



# **Private Securities Offerings Qualifications Examination (Test Series 82)**

## **Study Outline**

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## Introduction

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The FINRA Limited Representative-Private Securities Offerings Qualification Examination (Series 82) is used to qualify individuals seeking registration with FINRA under By-Laws Article III, Section 2, and the Membership and Registration Rules. A registered representative in this category may effect sales of private securities offerings only. The Series 82 exam does not qualify a registered representative in this category to effect sales of municipal or government securities, or equity interests in or the debt of direct participation programs (DPP securities). Moreover, the Series 82 exam permits a registered representative in this category only to effect sales of private placement securities as part of a primary offering. As such, representatives in this category will not be permitted to effect resales or engage in secondary market trading of private placement securities.

Candidates seeking to effect sales of municipal or government securities, or DPP securities, or effect resales or engage in secondary market trading of private placement securities must register in one or more of the other FINRA limited representative categories, or as General Securities Registered Representatives and pass the appropriate qualification exam(s).

This study outline has been prepared to assist FINRA member firms in preparing candidates to sit for the Series 82 exam. It may be used to structure or prepare training material, develop lecture notes and seminar programs, and as a training aid for the candidates themselves. The outline and the test are divided into the four topical sections, which are listed below along with the number of items designated to each section.

<b>Section</b>	<b>Description</b>	<b>Number Of Items</b>
1	Characteristics of Corporate Securities	13
2	Regulation of The Market for Registered and Unregistered Securities	45
3	Analyzing Corporate Securities and Investment Planning	16
4	Handling Customer Accounts and Industry Regulations	26
	<b>TOTAL</b>	<b>100</b>

### Structure of the Exam

The exam is composed of 100 multiple-choice items covering all of the materials in the following outline in accordance with the subject-matter distribution shown above. Candidates will be allowed 2 ½ hours to complete the exam. A candidate must correctly answer 70 percent

of the items to receive a passing grade. At the completion of the exam, each candidate will receive an informational breakdown of their performance on each section and their overall score. The exam is a closed-book test and candidates will not be permitted to use any reference material during their testing session. White boards/dry erase markers and basic electronic calculators will be provided to the candidates by the test administrator. Severe penalties are imposed on candidates who cheat on securities industry qualification exams. Exam items are updated regularly to reflect the most current interpretations of the rules and regulations. Items on new rules will be added to the pool of items for this exam within a reasonable period of their effective dates.

Information about qualifications exams may be found at <http://www.finra.org/industry/qualification-exams>

There are also sample Series 82 exam items written in the various formats. They do not mirror the difficulty level of the actual test items or the subject matter distribution of the test itself. Their use is merely to familiarize the candidate with the styles of multiple-choice items used in the Series 82 exam.

Please Note: Candidates are responsible for keeping abreast of changes made to the applicable rules and regulations, as the exam is updated when new rules are introduced and/or amended.

The following reference materials may be used in preparing for the exam

## References

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### **Appeal Securities Act Handbook**

Aspen Publishers  
7201 McKinney Circle  
Frederick, MD 21704

### **The Business of Investment Banking: A Comprehensive Overview**

K. Thomas Liaw  
John Wiley & Sons, Inc.  
One Wiley Drive  
Somerset, NJ 08875

### **Code of Federal Regulations Title 17 – Commodity and Securities Exchanges**

Superintendent of Documents  
U.S. Government Printing Office  
Washington, DC 20402

### **Dictionary of Finance and Investment Terms**

John Downes and Jordan E. Goodman  
Barron's Financial Guides  
250 Wireless Boulevard  
Hauppauge, NY 11788

### **How the Bond Market Works**

Robert Zipf  
Simon & Schuster Company  
Two Broadway  
New York, NY 10004

### **Inside Investment Banking**

Ernest Block  
Beard Group, Inc.  
P. O. Box 4250  
Frederick, MD 21705

### **Securities Law Handbook**

Harold S. Bloomenthal  
Clark Boardman Callahan  
375 Hudson Street  
New York, NY 10014

### **Securities Regulation**

Warren, Gorham & Lamont  
31 St. James Avenue  
Boston, MA 02116

### **The Stock Market, 7th Edition**

R. J. Teweles and E. S. Bradley  
John Wiley & Sons, Inc.  
605 Third Avenue  
New York, NY 10158

### **The Vest Pocket Guide to Stock Brokerage Math**

William A. Rini  
Simon & Schuster Company  
Two Broadway  
New York, NY 10004

### **Publications Available from FINRA at**

[www.finra.org](http://www.finra.org)

### **FINRA Rules**

### **NASD Rules**

### **FINRA Sanctions Guidelines**

### **FINRA Notices**

# 1.0

## Characteristics Of Corporate Securities

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### 1.1 Equity Securities

#### 1.1.1 Common Stock

1.1.1.1 Ownership in a corporation

1.1.1.2 Rights of stockholders

Limited liability

Proportionate ownership

Transfer rights

Receive dividends, when declared by board of directors

Record date

Payable date

Inspect corporate books

Subscribe proportionately to any new issue of stock

Vote at stockholders' meetings

Protect the corporation against wrongful acts of management

Restrain radical acts of the corporation

Residual claims to assets at dissolution

Statutory voting rights

Cumulative voting rights

Preemptive rights

Contingent voting rights of preferred stockholders

Proxies

Voting trusts

Trustee

Voting trust certificates

Beneficial interests

Non-voting common stock

1.1.1.3 Stock certificate

Negotiability

Endorsements and assignments

Transfer procedures

Transfer agent

Registrar

Fractional shares

1.1.1.4 Value at issuance

Par value

Normally an arbitrary amount

Full-paid and non-assessable

Low par value

- Excess recorded as paid-in surplus
- No-par value
- Stock with stated value
- Capital or paid-in surplus

- 1.1.1.5 Stock terms and definitions
  - Authorized stock
    - Reasons for authorizing more stock than that issued
  - Issued stock
  - Outstanding stock
  - Treasury stock
    - Reasons for reacquiring issued stock

**1.1.2 Preferred Stock**

- 1.1.2.1 Dividend preference over common
  - Dividend stated as percentage of par
  - Dividend stated in dollars per share
  - Adjustable/variable rates of return
  - Right to dividend only if declared by board
  - Auction rate

- 1.1.2.2 Asset preference of preferred over common

- 1.1.2.3 Classes of preferred and degree of preference

- 1.1.2.4 Types of preferred stock
  - Cumulative preferred
  - Participating preferred
  - Convertible preferred
    - Perpetual
    - Limited
    - Delayed
  - Callable preferred
    - Sinking fund provisions

- 1.1.2.5 Protective provisions regarding preferred stock

**1.1.3 Rights and Warrants**

- 1.1.3.1 Rights (subscription rights)
  - Issued in conjunction with additional stock offerings
  - Stock appreciation rights (SAR)
  - Employee stock options
  - Terms of offering
  - Value of subscription rights
  - Disposition of rights

- 1.1.3.2 Warrants (subscription warrants)
  - Origination of warrants
  - Warrant exercise terms

**1.1.4 American Depositary Receipts/American Depositary Shares; Global Depositary Receipts/Global Depositary Shares**

Origin and nature of ADR's/ADS's and GDS's/GDR's  
Sponsored vs. non-sponsored  
Duties of the issuing/depository bank  
Converts and distributes cash dividend in U.S. currency  
Converts and distributes rights offerings  
Distributes information on non-U.S. corporate developments  
Shareholders' rights to demand delivery of the underlying shares  
Relationship to ordinary shares

**1.1.5 International Securities**

Securities denominated in foreign currency versus those denominated in U.S. dollars  
Relationship to ADR's/ADS's and GDS's/GDR's  
Eurobonds

**1.2 Corporate Debt Securities**

**1.2.1 Features of Bonds**

**1.2.1.1 General characteristics**

Promise to pay  
Maturity of bonds and notes  
Denominations  
Registered as to both principal and interest  
Book-entry-only bonds  
Funded debt

**1.2.1.2 Terms of Payment**

Payable in legal tender at par  
Payable in one or more foreign currencies if issued abroad  
Interest payment periods

**1.2.1.3 Trust indenture or deed of trust**

Trustee  
Protective covenants  
Remedies of bondholders  
Acceleration of maturity in cases of default  
Releases of mortgaged property  
Protection for bondholders in consolidations and mergers  
Changes in trust indenture  
Voting provisions of indenture

**1.2.1.4 Debt Retirement**

**1.2.1.4.1 Call feature**

Optional vs. mandatory calls  
Advantage to issuer  
Eliminate issues with unfavorable indenture provisions  
Change terms of debt  
Reduce debt  
Refund high coupon bonds with low coupon bonds

- Call protection for investors
  - Expiration of minimum time period before call can be invoked
  - Call premiums

- 1.2.1.4.2 Put feature
  - Conventional bonds which allow the holder to redeem the bonds prior to maturity
  - Allows investors to reinvest principal at higher coupon rates as the opportunity arises
  - Put bonds carry slightly lower coupon rates than bonds without this feature and thereby save the issuer interest expense, but require the issuer to maintain funds available for early redemption

- 1.2.1.4.3 Redemption of bonds
  - Prior notice required
  - Partial calls
  - Bonds to be redeemed drawn by lot by trustee
  - Amortization through a sinking fund

- 1.2.1.4.4 Refunding of bonds
  - Direct exchange vs. sale of new issue
  - Refunding prior to maturity
  - Extensions of maturity

## **1.2.2 Types of Bonds**

- 1.2.2.1 Mortgage bonds
  - Debt obligation secured by property pledge
  - Priority of claim

- 1.2.2.2 Debenture Bonds
  - General credit obligations
  - Importance of protective covenants
  - Subordinated debentures
    - Unsecured junior claim
    - Subordinated to other debt issue(s)
  - Maturity
  - Higher yields
  - Conversion features

- 1.2.2.3 Convertible bonds

- 1.2.2.3.1 Convertible into either preferred or common, or units of both

- 1.2.2.3.2 Advantages/disadvantages to investor of convertible bonds
  - Coupon rate offers a "floor" return, but slightly lower than non-convertible bonds
  - Allows holder to participate in major upswings in the price of the common stock by converting the bonds or selling them outright
  - Holder's have prior claims to assets over shareholders in the event of corporate liquidation, but junior claims to mortgage bond holders

- 1.2.2.3.3 Advantage/disadvantages to issuer of convertible bonds



Issued at lower rate of interest than non-convertible bonds  
 Interest expense reduced upon conversion, but taxable income increased  
 Upon conversion, higher price usually obtained for issued stock  
 Reduced depressant effect on price of common at issuance  
 Upon conversion, shifts in "ownership" can occur

- 1.2.2.3.4 Conversion ratio or price
  - Factors affecting initial conversion rate or price
    - Price of stock at time of issuance
    - Earnings prospect
    - Market conditions
    - Length of conversion period
- 1.2.2.3.5 Time of conversion
  - At issuance
  - Delayed conversion
  - Expiration at maturity
  - Expiration prior to maturity
- 1.2.2.3.6 Protective features relative to:
  - Stock splits
  - Change in class of conversion securities
  - Stock dividends
  - Issuance of new shares of conversion stock
  - Merger, consolidation, dissolution
- 1.2.2.3.7 Factors influencing conversion
  - Computation of parity relationship
  - Arbitrages
  - Forced conversion by issuer
    - Increased dividend on stock
    - Call on bonds when market value of stock is higher than redemption price
    - Granting of substantial subscription rights to stockholders
- 1.2.2.4 Other types of bonds
  - 1.2.2.4.1 Collateral trust bonds
    - Secured by pledge of securities as collateral with a trustee
  - 1.2.2.4.2 Equipment trust obligations
    - Protective covenants
  - 1.2.2.4.3 Guaranteed bonds
    - Purpose
    - Forms of guarantee
      - Interest only
      - Both principal and interest
  - 1.2.2.4.4 Variable rate (income) bonds
    - Interest paid only if earned

Use during reorganizations  
Long maturities at issuance

- 1.2.2.4.5           Zero Coupon Bonds
  - Issued at steep discount from par
  - Reinvestment risk
  - Interest rate risk magnified due to no coupon payments
  - Credit risk magnified due to no coupon payments
  - Accreted discount taxable annually, creating a negative cash flow (phantom income) unless bonds are enveloped in a tax-deferred investment vehicle
  - Yields-to-maturity often slightly higher than comparable coupon bearing bonds

### **1.3           Asset-Backed Securities**

#### **1.3.1           Mortgage-Backed Securities**

- 1.3.1.1           Securitization of mortgages
- 1.3.1.2           Agency-issued mortgage-backed securities
  - Federal National Mortgage Association obligations – (FNMA or Fannie Mae)
  - Federal Home Loan Mortgage Corporation obligations – (FHLMC or Freddie Mac)
  - Government National Mortgage Association obligations – (GNMA or Ginnie Mae)
  - Repayment of interest and principal monthly
- 1.3.1.3           Corporate-issued mortgage-backed securities
  - Private label
- 1.3.1.4           Structured mortgage products
  - Collateralized mortgage obligations -- usually composed of private mortgages not qualified under VA or FHA
  - Interest only and principal only
  - Real Estate Mortgage Investment Conduits (REMICs)
    - May be "multiple class" with fast/slow pay segments
    - Payments may be allocated disproportionately among -tranches
    - REMICs offer certain tax and accounting benefits to issuers

#### **1.3.2           Real Estate Investment Trusts (REITS)**

- Real Estate Investment Trust Act
  - Organizational requirements
  - Asset composition
  - Sources of income
    - Rents from real property
    - Interest on obligations secured by real property
    - Gains from sale of real property, including mortgages on real property
    - Distribution from, and gains on the sale of securities, including other
- REITS
  - Limitations on amount of income from various sources

- Capital structure
  - Equity
  - Debt
- Tax requirements of the REIT
  - Minimum requirement for distribution of income
  - Distribution of capital gains
  - Taxability of undistributed income and gains

**1.3.3 Other Asset-Backed securities**

- Auto loan backed obligations
- Credit card debt backed securities
- Home equity loan backed securities
- Collateralized debt obligations (CDOs)

**1.3.4 General Features**

- Represent undivided interest in a pool of debt obligations or equities
- Underlying asset documents held by a custodian
- Interest and dividend collection serviced by the custodian

**1.4 Investment Companies**

- General characteristics
  - Registered under the Investment Company Act of 1940

**1.4.1 Closed-End Investment Companies**

- Registered under the Investment Company Act of 1940
- Each fund share represents a piece of a securities investment portfolio
- Maximum number of fund shares basically fixed at issuance
- Fund shares are often exchange listed and trade like equities

**1.4.2 Open-End Investment Companies (Mutual Funds)**

- Registered under the Investment Company Act of 1940
- General characteristics
- Sold by prospectus
- Determining the net asset value (NAV)
- Redemption of mutual fund shares

**1.4.3 Exchange traded funds (ETFs)**

- Registered under the Investment Company Act of 1940

**1.4.4 Unit Investment Trusts (UIT)**

- Registered under the Investment Company Act of 1940
- Fixed portfolio
- Redeemability

**1.4.5 Money Market Fund**

- Registered under the Investment Company Act of 1940
- Mutual funds which only invest in very short-term debt securities and money market instruments
- Structured such that one share usually equals \$1 NAV
- Fund shares not held by the broker/dealer not covered by SIPC and not insured by FDIC

- 1.4.6 Securities (funds) Exempt from the Investment Company Act of 1940**
  - Unregistered
  - Section 3c-7 – Exemption
    - Hedge funds
      - Characteristics
      - Suitability
      - Due diligence
    - Private equity funds
    - Qualified purchasers
- 1.5 Securities Exchange Act of 1934** (Issuer registration and reporting requirements)
  - 1.5.1 Section 12 — Registration requirements for securities**
    - Registration and periodic reporting requirements for securities of issuers engaged in interstate commerce and exchange listed securities
  - 1.5.2 Section 13 — Periodical and other Reports**
    - Disclosure of beneficial ownership of 5% or more in equity security registered with the SEC
- 1.6 Trust Indenture Act of 1939 — General Purposes**
  - Necessity of trustee to safeguard the rights of investors in registered debt obligations
  - Identification of rights and powers of trustee
  - Full disclosure of information in bond indentures
  - Participation of trustees in the preparation of indentures

## 2.0

# Regulation of the Market for Registered and Unregistered Securities

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### 2.1 Issuing Corporate Securities

#### 2.1.1 Types of Offerings

- Primary
- Secondary
- Private placement
- Private Investment in Public Equity Securities (PIPES)
- Rule 144A — Private resales of securities to institutions
  - Definition of qualified institutional buyer (QIB)
- Regulation S — Offers and sales made outside the United States without registration under the Securities Act of 1933

#### 2.1.2 Underwriting Commitments

##### 2.1.2.1 Types of commitments

- Firm commitment
- Stand-by commitment
- All or none
- Best efforts
- Mini-Max

##### 2.1.2.2 Securities Exchange Act of 1934 and SEC Rules Thereunder

Section 10 — Regulation of the use of manipulative and deceptive devices

Rule 10b-9 — Prohibited representations in connection with certain offerings

Section 15 — Registration and regulation of brokers and dealers

Rule 15c2-4 — Transmission or maintenance of payments received in connection with underwritings

#### 2.1.3 Investigation of Financing Proposals

##### 2.1.3.1 Feasibility study

##### 2.1.3.2 Letter of intent

##### 2.1.3.3 Due diligence — process to evaluate

- Financial data
- Industry data
- Operational data of issuer
- Management and employee relations
- Research, product development and expansion

#### 2.1.4 Mechanics of Distributions

##### 2.1.4.1 Role of dealer manager

- Appointment of selling group
- Handled by dealer manager
- Selling group agreement

- Liabilities of selling group members
  - Components of spread
    - Dealer manager fee
    - Selling group commission
  - Compensation in the form of warrants of stock
- 2.1.4.2 Role of the placement agent
  - Contractual obligation to issuer
    - Principal
    - Agency
  - Positioning private placement offering
  - Compensation
  - Offering period limitation
  - Identification of potential investors
    - Confidentiality agreement
    - Indication of interest
  - Distribution of private placement memorandum
  - Liabilities of placement agent
    - Regulatory and legal
  - Distribution of proceeds
- 2.1.4.3 NASD Rule 2420 — Dealing with Non-members
  - Need for issuer to contract separately with non-members
  - Prohibition on sharing fees under NASD Rule IM-2420(d)
- 2.1.4.4 Finders
  - Defined as an un-registered introducer
  - Prohibited practices
    - Sales compensation to non-members of a national securities exchange or association registered with the Securities and Exchange Commission
    - Referrals by non-members of individual clients to broker/dealers in exchange for compensation from broker/dealer
- 2.1.4.5 SEC Rule 3a4-1 — Associated persons of an issuer deemed not to be brokers
- 2.1.4.6 NASD Rule 1060(b) — Persons exempt from registration—foreign finders
- 2.1.5 Pricing of the Issue**
  - Priced according to prevailing:
    - Market conditions
    - Industry conditions
    - Customer demand
    - Issuer needs
- 2.1.6 Limitations on Marketing and Advertising for Private vs. Public Offerings**
  - 2.1.6.1 Section 2 — Definitions under the Act
    - 2.1.6.1.1 Distribution of information during a publicly-registered underwriting
      - Rule 134 — Communications not deemed a prospectus
      - Rule 137 — Definition of "offers", "participates", or "participation" in Section 2(11) in relation to certain publications by persons

- independent of participants in a distribution
  - Rule 138 — Definition of "offer for sale" and "offer to sell" in Sections 2(10) and 5(c) in relation to certain publications
  - Rule 139 — Definition of "offer for sale" and "offer to sell" in Sections 2(10) and 5(c) in relation to certain publications
- 2.1.6.2 Section 5 — Prohibitions Relating to Interstate Commerce and the Mails
  - Rule 135 — Notice of certain proposed offerings
  - Rule 135A — Generic advertising
  - Rule 153A — Definition of "preceded by a prospectus" as used in Section 5(b)(2) of the Act, in relation to certain transactions requiring approval of security holders
- 2.1.6.3 Section 12 — Civil Liabilities Arising in Connection with Prospectuses and
- 2.1.6.4 Special issues dealing with electronic offerings
  - SEC Release 34-42728 — Use of Electronic Media

## **2.2 Trading Corporate Securities**

### **2.2.1 Overview of Securities Markets (publicly traded securities)**

- 2.2.1.1 Dealer Market
  - Nasdaq tier securities
- 2.2.1.2 Auction markets
  - Exchange markets
- 2.2.1.3 Non-exchange securities in
  - Non-Nasdaq OTC
  - Bulletin Board and Pink sheets
- 2.2.1.4 Third market
  - Trading in exchange listed securities in OTC market
- 2.2.1.5 Fourth market
  - Private transactions between institutional investors without the use of a broker/dealer

## **2.3 Securities Act of 1933 and SEC Rules Thereunder**

### **2.3.1 Section 3 — Exempted securities (exempt by class or transaction)**

- 2.3.1.1 Classes of securities
  - Section 3(a)(3) — Note, draft, banker's acceptance, commercial paper
  - Section 3(a)(5) — Bank securities, savings and loan securities
  - Rule 147 — "Part of an issue", "person resident" and "doing business within" for purposes of Section 3(a)(11)
    - Transactions covered
    - Limitation on resales
    - Precautions against interstate offers and sales
- 2.3.1.2 Types of transactions

Section 3(b) — \$5,000,000 in any 12 month period by SEC Rule  
Regulation A offerings

- Purpose
- Limitation on size of offering
- Limitation on time period

## **2.3.2 Section 4 -- Exempted transactions**

- 2.3.2.1 Statutory exemptions
  - Section 4(a)(2) — Transactions by an issuer not involving any public offering
  - Section 4(6) — Transactions involving offers or sales by an issuer solely to one or more accredited investors up to the Section 3(b) maximum
- 2.3.2.2 Regulation D — Limited offer and sale of securities without SEC registration under the Securities Act of 1933 (Private offerings exemptions from registration)
  - 2.3.2.2.1 Rule 501 — Definitions and terms used in Regulation D
    - Accredited investor
    - Affiliate
    - Aggregate offering price
    - Number of purchasers
    - Executive officer
    - Issuer
    - Purchaser representative
  - 2.3.2.2.2 Rule 502 — General conditions to be met
    - Integration--6 month safe harbor rule
    - Information requirements
      - When information must be furnished
      - Type of information to be furnished
    - Limitation on manner of offering
    - Limitations on resale
  - 2.3.2.2.3 Rule 503 — Filing of notice of sale
    - Filing Form D
  - 2.3.2.2.4 Rule 504 — Exemption for limited offers and sales of securities not exceeding \$1,000,000
    - Exemption
    - Conditions to be met
    - Limitation on aggregate offering price
  - 2.3.2.2.5 Rule 505 — Exemption for limited offers and sales of securities not exceeding \$5,000,000
    - Exemption
    - Conditions to be met
    - Limitation on aggregate offering price
    - Limitation on number of purchasers
    - Disqualification



- 2.3.2.2.6 Rule 506 — Exemption for limited offers and sales without regard to dollar amount of offering
  - Exemption
  - Conditions to be met
  - Limitation of number of purchasers
  - Nature of purchasers
- 2.3.2.2.7 Rule 507 — Disqualifying provision relating to exemptions under Rules 504, 505 and 506
- 2.3.2.2.8 Rule 508 — Insignificant deviations from a term, condition or requirement of Regulation D

## **2.4 Securities Exchange Act of 1934 and SEC Rules Thereunder**

### **2.4.1 Section 3 -- Certain definitions under the Act**

- Section 3(a)(4) — Broker
- Section 3(a)(5) — Dealer
- Section 3(a)(10) — Security
- Section 3(a)(11) — Equity security
- Section 3(a)(12) — Exempted security
- Section 3(a)(18) — Person associated with a broker or dealer
- Section 3(a)(35) — Investment discretion
- Section 3(a)(39) — Statutory disqualification
- Section 3(a)(46) — Financial institution

### **2.4.2 Regulation FD — Disclosure (Issuer obligations)**

- 2.4.2.1 Rule 100 — General rule regarding selective disclosure
- 2.4.2.2 Rule 101 — Definitions

## **2.5 Insider Trading Regulations**

### **2.5.1 Insider Trading and Securities Fraud Enforcement Act of 1988**

- 2.5.1.1 Section 3 — Civil penalties of controlling persons for illegal insider trading by controlled persons
  - 2.5.1.1.1 Securities Exchange Act of 1934
    - Section 15(f) — Policies and procedures to be developed by broker/dealers to prevent misuse of material, non-public information
    - Section 21(d) — Injunctions and prosecution of offenses
    - Section 21A — Civil penalties
  - 2.5.1.1.2 Investment Advisers Act of 1940
    - Section 204 — Annual and other reports
    - Section 204A — Prevention of misuse of non-public information
- 2.5.1.2 Section 4 — Increases in criminal penalties
  - 2.5.1.2.1 Securities Exchange Act of 1934
    - Section 32(a) — Penalties
- 2.5.1.3 Section 5 — Liability to contemporaneous traders for insider trading
  - 2.5.1.3.1 Securities Exchange Act of 1934

Section 20A — Liability to contemporaneous traders for insider trading

- 2.5.2                    Securities Exchange Act of 1934 and SEC Rules Thereunder**
- 2.5.2.1                Section 10 — Regulation of the use of manipulative and deceptive devices
- 2.5.2.1.1             Rule 10b-3 — Employment of Manipulative and Deceptive Devices (by brokers or dealers)
  
- 2.5.2.1.2             Rule 10b-5 — Employment of Manipulative and Deceptive Devices (by individuals)
  - Insider Trading
    - Material information
    - Insiders and non-public information
    - Insiders and tippees
    - The Chinese Wall Doctrine
  
- 2.5.2.1.3             Rule 10b5-1 — Trading “on the basis of” material nonpublic information in insider trading
  
- 2.5.2.1.4             Rule 10b5-2 — Duties of trust or confidence in misappropriation insider trading cases

**2.5.3                    Sarbanes-Oxley Act (general understanding)**

**2.6                      FINRA/NASD — Regulations**

- 2.6.1                    Conduct Rules**
- 2.6.1.1                FINRA Rule 5130 — Restrictions on purchase and sale of initial equity public offerings
  - General prohibitions
  - Preconditions for sale
  - General exemptions
  - Issuer-directed securities
  - Anti-dilution provisions
  - Stand-by-purchasers
  - Undersubscribed offerings
  - Definitions
  
- 2.6.1.2                FINRA Rule 5122—Private placements of securities issued by members
  
- 2.6.1.3                Trading standards and practices
  - FINRA Rule 2010 — Standards of commercial honor and principles of trade
  
  - FINRA Rule 2140 — Interfering with the transfer of customer accounts in the context of employment disputes
  - FINRA Rule 5240 — Anti-intimidation/coordination
  - FINRA Rule 5270 — Front running policy
  - FINRA Rule 5280 — Trading ahead of research reports
  - FINRA Rule 5320 — Prohibition against trading ahead of customer orders

2.6.1.4

FINRA Rule 2241—Research Analysts and Research Reports  
NASD Rule 2711 — Research analyst and research reports

## 3.0

# Analyzing Corporate Securities And Investment Planning

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- 3.1**                    **Securities Analysis**
  
- 3.1.1**                **Fundamental Analysis**
- 3.1.1.1              Reading financial statements
- 3.1.1.1.1            The balance sheet
  - Assets
    - Current assets
    - Fixed assets
    - Intangible assets
  
  - Liabilities
    - Current liabilities
    - Long-term debt
    - Stockholders equity (net worth)
  
- 3.1.1.1.2            The income statement
  - Net sales
  - Operating expenses
  - Selling and administrative expenses
  - Depreciation
  - Operating income
  - Non-operating income
  - Total income (EBIT)
  - Interest on debt
  - (Pre-tax) income (EBT)
  - Taxes
  - Net income (EAT)
  
- 3.1.1.1.3            Importance of footnoted items
  - Extraordinary items
  - Non-recurring items
  - Fully diluted earnings
  
- 3.1.1.1.4            Corporate changes affecting financial statements
  - New issue of securities
  - Exercise of rights or warrants
  - Conversion of convertible securities
  - Stock dividends and splits
  - Cash dividends
  
- 3.1.1.1.5            Sources and uses of funds statement
  
- 3.1.1.2              Analyzing financial statement
- 3.1.1.2.1            Working capital
  
- 3.1.1.2.2            Profitability ratios

- Margin of profit
  - Earnings per share/Cash flow per share
  - Price earnings ratio
  - Dividend payout ratio
- 3.1.1.2.3 Short-term liquidity measures
  - Current ratio
  - Acid test ratio
- 3.1.1.2.4 Long-term solvency measures
  - Times interest earned ratio
  - Preferred dividend coverage
  - Leverage ratios
    - Stockholder's equity to total capital
    - Total debt to total capital
- 3.1.1.3 Analyzing corporate debt
  - Bond ratings
    - Standard and Poor's Corporation
    - Moody's Investors Service
  - Protective provisions of the issue
  - Call provisions
  - Interest rate risk/yield curve
  - Times interest earned ratio
  - Net tangible assets per bond
  - Yields
    - Coupon rate (nominal yield)
    - Current yield
    - Yield to maturity
    - Yield to call
    - Basis points
  - Special considerations for very low-grade ("junk") bonds
    - Usually rated lower than BB
    - Possess very high speculative elements as to the repayment of principal and interest
    - Often trade more like equities than higher-grade bonds
  - Credit risk
- 3.1.1.4 Analyzing equity corporate securities
  - Book value
    - Stated
    - Tangible
    - Goodwill
  - Market value
- 3.1.1.5 Analyzing U.S. Government securities
  - 3.1.1.5.1 U.S. Treasury Securities
    - Bills
    - Notes
    - Bonds
    - Strips

- Secondary market quotations
- Non-marketable Treasury instruments
  - U.S. savings bonds
  - State and local government series (SLGS)

- 3.1.1.5.2 Characteristics of U.S. Government securities
  - Fundamental characteristics
    - Treasury securities
      - Benchmark that is the source of credit, marketability and liquidity for other financial markets
      - Full faith and credit of the United States
    - Agency securities
      - Usually offer slightly higher yield than U.S. Treasury issues with similar terms and generally considered to carry the "moral obligation" of the U.S. Government

## **3.2 Economics**

### **3.2.1 Business Cycles**

- 3.2.1.1 Phases
  - Expansion
  - Peak
  - Recession
  - Trough
  - Depression
  - Inflation/deflation

- 3.2.1.2 Economic indicators
  - Gross national product (GNP)
  - National income
  - Components of GNP and NI and their relationship to each other
  - Gross domestic product (GDP)
  - Producer price index
  - Consumer price index

- 3.2.1.3 Market indices
  - Equity securities
    - Dow Jones Industrial Average
    - Standard and Poor's 500 Composite Index
    - New York Stock Exchange Common Stock Index
    - Nasdaq Composite Index
  - Debt securities
    - LIBOR
    - Treasury market
    - Cost of funds
    - Fed funds

### **3.2.2 Monetary Policies of the Federal Reserve**

- 3.2.2.1 Supply of money and interest rates
  - Relation to level of economic activity
  - Relation to prices of and return on securities investments

M1, M2, M3

- 3.2.2.2 Tools of the Federal Reserve Board
  - Open-market operations
  - Changes in the discount rate
  - Changes in bank reserve requirements
  - Margin requirements (Regulations T and U)
  - Moral suasion
- 3.2.2.3 Sequence effects generated by a Fed policy designed to contract (expand) the money supply
- 3.2.3 Fiscal Policies of the Federal Government**
  - Effects of use of congressional or executive authority to raise/lower federal taxes and/or spending
  - Effects of budget deficits/surpluses on the economy as a result of changes in fiscal policy
  - Effects of automatic stabilizers in cushioning economic swings (e.g., changes in private savings rates, welfare transfer payments, unemployment compensation, foreign exchange activity, etc.)
- 3.2.4 International Economic Factors**
  - 3.2.4.1 Currency valuation
    - Fluctuation
  - 3.2.4.2 Balance of payments
    - Relation between domestic inflation (deflation) and balance of payment deficits (surpluses)
- 3.3 Investor Suitability**
  - 3.3.1 Investment Objectives**
    - 3.3.1.1 Principal accumulation
      - Amount
      - Accumulation period
    - 3.3.1.2 Income
      - Current needs
      - Amount needed in future
        - Accumulation period
        - Payout period
  - 3.3.2 Financial Status**
    - Balance sheet
    - Income and expenses
    - Participation in benefit plans
    - Expected changes in financial status
  - 3.3.3 Investment Constraints**
    - Ability to risk loss of principal
    - Ability to risk loss of investment income

- income
  - Ability to assume purchasing power risk with regard to principal and
  - Ability or willingness to hold investments over relatively long periods
  - Requirements for marketability of securities held
  - Tax considerations
  - Investment temperament and investment experience
- 3.3.4 Legal/regulatory requirements**
  - 3.3.4.1 Fiduciary responsibilities
    - Uniform trust code
    - ERISA requirements
  - 3.3.4.2 Investment Company Act of 1940
    - Rule 17a-6 – Exemption of transactions with certain affiliated persons
    - Rule 17a-7 – Exemption of certain purchase or sale transactions between an investment company and certain affiliated persons thereof
  - 3.3.4.3 Investment Advisors Act of 1940
    - Section 206 – Prohibited transactions by investment advisors
  - 3.3.4.4 FINRA Rule 2090 – Know Your Customer
  - 3.3.4.5 FINRA Rule 2111 – Suitability
- 3.3.5 Risk and the Construction of Investment Portfolios**
  - 3.3.5.1 Credit risk and portfolio policies
    - 3.3.5.1.1 Definition of credit risk and its effect on future values of income and principal in different types of investments
    - 3.3.5.1.2 Appropriate mix of conservative and speculative securities in a portfolio derived from customer's ability to risk loss of principal and income
    - 3.3.5.1.3 Concentration of investment in a small number of issues vs. diversification
    - 3.3.5.1.4 Concentrated portfolios or portfolios heavily invested in speculative securities require an ability to hold securities during market fluctuations and also require significant investment management talents
  - 3.3.5.2 Interest rate risk and portfolio policies
    - 3.3.5.2.1 Definition of interest rate risk and its effect on future values of income and principal in different types of investments
    - 3.3.5.2.2 Appropriate mix of maturity schedules on debt obligations derived from customer's ability to risk loss of principal and income
      - Effect of long maturities
      - Effect of short maturities
      - Averaging effect on yields of various maturity spacing strategies
  - 3.3.5.3 Purchasing power risk and portfolio policies
    - 3.3.5.3.1 Definition of purchasing power risk and its effect on the constant dollar



- value of income and principal in different types of investments
- 3.3.5.3.2 Need to reconcile investment policies with regard to financial risk with policies designed to minimize loss of purchasing power
- 3.3.5.3.3 Balanced portfolio of bonds, preferred, common and convertible issues provides downside protection and potential inflation hedge
- 3.3.5.4 Other risk factors and portfolio policies
- 3.3.5.4.1 Marketability of securities in the portfolio and customer liquidity needs
- 3.3.5.4.2 Taxability of securities in the portfolio and customer tax bracket
- 3.3.5.4.3 Callability of securities in the portfolio and the importance of call protection given customer investment objectives
- 3.3.5.4.4 Convertibility of securities in the portfolio, the value of the conversion feature and the effect of potential forced conversions on customer objectives
- 3.3.5.4.5 Economic, social and political risks and their potential effects on customer investments
- 3.3.5.4.6 Currency rate risk

### **3.4 Tax Consequences of Securities Transactions**

#### **3.4.1 Holding Periods of Securities**

- 3.4.1.1 Closing date determines date of acquisition
- 3.4.1.2 Closing date of securities sold determines end of holding period and must be used by investor to establish year in which gain or loss is claimed

#### **3.4.2 Tax Basis of Securities**

- 3.4.2.1 Purchases
- 3.4.2.2 Exchange of securities
- 3.4.2.3 Stock rights
- 3.4.2.4 Gifts of securities
- 3.4.2.5 Inheritance of securities

#### **3.4.3 Tax Treatment of Securities Transactions**

- 3.4.3.1 Definition of a capital gain (loss)
- 3.4.3.2 Computation of net capital gains (losses)
- 3.4.3.3 Ordinary income tax treatment of realized net capital gains (fully effective 1/1/88)

- 3.4.3.4 Deduction of net capital losses from ordinary income
- 3.4.3.5 Limitation on net capital loss deductions
- 3.4.3.6 Loss carryover provisions
- 3.4.4 Tax Treatment of Dividend Income From Corporate Stock**
  - 3.4.4.1 Cash dividends
  - 3.4.4.2 Stock dividends (ordinary) and effect on cost basis
  - 3.4.4.3 Stock rights-receipt ordinarily not a taxable event
  - 3.4.4.4 Deductibility of a specified percentage of dividend income received by a corporation from stock holdings in other domestic and certain foreign corporations
- 3.4.5 Tax Treatment of Interest Income on Debt Obligations**
  - 3.4.5.1 Corporate obligations -- ordinary income taxable at federal, state and local levels
- 3.4.6 Special Tax Features of Bonds**
  - 3.4.6.1 Amortization of bond premiums (taxable bonds)
    - Election by investor
    - Amortized premium equals purchase cost minus value at maturity divided by number of years to maturity (or call)
    - Subtract amortized premium from each year's taxable income
    - Basis reduced by amount of amortized premium
    - Adjustment for bond premiums due to conversion privilege
  - 3.4.6.2 Amortization of bond discounts (taxable bonds)
    - 3.4.6.2.1 Discounted money market obligations
      - Interest income recognized at redemption or when sold
    - 3.4.6.3 Effect of accrued interest on bond income and cost basis at purchase and sale
    - 3.4.6.4 Accretion of discounts

## 4.0

### Handling Customer Accounts And Industry Regulations

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#### 4.1 Account Documentation

##### 4.1.1 New Account Form Information

- Identification data
  - Full name
  - Address
  - Social security or tax identification number
  - Citizenship
  - Whether of legal age
  - Net worth
  - Income
  - Power of Attorney
  - Occupation, name and address of employer
  - Signature of representative introducing the account
  - Signature of supervisor who accepts the account
  - Whether associated with FINRA firm

##### 4.1.2 Supplementary Documentation

- Name and signature of person(s) with authority to create activity in account
  - Limited authorization
  - Full authorization
- Joint account agreement form
- Uniform Gifts/Transfers to Minors Act
- Uniform Transfer on Death Securities Registration Act
- Documentation necessary for electronic private placement offerings
  - Documentation of customer authorization
  - Limitation of access
- Qualified institutional buyer (QIB) certification letter
- Determination of QIB or accredited investor status
- Representation letter regarding purchaser eligibility standards (representations and warranties letter)
- Subscription agreement
- Investor questionnaire
- Private placement memorandum
- Articles of incorporation
- Corporate resolutions
- Customer identification program (CIP) documentation

#### 4.2 Transactions in Accounts

##### 4.2.1 Types of Transactions

- Principal
- Agency
- Riskless principal

##### 4.2.2 Private placement documentation

Marking of subscription agreements/internal documents  
Retention of subscription agreement  
Payment  
Contractual settlement for private placement securities

### **4.3 General Regulation of Brokers and Dealers**

#### **4.3.1 Regulatory Purposes and Roles of:**

Securities Exchange Commission  
Self-Regulatory Organizations (FINRA Exchanges, MSRB)  
State securities agencies

#### **4.3.2 FINRA/NASD — Regulations**

- 4.3.2.1 By-Laws
  - Article I — Definitions
    - Associated Person of a member
  - Article III — Qualifications of members and associated persons
    - Section 1 — Persons eligible to become members and associated persons of members
    - Section 3 — Ineligibility of certain persons for membership or association
    - Section 4 — Definition of disqualification (statutory disqualification)
  - Article IV — Membership
  - Article V — Registered representatives and associated persons
- 4.3.2.2 General Provisions
  - 0140 — Applicability
- 4.3.2.3 Membership and Registration Rules
  - FINRA Rule 1122 — Filing of misleading information as to membership or registration
  - FINRA Rule 1250 — Continuing Education Requirements
  - NASD Rules 1000 — Membership application and associated person registration
  - Rule 1030 — Registration of representatives
  - Rule 1080 — Confidentiality of examinations
- 4.3.2.4 Conduct Rules
  - 4.3.2.4.1 FINRA Rule 2020 — Use of Manipulative, Deceptive or Other Fraudulent Devices
  - 4.3.2.4.2 FINRA Rule 2210 — Communications with the Public
  - 4.3.2.4.3 FINRA Rule 3230 — Telemarketing
  - 4.3.2.4.4 FINRA Rule 2150 — Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts
    - Improper use
    - Prohibition Against Guarantees
    - Sharing in accounts; extent permissible
  - FINRA Rule 4330 — Customer Protection — Permissible Use of Customers'

Securities	Authorization to Lend Customers' Margin Securities
	Requirements for Borrowing of Customers' Fully Paid or Excess
Margin	Securities
4.3.2.4.5	FINRA Rule 3240 — Borrowing From and Lending To Customers
4.3.2.4.6	FINRA Rule 2122 — Charges for services performed
4.3.2.4.7	FINRA Rule 5141 — Sales of Securities in a Fixed Price Offering
4.3.2.4.8	FINRA Rule 3110 — Supervision
	Supervisory system
	Written procedures
	Internal inspections
	Written approval
	Qualifications investigated
	Definitions
	Office of supervisory jurisdiction
	Branch office
4.3.2.4.9	FINRA Rule 3310 — Anti-money laundering compliance program
4.3.2.4.10	FINRA Rule 5121 — Public Offerings of Securities with Conflicts of
Interest	
4.3.2.4.11	FINRA Rule 3280 — Private securities transactions of an associated
person	
	Written notice
	Transactions for compensation
	Transactions not for compensation
	Definitions
	Private securities transaction
	Selling compensation
4.3.2.4.12	NASD Rule 3050 — Transactions for or by associated persons
4.3.2.4.13	FINRA Rule 3220 — Influencing or rewarding employees of others
4.3.2.4.14	FINRA Rule 2060 — Use of Information obtained in fiduciary capacity
4.3.2.5	FINRA Procedural Rules
4.3.2.5.1	Rule 8000 — Investigations and Sanctions
4.3.2.5.1.1	Rule 8100 — General provisions
	Rule 8110 — Availability of Manual to customers
	Rule 8120 — Definitions
4.3.2.5.1.2	Rule 8200 — Investigations
	Rule 8210 — Provision of information and testimony and

inspection and copying of books

- 4.3.2.5.1.3 Rule 8300 — Sanctions
  - Rule 8310 — Sanctions for violation of the rules
  - Rule 8311 — Effect of a suspension, revocation, cancellation or bar
  - Rule 8312 — FINRA BrokerCheck disclosure
  - Rule 8320 — Payment of fines, other monetary sanctions, or costs; summary action for failure to pay
  - Rule 8330 — Costs of proceedings

- 4.3.2.5.2 Rule 9000 — Code of Procedure
  - Rule 9100 — Application and purpose
  - Rule 9200 — Disciplinary proceedings
  - Rule 9300 — Review of disciplinary proceeding by National Adjudicatory Council and FINRA Board; application for SEC review
  - Rule 9500 — Other proceedings
  - Rule 9600 — Procedures for exemptions

- 4.3.2.5.3 FINRA Code of Arbitration Procedure
  - Part I Interpretive Material, Definitions, Organization and Authority
    - IM12000 and IM-13000 — Failure to act under provisions of code of arbitration procedure for customer/industry disputes
    - Rules 12105 and 13105 — Agreement of the parties
  - Part II General Arbitration Rules
    - Rule 12200 — Arbitration under an arbitration agreement or the rules of FINRA
    - Rule 12201 — Elective arbitration
    - Rule 12202 — Claims against inactive members
    - Rules 12204 and 13204—Class action claims
    - Rule 12205 — Shareholder derivative actions
    - Rule 13200 — Required arbitration
    - Rule 13201 — Statutory employment discrimination claims and disputes arising under a whistleblower statute that prohibits the use of predispute arbitration agreements
    - Rule 13202 — Claims involving registered clearing agencies
  - Part VIII Simplified Arbitration and Default Proceedings
    - Rules 12800 and 13800 — Simplified arbitration
    - Rules 12801 and 13801 — Default proceedings

- 4.3.2.5.4 Rule 14000 —Code of Mediation procedure

### **4.3.3 General Administrative Requirements for Broker/Dealers**

- 4.3.3.1 Disclosure requirements

- 4.3.3.1.1 SEC Rules

- Rule 10b-10 — Confirmation of transactions
- Rule 15c1-2 — Fraud and misrepresentation
- Rule 15c1-3 — Misrepresentation by brokers and dealers as to

registration

- Rule 15c1-5 — Disclosure of control
- Rule 15c1-6 — Disclosure of interest in distributions
- Regulation S-P — Privacy of consumer financial information

4.3.3.1.2            **FINRA Rules**  
                          FINRA Rule 2232 — Customer confirmations  
                          FINRA Rule 2262 — Disclosure of Control Relationship with Issuer  
                          FINRA Rule 2269 — Disclosure of Participation or Interest in Primary  
                          or Secondary Distribution  
                          FINRA Rule 2261— Disclosure of Financial Condition  
                          Requirement to furnish most recent report of the firm's financial  
condition

4.3.3.2            **Recordkeeping and reporting requirements**

4.3.3.2.1            **SEC Rules**  
                          Rule 17a-3 — Records to be made by certain exchange members,  
                          brokers and dealers  
                          Rule 17a-4 — Records to be preserved by certain exchange members,  
                          brokers and dealers  
                          Rule 17a-8 — Recordkeeping and reporting of currency and foreign  
transactions  
  
                          Rule 17f-2 — Fingerprinting of securities industry personnel

4.3.3.2.2            **FINRA Rules Reporting Requirements and Books and Records**

                          Rule 4530 — Reporting Requirements  
                          Rule 2268 Requirements When Using Predispute Arbitration  
                          Agreements for Customer Accounts  
                          Rule 4511— General Requirements  
                          Rule 4512 — Customer Account Information  
                          Rule 4513— Records of Written Customer Complaints  
                          Rule 4514— Authorization Records for Negotiable Instruments Drawn  
                          From Customer's Account

**4.4            Securities Investor Protection Act and SIPC Rules Thereunder**

**4.4.1            Customer claims**

                          Definition of "separate customer"  
                          Maximum limit on claims for cash and securities  
                          Valuation of claims  
                          Submission of claims to trustee  
                          Eligible and ineligible customers  
                          Customers of other firms with open transactions with a firm in SIPC  
                          liquidation

## Sample Item Formats

The items which follow are similar in format and content to items on the actual exam. They are not intended, however, to parallel either the level of difficulty or the subject coverage of the exam. Their purpose here is to assist candidates and training personnel in preparing for the types of multiple-choice items which will appear on the exam.

1. Which of the following best defines the "book value" of a common stock?
  - (A) The price at which the shares were originally issued
  - (B) The theoretical value per share the stock would have upon corporate liquidation \*\*
  - (C) The ratio of price to earnings for stocks
  - (D) An accounting figure used in determining dividend distributions
  
2. On a corporate balance sheet, all of the following would be listed under "current assets" **except**:
  - (A) inventory
  - (B) cash
  - (C) equipment \*\*
  - (D) accounts receivable
  
3. When a stock is held by a broker for a customer in "street name," it means that the stock is:
  - (A) Registered in the name of the customer
  - (B) In bearer form
  - (C) Registered in the name of the broker or its depository \*\*
  - (D) Accompanied by stock powers
  
4. Which of the following securities represents an ownership interest in a public corporation?
  - (A) Common stock \*\*
  - (B) Common stock warrants
  - (C) Corporate bonds
  - (D) Debentures