

- If a customer died in February, but her account was not closed until October, account records must be kept for at least six years after the date that the account was closed (i.e., October).
- If an account is being opened to purchase municipal securities, review and approval of the opening may be performed by either a General Securities Principal (Series 24) or a Municipal Securities Principal (Series 53). However, the daily review of transactions must be performed by the Municipal Securities Principal.
- A 403(b) retirement plan is available to employees of tax-exempt organizations [501(c)(3) organizations], which include religious and charitable entities. Eligible participants also include employees of public schools and colleges. The employee contributions are made using pre-tax dollars up to certain IRS limits and the earnings in the account are tax deferred.
- Employers are permitted, but not required, to allow employees to take loans from their 401(k) plans. The term of the loan is typically five years and the employer determines details of the loan agreement. The IRS limits the maximum amount to the lesser of half the amount vested or $50,000.
- When another person is added to an account, orders that are placed for the account will not be accepted until the change is completed.
- For a divorced woman to change from her married name back to her maiden name, a divorce decree is required. In this situation, a driver's license is NOT acceptable.
- If a 17-year-old's birthday is approaching and he wants to open a brokerage account, the most appropriate course of action is for an RR to refuse to open the account.
- For a person who has discretionary authority over a customer's account to be able to receive the customer's confirmations, written approval must be obtained from the customer and the customer must also receive duplicate copies.
- A client wants to give his firm discretionary authority and tells his registered representative (RR) that the forms are in the mail. In this case, the RR may not exercise discretion until the forms are received and approved; even if there's negative news on one of the client's holdings.
- A prime brokerage account offers institutions and hedge funds the ability to receive bundled services at reduced costs.

- Before opening an account at another financial institution, employees of broker-dealers are required to provide the executing firm with written notification of their association with another member firm and obtain their employer's written permission.
- If a customer has experience with writing covered calls, but now wants to begin writing uncovered calls, her registered representative needs to update her investment objective to speculation.
- If a tenant in a joint account dies and the assets are moved to the survivor's individual account, records of the change must be maintained for a period of not less than six years after the move.

CHAPTER 3 CUSTOMER COMMUNICATIONS

- If a registered representative obtains her firm's approval, she's permitted to attend an educational seminar.
- If a registered representative conducts a seminar which is only attended by representatives from other broker-dealers, it's considered institutional communication.
- If an email is sent to 40 persons (20 retail investors and 20 institutional investors) within a 30-calendar-day period, it's considered correspondence. The key is the number of retail investors to which it's sent.
- If an email is sent to 40 persons (30 retail investors and 10 institutional investors) within a 30-calendar-day period, it's considered a retail communication (more than 25 retail investors).
- If municipal bonds are issued or trading at a discount, any advertisement about the bonds must use the yield-to-maturity.
- If a person is employed by a broker-dealer and also makes decisions for a municipality (e.g., water & sewer department or school district), the MSRB considers this a control relationship. This relationship must be disclosed to clients at least verbally before the trade, followed by written disclosure after the trade.
- If a registered representative receives text messages on a mobile device from customers of the firm, the broker-dealer is required to maintain a record of this communication.
- If customer comments and a firm's response are posted on an approved social media site, they're considered to be made on an interactive forum, defined as a retail communication, but only subject to review and supervision.

CHAPTER 4 EQUITIES

- A standard corporation (C Corporation) is taxed separately from its owners and has an unlimited number of shareholders.
- C Corporation income is taxed twice — it's first taxed at the corporate level and, if distributed as a dividend to shareholders, the income is then taxed to the shareholder.
- During periods of stable interest rates, convertible preferred stock tends to be the most volatile type of preferred stock.
- If a company anticipates high earnings, its participating preferred stock will be the most suitable of its types of preferred stock.
- The IRS only recognizes two methods for calculating the cost basis for capital gains or losses on stock transactions: 1) first-in, first-out (FIFO) and 2) specific identification. FIFO uses the oldest shares (i.e., shares purchased first) to calculate the cost basis, while specific identification allows taxpayers to choose which of their shares will be used to find the cost basis.
- If the same stock is purchased on different occasions and some of the shares are later sold, unless the client identifies the shares being sold, the IRS will assume that FIFO (first-in, first-out) will be used to determine whether a gain/loss is short-term or long-term.

- FIFO generally results in greater gains for tax purposes than LIFO.
- Preferred stock doesn't participate in rights offerings; instead, this is a privilege of common stock.
- Assuming normal market conditions, the value of the different types of preferred stock listed from the most valuable to the least valuable is: cumulative, participating, convertible, non-cumulative.
- K Shares of preferred stock begin with a fixed rate; however, in approximately five years, they will change to a floating rate that will increase along with market interest rates.
- K Shares of preferred stock are generally depository shares, with each share representing a certain number of preferred shares (e.g., one depository share is represented by 25 preferred shares).
- The characteristics of K Shares of preferred stock include that they're non-cumulative, their dividends are considered qualified for tax purposes, and they generally offer no voting rights.
- Super voting preferred stock (or common stock) provides its owners with the ability to control a company with less than 50% ownership of the common stock. Each share will represent more than one vote.
- If a corporation receives dividends from another corporation in which its ownership is less than 20%, it can exclude 50% of the dividend income from corporate income.
- If a corporation receives dividends from another corporation in which its ownership is 20% or more, it can exclude 65% of the dividend income from corporate income.
- A customer who doesn't currently own stock in ABC and wants to participate in a tender offer of ABC should purchase ABC stock, NOT options or convertible bonds of ABC.
- A foreign stock is valued at $540 per share and has a $12.50 annual dividend which is paid semiannually. If the stock trades in the U.S. as an ADR at 10% of its value, it's price would be $54 per share and it would pay a $0.625 semiannual dividend.

CHAPTER 5 FUNDAMENTALS OF DEBT

- Defeasance refers to the process by which an issuer deposits funds into an escrow account that are sufficient to satisfy its payment obligations to bondholders. Ultimately, all rights and liens that the bondholders previously had on any of the issuer's assets or collateral are eliminated. The liability for the old bond issue is now assumed by the trustee of the escrow account.
- For a pre-refunded bond, its principal and remaining interest will be paid from the proceeds of the refunding bond on a call date. The proceeds are deposited into an escrow account.
- When the proceeds from a refunding bond are deposited into an escrow account and used to pay the refunded bond's principal and interest at maturity, the bonds are considered to be "escrowed-to-maturity".

CHAPTER 6 CORPORATE DEBT

- An investor who purchases a zero-coupon municipal bond that's callable at 103 will receive 103% of the compounded accreted value.
- Long-term bonds with long durations (e.g., zero-coupon bonds) tend to perform well during periods of deflation.
- The compound accreted value (CAV) of a security is equal to the initial principal amount plus the accreted value to date. Capital appreciation bonds (CAB) are valued in this manner.
- For a reverse convertible, if the knock-in level is reached, the holder will receive stock that's lower in value than the principal on the bond.
- An ETN is subject to the creditworthiness of the issuer and may depreciate regardless of the performance of the underlying index.

- The Federal Deposit Insurance Corporation (FDIC) provides insurance for up to $250,000 per depositors at each bank. Joint bank accounts are covered for up to $500,000 (i.e., $250,000 for each individual).
- Long-term CDs, also referred to as brokered CDs, are created by banks and sold by broker-dealers.
- Long-term CDs have maturities that range from 2 to 20 years and are insured up to FDIC limits.

CHAPTER 7 MUNICIPAL DEBT

- An investor who purchases a municipal bond that has one year remaining to maturity is entitled to 360 days of interest at maturity.
- For auction rate securities, the clearing rate is the settled rate when an auction is successful.
- Property values, debt coverage ratios, competing facilities, and demographics are useful when examining the credit risk of a municipal bond; however, the direction of interest rates is not.
- Some municipal zero-coupon bonds are referred to as capital appreciation bonds (CAB). CABs are NOT suitable for investors who are seeking income.
- If a municipal bond is purchased at 105 and it matures in 10 years, it will be amortized at $5 per year. After six years, its cost basis will be 102. If the bond is sold at 103, the result is a $10 long-term capital gain.
- If the money in a Coverdell Education Savings Account is not used by the beneficiary's 30th birthday, it can be transferred to another member of the beneficiary's family who is under the age of 30.
- In a 529 plan, as the beneficiary approaches college age, a suitable investment strategy is to move from growth-oriented securities (e.g., equities) to income-oriented securities (e.g., bonds and money market funds). Once the funds are being used, the account should be invested in money-market funds or other short-term investments.
- IRS rules allow for reallocation of investments in a 529 plan to be made twice per year.
- In addition to using their account proceeds for college costs, individuals may take up to $10,000 in distributions annually from their 529 plans to pay for private school tuition and books for grades K through 12— (this is a provision under the Tax Reform Act) and may 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 and is a provision of the SECURE Act).
- A person may front-load a 529 plan with an initial gift of $75,000 per beneficiary, which is treated as if $15,000 is being contributed each year over a five-year period. For a married couple, the amount is $150,000 per beneficiary.

CHAPTER 8 U.S. TREASURY AND GOVERNMENT AGENCY DEBT

- Private label CMOs are subject to the credit risk of their issuers, while government sponsored CMOs are guaranteed by the GSE or U.S. government.
- If interest rates decline, CMOs are subject to prepayment risk.
- If interest rates increase, CMOs are subject to extension risk.
- Interest received on Federal National Mortgage Association (FNMA) and Government National Mortgage Association (GNMA) debt is subject to federal, state, and local taxes.
- The CMO tranche with the lowest amount of prepayment risk is the Planned Amortization Class (PAC).
- The CMO tranche that provides the greatest safety of principal is the A tranche (fast-pay tranche).
- Any type of retail communication or correspondence may not compare CMOs to any other security, especially bank CDs.

CHAPTER 9 INVESTMENT COMPANIES

- Breakpoints are permitted for investments in the same fund family even if the shares are purchased at a different broker-dealer. The fund shares can be the same or any other mutual fund within the family of funds.
- Breakpoints are available for any investments that are made by a customer's immediate family (e.g., spouse, children).
- Before mutual fund shares are purchased by a customer and to determine whether a breakpoint is available, a RR must ask whether the client owns other mutual fund shares within the same fund family or in a relative's account, even if the account is held by another broker-dealer.
- Interval Funds have the following characteristics:
  - They're a type of closed-end fund that continuously offers shares to investors and are required to continuously calculate their net asset value
  - Their shares do NOT trade in the secondary market on an exchange; instead, investors are only allowed to sell a portion of their shares back to the fund at the current net asset value at a preset interval (e.g., monthly, quarterly, semiannually)
  - They provide individual investors with access to the types of exotic or alternative investments (e.g., private equity and certain commercial real estate investments) that are typically limited to hedge funds and institutional investors
  - They're considered illiquid investments and are most suitable for long-term investors who can tie up their money for an extended period, investors seeking income-producing investments, and investors seeking to diversify their portfolios
- Mutual fund Class A shares assess a front-end sales charge and qualify for breakpoints.
- Mutual fund Class B shares assess a back-end sales charge and do NOT qualify for breakpoints.
- Investors who intend to make large dollar purchases of mutual fund shares should purchase Class A shares in order to qualify for a breakpoint.
- An alternative to selling short is to purchase an inverse ETF.
- The net asset value of an ETF is recalculated each day using the value of the securities in the underlying index.
- The value of an inverse ETF that perfectly tracks the index will fall at the same percentage that the index rises, also it will rise at the same percentage that the index falls.
- If the benchmark for a 2x leveraged index ETF rises 10%, then falls 10%, an investment in the ETF will be down 4%.
- If the benchmark for a 2x inverse index ETF rises 10%, then falls 10%, an investment in the ETF will be down 4%.
- A 10% increase in the value of an ETF and a subsequent 10% decrease in the same ETF on the next day will result in a loss on the investment.
- An individual purchases a $1,000,000 of a 2x leveraged Oil & Gas ETF. On the first day, the underlying index rises by 10%, which results in the ETF's value rising to $1,200,000 (up 2x or 20%). On the next day, the underlying index falls by 10%, which results in the ETF's value falling to $960,000 (down 2x or 20% of $1,200,000). After two days, the result is a loss of $40,000.
- Gold equity mutual funds (precious metals funds) tend to do well when the economy is performing poorly.
- A gold equity fund is generally suitable for investors who are willing to assume significant risk.

- Investors who are interested in adding leverage to their accounts without opening a margin account could purchase leveraged ETFs.
- ETFs provide a tax advantage over mutual funds because investors are able to control the timing of the sale of shares and, as a result, when a capital gain or loss may be realized.

CHAPTER 10 VARIABLE PRODUCTS

- When receiving the death benefit from an annuity, the beneficiary is not subject to a tax penalty. However, the amount that exceeds the cost basis is subject to taxation at ordinary rates.
- If the actual rate of growth in the separate account of a variable annuity exceeds the assumed interest rate (AIR), that month's payment will exceed the previous month's payment.
- An annuitant will receive the greatest payout from the life annuity settlement option.
- A life annuity with a short period certain settlement option will offer a greater monthly payout than a unit refund life annuity settlement option. The reason is that the former only guarantees payments for a short period, while the latter guarantees the payout of the accumulated value less expenses.
- Variable annuity L shares are referred to short surrender securities and have deferred sales charges that decline to zero in three to four years.
- In a variable life insurance policy, the death benefit may exceed the guaranteed minimum based on the value of the subaccount products.
- After annuitizing, investors are still permitted to make changes to the allocations of the investment portfolio.

CHAPTER 11 ALTERNATIVE PRODUCTS

- A qualifying S Corporation is not a taxable entity; instead, its profits and losses are passed through to its shareholders (i.e., the shareholders report their portion of profit and losses on their individual income tax returns).
- An exploratory oil and gas program usually have the highest initial deductions and the lowest cost to buy in.
- A tax credit reduces a person's tax liability, whereas a tax deduction reduces a person's taxable income.
- A registered representative who's been given discretionary authority over a client's account can only purchase limited partnership interests in the account if the client's written permission is obtained.
- The rights and obligations of the general and limited partners are found in the Agreement of Limited Partnership (also referred to as the Partnership Agreement).
- A limited partner is responsible for the recourse debt that equals her percentage of interest in the limited partnership.
- Raw land investments carry the greatest risk of all real estate limited partnerships, while exploratory (wildcat) programs carry the greatest risk of all oil and gas limited partnerships.
- The value of an REIT increases when occupancy rates and property values increase.
- A hybrid REIT includes both a mortgage REIT and an equity REIT.
- Hedge fund fees are often higher than those of mutual funds and frequently include both a management fee (e.g., 2%) and a performance or incentive fee for the manager (e.g., 20%), which is expressed as a percentage of the increase in the fund's NAV.
- Some hedge funds also assess withdrawal fees against investors that remove money from a hedge fund account.

CHAPTER 12 OPTIONS

- Whether an option is in- or out-of-the-money is NOT based on the option's premium.
- Buying a call is more profitable than buying a straddle if the underlying security appreciates in value.
- The maximum loss for the buyer of an option is equal to the maximum gain for the writer of that option (i.e., the premium).
- Call options with lower strike prices are more valuable (dominant) than those with higher strike prices.
- Put options with higher strike prices are more valuable (dominant) than those with lower strike prices.
- A ratio call writing strategy (variable hedge) is an option position in which more call options are written than the number of shares owned by the investor (and available to cover the calls). For example, 2 calls are written against only 100 long shares. The position's strategy is neutral and investors are exposed to unlimited potential risk.
- A credit put spread is a bullish option strategy, but a debit put spread is a bearish option strategy.
- A credit call spread is a bearish option strategy, but a debit call spread is a bullish option strategy.
- If an investor adds an equity option to an existing option position to create a straddle, she's considered to have "legged" into the position.
- VIX options are based on the implied volatility of S&P 500 Index options.
- A VIX call may be purchased in anticipation of an abrupt drop in the market.
- Index options are cash settled, which means that no securities are delivered or received at exercise.
- If an ETF option is exercised, shares of the ETF will be delivered.
- An American company that's buying goods from a foreign country and paying in that country's currency may buy foreign currency calls to hedge.
- A foreign company that's selling goods in the U.S. and receiving U.S. dollars may also buy foreign currency calls to hedge.
- A butterfly call spread consists of two long calls and two short calls. The two short calls have the middle strike price, while one long call has a higher strike price and the other long call has a lower strike. The maximum gain is found when the stock closes at the middle strike price; therefore, the investor's strategy is for the stock's price to remain neutral.
- An investor who is long stock and wants to increase her income, but not in the current year, could write an American style option that expires in the next year.
- When calls are written on the underlying stock (covered calls), the premiums received on expired calls are treated as short-term gains and the investor's cost basis for the underlying stock remains at his original purchase price.
- If an investor owns an option and the underlying stock is the subject of an even stock split (2-for-1, 3-for-1, etc.), the number of shares underlying each option contract remains at 100, the number of contracts increases by the amount of the split, and the strike price is reduced by the reciprocal of the split (1/2, 1/3, etc.).
- If the OCC sets the IBM option position limit at 200,000 contracts, an investor is permitted to buy 200,000 calls (bullish) and sell 200,000 calls (bearish) since these positions are on opposite sides of the market. However, it's a violation for an investor to buy 150,000 calls and sell 100,000 puts since this equals a total of 250,000 contracts on the same side of the market (bullish).

CHAPTER 13 OFFERINGS

- In order to purchase an offering being conducted under Rule 147, a customer must be a resident of the state in which the offering is being conducted. Owning a vacation home in the state, signing a suitability statement, or being an accredited investor are not sufficient.
- In a municipal underwriting, the normal process by which the syndicate manager will allocate orders is 1) presale, 2) group net, 3) net designated, 4) member, 5) group less concession. Although this is the priority for all five order types, a question may only provide the first four types.
- The Jumpstart Our Business Startups (JOBS) Act allows small businesses to raise capital using the internet through a process that's referred to as crowdfunding.
- Capital that's raised through crowdfunding may only be done through an online platform of a broker-dealer or an approved funding portal.
- The amount that a person may invest through crowdfunding is limited based on his annual income and/or net worth.
- For a bank or savings and loan association to qualify as a QIB, it must have a minimum net worth of $25 million.
- A spinoff transaction allows shareholders to retain their original shares while receiving shares in a newly created entity.
- Shares that are newly distributed as a result of a merger are subject to registration under SEC Rule 145.
- Individual investors, even accredited investors, are not considered qualified institutional buyers (QIBs).
- A negative consent letter makes a statement that, if ignored by the recipient, is considered confirmed by that person. This can be used to satisfy the pre-conditions of sale requirement under the New Issue Rule.

CHAPTER 14 INVESTMENT RISKS, RETURNS AND DISCLOSURES

- A registered representative is required to help prevent the financial exploitation of a customer who's a *Specified Adult* even if the adult has appointed a trusted contact person. A "specified adult" is a natural person who's age 65 or older or a natural person who's age 18 or older and is believed by the member firm to have a mental or physical impairment that renders the individual unable to protect her own interests.
  - *Financial exploitation* includes:
    - Wrongful/unauthorized taking, withholding, appropriation, or use of a specified adult's funds or securities; or
    - Any act or omission taken by a person, including through the use of a power of attorney, guardianship, or any other authority, regarding a specified adult, to:
      - Obtain control, through deception, intimidation, or undue influence, over the specified adult's money, assets or property; or
      - Convert the specified adult's money, assets or property
- If an RR suspects the trusted contact is attempting to or is taking advantage of a customer who may have diminished capacity, the RR should discuss the matter with a principal of the firm and the compliance department prior to placing a *temporary hold* on the account.
- If there's a reasonable belief of the existence of financial exploitation, a firm may place a *temporary hold* on the disbursement of a specified adult's funds or securities. However, FINRA requires a firm to conduct an internal investigation to review the facts and circumstances that caused it to reasonably believe that financial exploitation of the specified adult has occurred, is occurring, has been attempted or will be attempted.

  - If an RR suspects that the trusted contact person is attempting to or is taking advantage of a customer who may have diminished capacity, the RR should discuss the matter with a principal of the firm and the firm's compliance department *prior to placing a temporary hold on the account*.
  - The firm will NOT contact the trusted contact person to the notify her of the temporary hold if it reasonably believes that the trusted contact person has engaged, is engaged, or will engage in the financial exploitation of the specified adult.
- If an elderly investor seems disoriented and confused (possibly experiencing dementia or diminished capacity), the best course of action for the RR is to discuss the situation with her supervisor and/or legal and compliance department, or if appropriate, recommend for the client bring a close family member or friend to a meeting.
- Individuals may transfer assets or give gifts of up to $15,000 per year to any number of persons (related or unrelated) without incurring gift taxes ($30,000 for a married couple).
- Systematic risk is referred to as non-diversifiable risk. Market risk is an example of systematic risk and is measured by an asset's beta.
- Non-systematic risk is referred to as diversifiable risk. Business risk is an example of non-systematic risk.
- The allocation of an individual's portfolio is based on his current situation, not his potential situation.
- When using an asset allocation model, the percentage that's invested in equities (stocks) is generally equal to the difference in the customer's age and 100. The balance is then invested in short-term, intermediate, and/or long-term debt (bonds).
- The Automated Customer Account Transfer Service (ACATS) system is used for transferring accounts from one firm to another. Under FINRA rules, validation must occur within one business day and transfer must occur within three business days.
- If a client intends to transfer her account to another firm, she begins the process by completing a Transfer Initiation Form (TIF).
- If investors want to determine their unrealized gains and/or losses, this information is found on their account statement (not on a confirmation).

CHAPTER 15 PORTFOLIO AND MARKET ANALYSIS

- The Capital Asset Pricing Model (CAPM) is used to determine whether an investment's rate of return is appropriate given the level of risk.
- The risk-free rate of return (Treasury yield) is the starting point for risk used under CAPM.
- The total market (S&P 500 Index) is given a beta of 1.0. An investment with a beta of greater than 1.0 is considered more volatile than the market. An investment with a beta of less than 1.0 is considered less volatile than the market. An investment with a negative beta (-) is assumed to move in the opposite direction to the market.
- Alpha is a measure of an investment's excess return compared to the risk-adjusted return expected, based on the portfolio's beta. If a fund's investment adviser is changed, the investment's alpha would be expected to change as well.
- If the energy sector of the S&P 500 has a beta of 1.6 and the S&P 500 increased by 10%, an investor could expect an increase of approximately 16% in the energy sector.
- A customer who's primarily investing in bonds, preferred stock, and utility company common stock would be concerned about changing interest rates and its effect on the value of the portfolio.

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CHAPTER 16 FUNDAMENTAL ANALYSIS

- If a company repurchases its own shares in the market, its EPS will normally increase.
- Fixed assets are shown on the balance sheet at their original cost less depreciation.
- An offering of stock that's sold above par value is recorded on the balance sheet as Capital Surplus. A more common term for this excess is Paid-in Capital.
- The price of a stock divided by its price-to-earnings ratio equals the stock's earnings per share.
- The quick asset ratio (also referred to as the acid test ratio) is calculated by adding cash, accounts receivable, and marketable securities and then dividing by current liabilities.

CHAPTER 17 ORDERS AND TRADE EXECUTIONS

- Orders that are left on a voicemail may be accepted; however, this is not a requirement.
- If an investor sells stock short and the stock pays a dividend, the short seller is responsible for paying the dividend amount to the lender.
- If a company executes a reverse stock split, all open orders for the stock are cancelled.
- The minimum quote for stocks that are priced above $1.00 is in cents.
- TRACE is a reporting system for corporate bonds.
- When used in reference to a Nasdaq market maker's quote, the spread is the difference between the price at which a firm is willing to buy (bid) versus the price at which the firm is willing to sell (ask or offer) a security.
- Front-running is the prohibited practice of a broker-dealer or RR buying or selling stock or options before the public release of proprietary information concerning a large block order. This is not considered insider trading.
- Spoofing involves entering orders with the intent to cancel them before they're executed for the purpose of inducing others to trade at those prices.
- Stocks that are unlisted and not quoted in the OTC market are considered to be grey (or gray) market stocks. This may often also refer to pre-IPO shares.

CHAPTER 18 MARGIN

- The margin requirements on leveraged ETFs are the leveraged factor (2x or 3x) multiplied by 25% (for long positions) or 30% (for short positions).
- Long market value, plus credit balance, minus debit balance, minus short market value equals the total equity in a combined (mixed) margin account.
- A margin account is restricted when equity is less than 50% of market value.
- The term mark-to-the-market refers to the adjustment made in a customer's margin account due to a change in market value. This is done daily.
- If the equity increases in a margin account, SMA is created. However, if the equity subsequently declines, SMA will NOT decline.
- The debit balance is increased for interest charges, but decreased for cash dividends that are credited to the account.

CHAPTER 19 SETTLEMENT AND REGULATORY REPORTING

- The process of determining who's obligated to meet the terms of an option's exercise is referred to as assignment.
- OATS is a system that tracks an order from receipt, to routing, to modification, cancellation or execution.
- EMMA is a system that receives municipal documents from issuers and underwriters and can be accessed by the public for informational and educational purposes.
- A DK notice is sent between broker-dealers when receiving an unrecognized trade; it's not sent to customers.
- In a DVP or RVP transaction, the client must identify the third-party bank or institution that will handle delivery and settlement of securities and funds.

CHAPTER 20 RESOLVING DISPUTES AND SUITABILITY

- An RR is required to update his Form U4 if a lien is placed against him, regardless of the dollar amount of the lien.
- If an individual is or has been charged with any felony and/or certain misdemeanors, he's required to disclose this information on Form U4.
- Convictions for any felony or securities-related misdemeanors within the last 10 years will subject a person to statutory disqualification. The conviction can be from any domestic, foreign or military court.
- If a customer submits a written complaint to a broker-dealer and later withdraws it, the firm has an obligation to maintain a record of the complaint as well as any action taken to resolve it.
- An RR doesn't enter orders into an error account; instead, a principal places orders into the error account.
- According to FINRA, complaints must be maintained in a file for four years.
- Mediation is an informal process that's used to resolve disputes.
- Variable annuity L shares are most suitable when using a 1035 exchange.
- If an individual's investment objective is capital growth, but he wants to engage in intraday trading, he could consider an exchange traded fund (ETF).
- The most suitable limited partnership program for an individual who wants to invest in an oil and gas program with the least amount of risk is an oil and gas income program.
- A short-duration strategy is the most suitable method of reducing interest-rate risk in a bond portfolio.
- An investor who anticipates a decline in the value of a security, but can only afford to lose the entire value of the investment, should purchase put options on the security.
- A customer who's subject to the AMT and is seeking tax-free income should purchase non-AMT municipal bonds.
- A 60-year-old individual who's about to retire is heavily invested in one company's stock. The most suitable adjustment to the portfolio is to reallocate the assets to 60% bonds and 40% equity.
- An options investor who expects that a stock is about to appreciate, but wants to limit potential losses, should consider a bullish call spread.
- If a daughter has trading authority in her mother's account and believes that inappropriate fees are being charged, she can file a complaint with the firm.
- With principal approval, a registered representative can perform a cancel and rebill to rectify an order being executed in the wrong account for a client.
- An investor who has a large sum of money to invest, but will need to liquidate the investment within the next couple of years, may find the class A shares of a mutual fund to be most suitable.
- It's unsuitable to recommend the purchase of class B mutual fund shares to a customer who has a significant amount of money to invest and a short investment horizon.

- A sell stop order is the most cost-effective method of protecting an investment from a decline in value.
- A high beta stock is most suitable for aggressive investors, while a low beta stock is most suitable for conservative investors.
- Blue chip preferred stock is most suitable for investors seeking income, NOT capital appreciation or preservation of capital.

KEY FORMULAS

Chapter 4 – Equities

- Outstanding Stock = *Issued Stock – Treasury Stock*
- 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 cost basis per share =
    Original Cost Basis Per Share x Inverse of Split Ratio
- If a company issues a **stock dividend**:
  - To determine the new number of shares =
    Number of Shares Owned x Dividend %
  - To determine the new cost basis per share =
    Total initial investment ÷ Total Shares Owned (including new shares)
- To find a company's **market capitalization**:
  Current Market Price x Number of Shares Outstanding
- To determine the capital gain or loss of the sale of **gifted securities**:
  Sale Price – Donor's Cost Basis or Market Value at Time of Gift (whichever is lower)
- To determine the capital gain or loss of the sale of **inherited securities**:
  Sale Price – Market Value at Death of Donor
  (Holding Period is always long-term)
- 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).
- To find the **Parity Price** of common stock:

$$\text{Parity Price of Common} = \frac{\text{Preferred Price}}{\text{Conversion Ratio}}$$

- To find the **Parity Price** of convertible preferred stock:

$$\text{Parity Price of Preferred} = \text{Common Stock Price x Conversion Ratio}$$

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Chapter 5 – Fundamentals of Debt

- To calculate **Current Yield (for a bond)**:

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

Chapter 6 – Corporate Debt

- To calculate the **Conversion Ratio** of a convertible bond:

$$\text{Conversion Ratio} = \frac{\text{Par Value (\$1,000)}}{\text{Conversion Price}}$$

  - For example, if the conversion price is $20, then the conversion ratio is 50-for-1 ($1,000 par value ÷ $20).

- To find the **Parity Price** of common stock:

$$\text{Parity Price of Common} = \frac{\text{Bond Price}}{\text{Conversion Ratio}}$$

- To find the **Parity Price** of the convertible bond:

$$\text{Parity Price of the Bond} = \text{Common Stock Price} \times \text{Conversion Ratio}$$

Chapter 7 – Municipal Debt

- To calculate a municipal bond's **Taxable Equivalent Yield**:

$$\text{Taxable Equivalent Yield} = \frac{\text{Municipal Yield}}{(100\% - \text{Tax Bracket } \%)}$$

- To calculate a taxable bond's **Net (After-Tax) Yield**:

$$\text{Net (After-Tax) Yield} = \text{Taxable Yield} \times (100\% - \text{Tax Bracket } \%)$$

- To determine the **capital gain or loss** of a municipal bond that was purchased at a premium and sold prior to maturity:

Sale Price – Amortized Basis

(Amortized basis is calculated by reducing the original cost by the total amortization)

For example, a 10-year bond is purchased for $1,200. Six years later, it's sold for $1,100. The bond is amortized by $20 each year ($200 premium ÷ 10 years). After six years, the basis is amortized by $120 to $1,080. If sold for $1,100, there's a $20 capital gain.

Chapter 8 – U.S. Treasury and Government Agency Debt

- For T-notes, T-bonds, and agency securities:
  - Per $1,000, every 1/32 of a point = $31.25
- To calculate the price of a government or agency security that's **quoted in 32nds**:

  Convert the fraction into a decimal and multiply the amount by the par value

Chapter 9 – Investment Companies

- To determine the **sales charge percentage**:

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

- To calculate the **POP**:

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

- To calculate the **change in value** of an ETF:

  Original Value + % Increase in Value ***OR***

  Original Value – % Decrease in Value

- To calculate the **change in value** of an Inverse ETF:

  Original Value + % Decrease in Value ***OR***

  Original Value – % ***In****crease in Value*

Chapter 12 – 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 strike price
  - Puts are IN-THE-MONEY if the stock's market price is below the strike price
  - Calls are AT-THE-MONEY if the stock's market price is equal to the strike price
  - Puts are AT-THE-MONEY if the stock's market price is equal to the strike price
  - Calls are OUT-OF-THE-MONEY if the stock's market price is below the strike price
  - Puts are OUT-OF-THE-MONEY if the stock's market price is above the strike price

- To calculate the breakeven for the buyer **OR** seller of a call: *Strike Price + Premium*
- To calculate the breakeven for the buyer **OR** seller of a put: *Strike Price – Premium*
- To calculate the breakeven points for a long or short straddle or combination:

  *Strike Price of the Call + Total Premium **AND***
  Strike Price of the Put – Total Premium
- To calculate the breakeven for a call spread:
  Lower Strike Price + Net Premium
- To calculate the breakeven for a put spread:
  Higher Strike Price – Net Premium
- To calculate the breakeven for a protective put (long stock and long put):
  Original Cost of Stock + Premium
- To calculate the breakeven for a covered call (long stock and short call):
  Original Cost of Stock – Premium
- To calculate the breakeven for a protective call (short stock and long call):
  Short Sale Proceeds – Premium
- To calculate the breakeven for a covered put (short stock and short put):
  Short Sale Proceeds + Premium

Chapter 13 – Offerings

- Equity IPO Underwriting Spread Components:

Manager's Fee	Underwriter's Fee (Risk)	Concession (Sales)

- Municipal Bond Underwriting Spread Components:

Manager's Fee	Additional Takedown (Risk)	Concession (Sales)

Chapter 16 – Fundamental Analysis

- The **Balance Sheet Formula**:

  Total Assets = Total liabilities + Shareholders' Equity OR

  Shareholders' Equity = Total Assets – Total Liabilities

- To calculate **Working Capital**:

  Working Capital = Current Assets – Current Liabilities

- To calculate **Current Ratio**:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

- To calculate **Quick Asset (Acid Test) Ratio**:

$$\text{Quick Asset (Acid Test) Ratio} = \frac{(\text{Current Assets} - \text{Inventory})}{\text{Current Liabilities}}$$

- To calculate the **Debt-to-Equity Ratio**:

$$\text{Debt-to-Equity Ratio} = \frac{\text{Debt}}{\text{Total Shareholders' Equity}}$$

- To calculate basic **Earnings Per Share (EPS)**:

$$\text{Basic EPS} = \frac{(\text{Net Income} - \text{Preferred Dividend})}{\text{Total Common Shares Outstanding}}$$

- To calculate **Current Yield (for stock)**:

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

- To calculate **Dividend Payout Ratio**:

$$\text{Dividend Payout Ratio} = \frac{\text{Annual Common Stock Dividend}}{\text{EPS}}$$

- To calculate **Price/Earnings (P/E) Ratio**:

$$\text{Price/Earnings Ratio} = \frac{\text{Current Market Price}}{\text{EPS}}$$

Chapter 18 – Margin

- To calculate equity in a long margin account:

  Equity (EQ) = Long Market Value (LMV) – Debit Balance

- To calculate equity in a short margin account:

  Equity (EQ) = Credit Balance (CR) – Short Market Value (SMV)

- To calculate the **total (combined) equity**, the formula is:

  LMV + Credit – Debit – SMV

- Excess Equity = Equity that exceeds 50% of the Current Market Value
- The minimum maintenance requirement for a long position is:

  25% of the Long Market Value (LMV)

- The minimum maintenance requirement for a short position is:

  30% of the Short Market Value (SMV)

- To calculate the margin requirement for a Leveraged ETF:

  Leverage Factor x Minimum Maintenance Requirement

