Registered Options Representative Qualification Examination (Test Series 42)

Study Outline

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INTRODUCTION

The Series 42 examination is a pure options examination that is used to qualify a candidate as a registered options representative. A co-requisite to registration as a Series 42 representative is registration as a Limited Representative—Corporate Securities (Series 62) or Limited Representative – Government Securities (Series 72). The Series 42 examination is composed of four major sections as follows:

Section	Title	Number of Questions
1	Terminology, Types of Options, Investment Strategies and Taxation	**20**
2	Handling Options Accounts	**14**
3	Trading and Settlement Practices	**10**
4	Qualifications and Business Conduct of Registered Options Representatives; Reporting and Recordkeeping Requirements	**6**
Total		**50**

Structure of the Examination

The examination is composed of 50 multiple-choice questions covering all of the materials in the following outline in accordance with the subject-matter distribution shown above. Candidates will be allowed 1 ½ hours to complete the examination. A candidate must correctly answer 70 percent of the questions to receive a passing grade. At the completion of the examination, each candidate will receive an informational breakdown of their performance on each section and their overall score. The examination is a closed-book test and candidates will not be permitted to use any reference material during their testing session. Scratch paper and a basic electronic calculator will be provided by the test center administrator. Severe penalties are imposed on candidates who cheat on securities industry qualification examinations. Examination questions are updated regularly to reflect the most current interpretations of the rules and regulations. Questions on new rules will be added to the pool of questions for this examination within a reasonable period of their effective dates.

Unless a question specifically asks about conventional OTC options, all questions should be read and answered as they would apply to exchange listed standardized options. Also, unless a question is specifically worded to the contrary, all questions involving calculations exclude commissions and other transaction cost considerations.

Copies of this outline and registration applications may be obtained from the FINRA Web Site at www.finra.org.

There are also sample Series 42 test questions written in the various formats. They do not mirror the difficulty level of the actual test questions or the subject matter distribution of the test itself. Their use is merely to familiarize the candidate with the styles of multiple-choice questions used in the Series 42 Examination.

The following reference materials may be used in preparing for the examination.

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

REFERENCES

While options rules are to a large extent uniform throughout the industry, trading floor procedures and operations requirements for conducting an options business vary slightly from exchange to exchange. Options educational material may be obtained by contacting the following organizations:

Dictionary of Finance and Investment Terms
Barron's Educational Series, Inc.
250 Wireless Boulevard
Hauppauge, NY 11788
www.barronsedu.com

Getting Started in Options, 6th ed.
Michael C. Thomsett
John Wiley Publishers, Inc.
111 River Street
Hoboken, NJ 07030

How I Trade Options
Jon Najarian
John Wiley Publishers, Inc.
111 River Street
Hoboken, NJ 07030

An Introduction to Options Trading
Frans de Weert
John Wiley Publishers, Inc.
111 River Street
Hoboken, NJ 07030

Options, Futures, and Other Derivative Securities
J.C. Hull
Prentice Hall
Englewood Cliffs, NJ 07632

Securities Act Handbook
Aspen Publishers
111 Eighth Avenue
New York, NY 10011

The Stock Market
7th Edition
R.J. Teweles and E.S. Bradley
John Wiley & Sons, Inc.
605 Third Avenue
New York, NY 10158

Other publications are available through the FINRA Web Site:

Compliance Checklist
NASD Guide to Rule Interpretations
Notices to Members
NASD Sanctions Guidelines

Other Websites:

www.cboe.com
www.the options institute.com
www.1888options.com
www.law.uc.edu/CCL/xyz/sldtoc.html

1.0
Terminology, Types of Options, Investment Strategies and Taxation

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1.1 Terminology

- **Understand terms and definitions of options products, investment strategies, and the inherent risks**
- **Apply knowledge of terms and definitions of options transactions**

1.1.1 Basic Definitions

Type
- Classification of an option as either a put or a call

Call
- Gives the buyer (holder) the right to purchase underlying instrument at a fixed price until a specified expiration date
- Obligates the writer (seller), if assigned, to sell the underlying instrument at the exercise price

Put
- Gives the buyer (holder) the right to sell a particular underlying instrument at a fixed price until a specified expiration date
- Obligates the writer (seller), if assigned, to buy the underlying instrument at the exercise price

Class
- All options of the same type covering the same underlying instrument

Series
- Put or call options of the same class having the same strike price and expiration month

1.1.2 Options Nomenclature

Options Clearing Corporation (OCC)
- Issuer and guarantor of listed options contracts
- Serves as clearing agency for all listed options
- Provides the Option Disclosure Document

Strike price (exercise price)
- The price per unit at which the holder of an option may purchase (in the case of a call option) or sell (in the case of a put option) the underlying instrument

Strike Price Intervals – General Understanding
- Dependent on the price level of the stocks
- Usually vary from 2 1/2 to 10
- Vary according to contract

Expiration date
- Equity and index options
  - The date that the right to buy or sell the underlying instrument terminates
  - Saturday following the third Friday of the expiration month
- Foreign currency options

Firms and exchanges may set deadlines for last trade orders in spot expiration options
11:59 p.m. EST on the Saturday preceding the third Wednesday of the settlement date of the option

Expiration Cycles
Cycles vary according to the underlying issue and exchange

Exercise
The use of the holder's right to buy or sell the underlying instrument

Exercise style
European style— can be exercised only on expiration date
American style - can be exercised anytime up to and including expiration date

Exercise/Assignment Settlement
Equity options
By delivery or receipt of the underlying securities three business days after exercise
Index options
For cash delivery or receipt of the underlying securities – T+1
By cash payment on the next business day
Settlement amount is the difference between strike price and index closing value
Foreign currency options

Assignment
The option writer is required to fulfill the contractual obligation by delivering the underlying instrument, in the case of a call, or to take delivery of the underlying instrument, in the case of a put

Premium
Price paid or received for a call or a put option

Factors affecting options premiums
Current price of underlying instrument
Exercise price of option
Time remaining
Volatility of underlying instrument
Dividend rate
Current interest rates or yield curve
Prevailing market conditions

In-the-money
When the strike of a call is less than the current price of the underlying instrument, or the strike price of a put is greater than the current market price of the underlying instrument

Parity
When an in-the-money option's premium equals its intrinsic value

Out-of-the-money
When the strike price of a call is greater than the current price of the underlying instrument or the strike price of a put is less than the current price of the underlying instrument

Intrinsic value
The in-the-money amount of an option premium

Time value

The portion of an option premium that exceeds the intrinsic value relative to the time left on the option

Opening transaction

The buying or selling of an option that initiates or increases a position

Closing transaction

The buying or selling of an option that eliminates or decreases a position

A closing sell (buy) that offsets the opening buy (sell)

Open interest

The total number of options currently outstanding in any series, class, or type

Opening rotation

Upon the opening of the options market, the order book official (OBO) or specialist is required to conduct trading rotations which consist of calling for bids and offers from the crowd for each option series

Closing rotation

Conducted in order to establish a closing price or quote for each option series that is representative of its relationship to the price of the underlying instrument

Position and exercise limits

The maximum number of contracts on the same side of the market in the same underlying security that an individual or group of individuals acting in concert may control

Long put and short call positions are aggregated

Long call and short put positions are aggregated

Covered call

A writer is covered if long one of the following:

- The underlying instrument or securities convertible into the underlying instrument without the payment of money
- A call option with the same or lower strike price that expires on or after the short call
- A specific deposit, escrow receipt, or guarantee letter equal in quantity or value of the underlying shares represented by the contract

Covered put

A writer is covered if long one of the following:

- A put with the same or higher strike price expiring on or after the short put
- A short put covered by cash sufficient to pay for the full assignment of the underlying security
- An escrow receipt or option guarantee letter

Uncovered (naked) call writer

A call writer is uncovered when he does not own either the underlying instrument upon which the option is written, a long call of the same class with an equal or lower strike price, or an escrow receipt (potentially unlimited risk)

Uncovered (naked) put writer

A put writer is uncovered when he does not hold a long put of the same class with an equal or higher strike price, or an option guarantee letter

Spread

Long and short positions in different series of the same class at the same time

Debit spread - when the cost of the option purchased is more than the proceeds of the option sold
Credit spread - when the proceeds of the option sold exceed the cost of the option purchased
Types of Spread
Bull spread
Bear spread
Time spread
Diagonal spread
Variable spread
Butterfly spread
Box spread
Reverse conversion
Collars
Reverse collars
Straddle
A put and call (either both long or both short) on the same underlying instrument with the same exercise price and the same expiration month
Combination
A put and a call (either both long or both short) on the same underlying instrument with different exercise prices and/or expiration dates
Ratio writing/spreading
A strategy where more short options are held than either long options or the underlying instrument (part of the position is uncovered)
Hedges
Strategies used to offset investment risk

1.1.3 FINRA Rules
Rule 2360(b)(2)—Definitions
Supplementary Material .1—Position limits
Rule 2360(b)(4)—Exercise limits
Rule 2360(b)(23)(A)—Exercise of options contracts
Rule 2352—Definitions
Rule 4210—Definitions

1.2 Types of Options

1.2.1 Equity Options

1.2.1.1 Underlying Securities
Common stocks listed on exchanges

1.2.1.2 Selection/Withdrawal Process - General Understanding
Options listings determined by exchanges
New series may not be offered if stocks become relatively low-priced, closely held, or inactive

1.2.1.3 Adjustment to Terms
Cash dividends - no adjustment
Stock dividends –

Adjusted exercise price, adjusted number of shares

Stock splits

Less than 100 share multiples: adjusted exercise price, adjusted number of shares

Stock splits

Multiples of 100 shares: split contracts, adjusted exercise price

Spin-offs, rights, and warrants –

Adjusted to reflect security distribution exercise price and number of shares rounded to the next lowest whole share

1.2.2 Foreign Currency Options

1.2.2.1 Underlying Currencies

Interbank market

Spot transactions settle in 2 business days

Forward transactions settle in more than 2 business days

Forward exchange rates differ from spot

Exchange rates

European terms - reciprocal relationship, unit of foreign currency per $1

U.S. terms – reciprocal relationship, U.S. dollars per unit of foreign currency

1.2.2.2 FINRA Rules

Rule 2350—Trading in index warrants, currency index warrants, currency warrants

Rule 2351(a)—Applicability

1.2.3 Index Options

1.2.3.1 Underlying Securities

An index or group of securities intended to reflect movement in the market or a particular industry or sector

Broad-based index

Tracks a specific segment of the market or the market as a whole

Narrow-based index

A sector-based index meant to reflect movement in a particular industry group or sector of the economy

Exchange traded funds (ETFs) and holders

Volatility index (VIX)

1.3 Investment Strategies for Various Market Scenarios

- **Understand appropriate investment strategies for customers**

1.3.1 Strategies Based on Market Outlook

1.3.1.1 Neutral

Covered call writing (at market)

Straddle writing

Combination writing

1.3.1.2 Bullish

Covered call writing (above market)
Uncovered put writing
Call purchasing
Long stock/long put
Bull spreading

1.3.1.3 Bearish

Uncovered call writing
Put purchasing
Bear spreading

1.3.2 Using Puts or Calls

1.3.2.1 Call buying strategies

Alternative to buying the underlying security
To lock-in a purchase price
To hedge a short sale

1.3.2.2 Put buying strategies

To hedge a long position
Alternative to short sale

1.3.2.3 Covered call writing concepts

Increase yield
Hedge a position
Rolling

1.3.2.4 Put writing concepts

Increase income
Acquire stocks below current prices

1.3.3 Other Strategy Considerations

1.3.3.1 Synthetic positions

Long stock/short call = short put
Short stock/long call = long put
Short stock/short put = short call
Long call/short put = long stock
Long stock/long put = long call
Short call/long put = short stock

1.4 Calculation of Profit, Loss and Breakeven

- **Know how to calculate profit, loss and breakeven points of various strategies**
- **Recognize uneconomic trades**

1.4.1 Ability to calculate potential profit, loss, and breakeven point

Profit or loss will fluctuate due to market activity until the position is closed-out or expires
Uneconomic trades

1.5 Taxation

- **Understand tax implications of options transactions**
- **Understand wash sales and their impact**

1.5.1 General Concepts

Identification of securities
Holding periods of securities
Wash sale rules
Applicable time period of 30 days prior to and after a sale
Definition of "substantially identical" property
Case by case determination by IRS
General guidelines
Securities of different corporations - not normally considered substantially identical securities
Each option series is deemed a different type of security

1.5.2 Tax Treatment of Listed Put and Call Options

1.5.2.1 Options purchased by investors
Impact of a put purchase on the holding period of the underlying security
Closing sale of options
Proceeds minus cost equals gain or loss
Holding period determines short or long-term nature
Expired options
Expiration date treated as sale date
Premium equals amount of loss
Exercised call options
Addition of call premium to cost basis of acquired security
Exercised put options

1.5.2.2 Options written by investors
Closing purchase of options
Short-term gain or loss
Expired options
Short- term gain treatment of premiums received
Exercised put option
Exercise price minus premium equals cost basis of acquired security
Holding period of acquired stock begins on day following exercise of put
Exercise of call option
Sale proceeds from stock plus call premium equals proceeds of transaction for tax purposes
Gain or loss established by subtracting original cost basis of security sold from total sale proceeds of transaction
Qualified versus unqualified for tax purposes

2.0
Handling Options Accounts

2.1 Customer Accounts

2.1.1 New Options Account Information

2.1.1.1 Essential facts necessary from the customer
- Marital status
- Age
- Investment objectives
- Financial situation
  - Employment status
  - Estimated annual income
  - Estimated net worth
  - Estimated liquid net worth
- Investment experience and knowledge
- FINRA Rule 2360— Diligence in opening accounts

2.1.1.2 ROP approval based on evaluation of essential facts obtained from the customer
- Approval required not later than the time an initial option order is accepted for the account
- Options account approval may be limited to certain strategies
- FINRA Rule 2360(b)(16)(C)—Diligence in opening accounts

2.1.1.3 Risk Disclosure Documents
- Delivery requirements
  - Delivered to customer at or prior to the initial approval of the account
- Special statement for uncovered options writers
- FINRA Rule 2360(b)(11)—Delivery of current disclosure documents

2.1.2 Customer Account Documentation

Customer must agree that the agreement be handled 'in accordance with self-regulatory organizations' and OCC rules
Customer must agree not to the violate position or exercise limits
Verification of customer background and financial information

2.1.3 Discretionary Options Accounts

2.1.3.1 Accounts must be opened in accordance with securities industry rules and firm’s policies and procedures

2.1.3.2 Authorization by the customer and approval by appropriate firm personnel required
- Customer must authorize use of discretion in writing
- Account must be accepted in writing by a ROP and approval reviewed by a ROP Designated by the member firm

Each order must be approved and initialed by a ROP on the day of entry, and must be identified as discretionary at the time of entry
Frequent supervisory review of the account by the ROP Designated by the member firm
Excessive transactions prohibited
Options programs
Customer must be furnished with a written explanation of the nature and risks of such program
FINRA Rule 2360(b)(18)—Discretionary accounts

2.2 Transactions in Options Accounts

2.2.1 Suitability of Recommendations

Assess customer's investment experience and knowledge
Clear understanding of customer's investment objectives
Need for customer understanding of options strategies and their inherent risks
Customer must be capable of meeting foreseeable margin calls with respect to both the option positions and any other portfolio security positions
Customer must be capable of meeting the obligation of option assignments
Financial ability to assume risk/loss
Potential for excessive transaction costs
Effects of certain options transactions on the tax holding periods of underlying stock positions
Consequences of exercise
Tax implications
Margin implications
Investment risks relative to customer's total portfolio
Prohibition against excessive trading activity
FINRA Rules
Rule 2111—Suitability
Rule 2360(b)(19)—Suitability

2.2.2 Types of orders

Market
Limit
Day
GTC
Stop
Stop limit
All-or-none
Spread
Straddle
Combination
Fill-or-kill
Immediate-or-cancel
Not held
At the close/At the open

2.2.3 Order tickets

FINRA Rules

Rule 2360(b)(12)—Confirmations
Securities Exchange Act of 1934
Rule 10b-10—Confirmation of transactions

2.2.4 Prohibited Transactions

2.2.4.1 Transactions with issuers
Member may not accept a transaction for sale (writing) of call options on behalf of the issuer of the underlying security
FINRA Rule 2360(b)(13)—Transactions with issuers

2.2.4.2 Transactions in restricted securities
Members may not accept transactions for covered calls in restricted securities
FINRA Rule 2360(b)(14)—Restricted stock

2.3 Communications with Customers

- **Ensure that all advertisements, educational material and sales literature are approved in advance by the designated ROP**
- **Comply with recordkeeping and record retention requirements**
- **Understand the restrictions regarding the use of 'internal use only' sales material**
- **Observe telemarketing procedures, *e.g.*, maintain 'do not call' list**

2.3.1 FINRA Rule 2220—Options Communications

Definitions
Advertisement
Sales literature
Market letters
Research reports
Internal communications
Exchange-produced materials
Seminar texts
Worksheets
Telemarketing scripts
Correspondence
Institutional sales material
Approval by ROP Designated by the firm and recordkeeping
FINRA approval requirements and review procedures
General standards
Prohibitions against:
Untrue statements and material omissions
Promises of specific results or exaggerated claims
Hedge clauses or disclaimers
Failure to meet general standards of good faith and fair dealing
Communications that would constitute a prospectus

2.3.2 Statement of account to customers

FINRA Rule 2360(b)(15)—Statements of account

2.4 Extension of Credit in the Securities Industry

- **Understand margin implications associated with various strategies**
- **Understand minimum margin requirements set by regulation for initial/maintenance requirements**
- **Recognize that firms and/or exchanges may set higher requirements**
- **Obtain documentation related to the margin agreement**
- **Understand margin calculations**
- **Know how to calculate initial/maintenance call**
- **Understand mark to market to calculate amount of margin call**
- **Know what is required to meet margin calls**
- **Know the acceptable collateral deposits**
- **Understand portfolio margining**
- **Understand day trading requirements**

2.4.1 Regulatory Margin Requirements

Long-term options

Pay in full for each put or call

LEAPs—long-term options that expire in excess of nine months and have special margin treatment

Short options

100% of options proceeds plus 20% of underlying security value less out-of-the money amount, if any, to a minimum of option proceeds plus 10% of underlying security value in the case of a call option and 10% of the exercise price in the case of put options

Spreads

For a spread to qualify for margin, the short position must expire at or prior to the long position

For debit spreads, payment for the net debit must be made in full

For credit spreads, the difference between the exercise prices of the options

Straddle/Combination

For long put and long call, payment for the debit on each leg is required in full

Short put and short call

Short put or short call requirement, which ever is greater, increased by the current option premium of the other side

Covered put (short put and short the underlying security)

No requirement on short put; 50% initial requirement on stock position

Covered call (short call and long the underlying security)

No requirement on short call; 50% initial requirement on stock position

Short call and long marginable convertibles

No requirement on short call; 50% requirement on convertible security

Must be immediately convertible or exchangeable

The right to convert may not expire before the short call

Short call and long marginable warrants

No requirements on short call; 50% requirement on warrants plus amount by which exercise price of warrants exceeds option exercise price; long warrants may not expire before the short call

FINRA Rule 4210—Margin Requirements

3.0
Trading and Settlement Practices

3.1 Trading Practices

- **Understand the roles and responsibilities of market participants**
- **Comply with relevant position/exercise limits**
- **Understand appropriate aggregation of accounts for reporting position limits, exercise limits, and large positions (acting in concert rules)**

3.1.1 Exchange Operations

Agency capacity
Principal capacity
Cabinet trading
- .01 per lot ($1.00 per contract)
- Time priority
- Not reported to vendors
- Off-floor accommodations

FINRA Rule 2360(b)(24) – Options transactions and reports by market makers in listed securities

3.1.2 Trading Rotation (General Understanding)

Opening
Closing
- Business day prior to expiration

Intra-day
- Reopen after halt

3.1.3 Trading Halts

FINRA Rules
- Rule 5260—Prohibition on Transactions, Publication of Quotations, or Publication of Indications of Interest During Trading Halts
- Rule 6120—Trading Halts

3.2 Exercise/Assignment of Options

- **Understand the mechanics of tendering of exercise notices for options; exercise by exception and same day exercise**
- **Understand the effect of exercise prior to ex-dividend date**
- **Understand applicable time limitations**
- **Understand the mechanics of assignment, particularly on ex-dividend date**
- **Understand OCC assignment procedure**
- **Understand firm procedures for allocating customer assignments (FIFO, random)**
- **Ensure customer notification of allocation method**
- **Understand the requirements for delivery and payment/settlement**

3.2.1 Assignment of Exercise Notices

Effect of assignment on ex-dividend date of equities
OCC assignment procedure
Acceptable procedures for allocating customer assignments
Allocation methods
Delivery and payment /settlement date
FINRA Rule 2360(b)(23)(C)—Allocation of exercise assignment notices

3.2.2 Tender of Exercise Notices

Equity options
- Effect of exercise prior to ex-dividend date
- Time limitations
- Same day exercise
- Exercise by exception
- Automatic exercise
- Contrary exercise advice

Index options
Foreign currency options
FINRA Rule 2360(b)(23)—Tendering procedures for exercise of options

3.3 Transaction Review and Settlement Procedures

- **Understand the settlement procedures, *e.g.*, prompt receipt and delivery, affirmative determination, denominations of delivery, assignments, ex-dividend transactions, etc.**
- **Ensure proper documentation is obtained for settlement**
- **Ensure proper handling of customer requests to transfer accounts**

3.3.1 Transaction Review

Contract adjustments
Position adjustments
Trade adjustments form
Types of errors
- Account type errors (firm/customer)
- Trade type error (open/close)

FINRA Rule 11890—Clearly Erroneous Transactions

3.3.2 Settlement and Delivery Practices

3.3.2.1 Delivery requirements
- FINRA Rule 2360(b)(23)(D)—Delivery and payment

3.3.2.2.1.1.1 Account transfer requirements
- FINRA Rules
  - Rule 2140 - Interfering with the transfer of customer accounts in the context of employment disputes
  - Rule 11870—Customer account transfer contracts

4.0
Qualification and Business Conduct of Registered Options Representatives; Reporting and Recordkeeping Requirements

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4.1.1 NASD Qualification and Registration Requirements

4.1.1.1 Rule 1022(f)—Limited principal—registered options and security futures
4.1.1.2 Rule 1022(g)—Limited principal—general securities sales supervisor
4.1.1.3 Rule 1032(a) General securities representative
4.1.1.4 Rule 1032(d)—Limited representative—options and security futures
4.1.1.5 Rule 1032(e)—Limited Representative—corporate securities
4.4.1.6 Rule 1080–Confidentiality of examinations

4.1.2 Special Registration Review for Disciplinary History

4.1.2.1 Statutory Disqualification
FINRA By-Laws
Article 3 Sec.4—Definition of disqualification

4.1.3 Continuing Education for Registered Persons

4.1.3.1 Regulatory element
FINRA Rule 1250 —Continuing Education Requirements

4.1.3.2 Firm element
FINRA Rule 1250 —Continuing Education Requirements

4.2 Conduct of Associated Persons

4.2.1 Insider Trading
Insider Trading and Securities Fraud Enforcement Act of 1988
Section 3—Civil penalties of controlling persons for illegal insider trading by controlled persons

4.2.2 Securities Exchange Act of 1934
Section 15(f)—Registration and regulation of brokers and dealers – written policies and procedures relating to misuse of material, non-public information
Rule 10b-5—Employment of manipulative or deceptive devices
Rule 10b5-1—Trading on the basis of material nonpublic information in insider trading cases
Rule 10b5-2—Duties of trust or confidence in misappropriation insider trading cases

4.2.3 FINRA Rules
Rule 5130—Restrictions on the Purchase and Sale of Initial Equity Public Offerings
Rule 3240— Borrowing From or Lending to Customers

Rule 3270 – Outside Business Activities of Registered Persons
Rule 3310- Anti-Money Laundering Compliance Program

Conduct Rules

FINRA Rule 2110—Standards of commercial honor and principles of trade
FINRA Rule 2150 Customers' Securities or Funds
Rule 2330(e)—Prohibition against guarantees
Rule 2330 (f)—Sharing in Accounts; Extent Permissible
NASD Rule 3010–Supervision
NASD Rule 3040–Private securities transactions of an associated person
Definitions
Private securities transaction
Selling compensation
NASD Rule 3050—Transactions for or by associated persons

4.3 Customer Complaints

- **Document and report customer complaints**
- **Understand firm and SRO reporting requirements**
- **Ensure that options related complaints are forwarded to the registered representative's supervisor immediately**

4.3.1 Handling Customer Complaints and Reporting Requirements

Must be kept in a central file/log
Branch offices must forward complaint to the central file no later than 30 days after receipt
Maintain a copy at the branch office
FINRA Rule
Rule 4513—Records of Written Customer Complaints
Rule 4530—Reporting Requirements

4.4 Disciplinary Proceedings and Arbitration/Mediation

- **Understand the consequences of failure to comply with industry regulations**
- **Understand the effect of signing a pre-dispute arbitration clause**
- **Understand matters subject to arbitration**
- **Understand the difference between arbitration and mediation processes**

4.4.1 FINRA Rules—Investigations, Sanctions and disciplinary proceedings

Rule 8000—Investigations and sanctions
Rule 8210—Provisions of information and testimony and inspection and copying of books
Rule 8310—Sanction for violation of the rules
Rule 8320—Payment of fines, other monetary sanctions, or costs; summary action for failure to pay

4.4.2 FINRA Rules—Code of Procedure

Rule 9200 Series—Disciplinary proceedings
Rule 9300 Series—Review of disciplinary proceeding by National Adjudicatory Council and NASD Board; application for Commission review

4.4.3 FINRA Rules—Arbitration and Mediation Procedures

Rule 2263 – Arbitration Disclosure to Associated Persons Signing or Acknowledging Form U4
Rule 10100—Administrative provisions
Rule 10200—Industry and clearing controversies
Rule 10300—Uniform code of arbitration
Rule 10400—Mediation rules

4.5 Recordkeeping and Reporting Requirements

- **Understand firm and regulatory requirements regarding review of correspondence, complaints and records**
- **Comply with all document retention requirements, including any action taken**

4.5.1 Books and Records

4.5.1.1 FINRA Rules

Rule 2360(b)(17)—Maintenance of records
Rule 4510 Series—Books and Records Requirements

4.5.1.2 Securities Exchange Act of 1934

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—Financial record keeping and reporting of currency and foreign transactions

SAMPLE QUESTIONS

The questions that appear on the following pages are similar in format and content to questions on the examination. These sample questions, however, are not intended to exactly parallel either the level of difficulty or the subject coverage of the actual examination. The purpose here is to acquaint candidates and training personnel with the types of multiple-choice questions which will appear on the examination.

Answers

1. (D)
2. (B)
3. (C)
4. (C)

Questions

1. When XYZ commences trading "ex" a 5% stock dividend, what will be (a) the adjusted exercise price and, (b) the adjusted number of shares, for the XYZ July 50 contracts held on ex-date?

(A) (a) 50 and (b) 100
(B) (a) 50 and (b) 105
(C) (a) 47 5/8 and (b) 95
(D) (a) 47 5/8 and (b) 105

2. A customer with no other cash or securities in the account sells one XYZ Jul 100 call for 10 and buys 100 shares of XYZ at $105 per share. What is the market price per share of XYZ stock at which the customer breaks even?

(A) $90
(B) $95
(C) $110
(D) $115

3. How long must advertisements, market letters, and sales literature, issued by a member firm, pertaining to listed options be retained and readily available for inspection?

(A) 6 months
(B) 1 year
(C) 3 years
(D) 5 years

4. A customer buys I XYZ Oct 50 put at a premium of $7 and subsequently exercises the put with stock purchased at $40 per share. For Federal income tax purposes, the sale proceeds upon exercise of the put are equal to

(A) $3,300
(B) $4,000
(C) $4,300
(D) $5,000