Government Securities Limited Representative Qualification Examination (Test Series 72)

Study Outline

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Introduction

The Government Securities Limited Representative Qualification Examination (Series 72) is used to qualify persons seeking registration with FINRA under FINRA By-Laws Article III, Section 2 and Rule 1032(f). Registered representatives in this limited category of registration are permitted to transact a member's business in government securities, agency securities, and agency-backed mortgage securities. This category, by itself, does not allow a registered representative to transact a member's business in options on government securities. Candidates seeking to conduct transactions in this latter product must also register as registered options representatives.

This study outline has been prepared to assist member firms in preparing candidates to sit for the Series 72 Examination. It may be used to structure or prepare training material and develop lecture notes and seminar programs, as well as a training aid for the candidates themselves. The outline and the test are divided into the six sections, which are listed below along with the number of questions devoted to each section.

Section	Description	Number of Questions
1	Government Securities	22
2	Mortgaged-Backed Securities	25
3	Related Securities and Financial Instruments	9
4	Economic Activity, Government Policy and the Behavior of Interest Rates	13
5	Securities Industry Regulations and Legal Considerations	15
6	Customer Considerations	16
Total		**100**

Structure of the Examination

The examination is composed of 100 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 3 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.

Information about qualifications exams may be found at
www.finra.org/Industry/Compliance/Registration/QualificationsExams/RegisteredReps/Qualifications/index.htm

There are also sample Series 72 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 72 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.

1.0
Government Securities

1.1 Types and characteristics of Government Securities

1.1.1 Direct Obligations of the U.S. Treasury

1.1.1.1 Treasury securities — Benchmark that is the source of credit, marketability and liquidity for other financial markets

- Full faith and credit of the United States
- Treasury bills
- Treasury notes
- Treasury bonds
- Separate Trading of Registered Interest and Principal of Securities (STRIPS)
- Treasury inflation-indexed securities (also referred to as TIPS)

1.1.1.2 Non-marketable Treasury instruments

- United States Savings Bonds (Series EE and I)
- SLGS (State and Local Government Series)

1.1.2 Agency Securities - As a group, second only to Treasury securities for credit quality

1.1.2.1 General characteristics

- Provide selected sectors of the economy with funding, capital or liquidity
- May or may not be a direct obligation of the U.S. Government
- Marketability and liquidity vary from issue to issue
- Some issuers may be referred to as Government sponsored entities or GSE

1.1.2.2 Agencies with securities having explicit backing (full faith and credit) of the U.S. Government

- Government National Mortgage Association (GNMA or Ginnie Mae)
- Private Export Funding Corporation (PEFCO)
- Small Business Administration (SBA)

1.1.2.3 Agencies with securities that do not have explicit backing of the U.S. Government

- Federal Agricultural Mortgage Corporation (FAMC or Farmer Mac)
- Federal Farm Credit Banks (FFCB)
- Federal Home Loan Banks (FHLB)

Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac)
Federal National Mortgage Association (FNMA or Fannie Mae)
Financing Corporation (FICO)
Resolution Funding Corporation (Refcorp)
Tennessee Valley Authority (TVA)

1.1.2.4 Types of issued Agency securities
- Debentures
- Discount notes
- Global issues
- Medium-term notes
- Structured notes
- Reference notes (benchmark securities)

1.1.3 Stripped Securities
- Definition
- Features
- Mechanics of creating and trading
- Types
  - Treasury STRIPS (Separate Trading of Registered Interest and Principal of Securities)
  - Agency stripped securities

1.1.4 Maturity and Denominations of Various Government Securities

1.1.5 Call Provisions
- Continuous call provisions
- Discrete call provisions
- One-time-only calls

1.1.6 Interest Payment Methods
- Frequency of payment
- Fixed
- Discount
- At maturity
- Variable
- Floater: indexed to
  - Treasury bills
  - CMT (Constant Maturity Treasury)
  - LIBOR (London Interbank Offered Rate)
- Inverse floater
- Indexed notes and bonds
- Step ups
- Interest rate floor and/or caps

1.1.7 Methods of Quotation

- Current yield
- Day count method
- Discount basis/Bond equivalent yield
- Dollar price
- Money market equivalent yield
- Option adjusted spread (OAS)
- Quotation services
- Quotations vs. firm market
- Value of a basis point (.0001 or .01%)
- Yield to call
- Yield to maturity
- Yield/spread relationship

1.1.8 Methods of Settlement and Delivery

- Settlement
  - Regular
  - Cash
  - When issued
  - Delayed
    - Corporate settlement
    - Skip Day
- Accrued interest
- Financing positions under delayed settlement
- Forms of delivery
  - Book entry only
  - Fully registered

1.2 The Market for Government Securities

1.2.1 Participants in the Market and the Role of Each

- Federal Reserve
- Primary dealers
- Government securities dealers
- Government securities brokers and inter-dealer brokers
- Investors, retail and institutional

1.2.2 Functions of a Trader

- Financing the trading position
  - Bank financing
  - Repurchase Agreements (REPOs)
  - Securities borrowing and lending
- Give quotes
- Hedging/arbitrage
- Make markets
- Position trading

Securing collateral for delivery/reverse repos
Supply information to salespersons

1.2.3 New Issues

1.2.3.1 U.S. Treasury auction process
- Treasury announcement
- Types and mechanics of bids
  - Competitive
  - Non-competitive
  - Treasury direct
  - Basis of awards/prorating of awards
  - Limitations on auction awards
- Types of auctions
  - Standard
  - Dutch
- Reopening of existing issues

1.2.3.2 Primary market for Agency securities
- Selling group
  - Discount note program
  - Debenture program
- Negotiated
  - Reverse inquiry
  - Dealer reallowance
  - Concession
- Competitive bidding

1.2.4 The Secondary Market

1.2.4.1 Kinds of transactions
- Principal
- Agent

1.2.4.2 When-issued trading
- Pre-auction trading of Treasury securities
- Post-auction trading of Treasury securities
- Forward/reverse roll trading

1.2.4.3 Methods of comparing bond prices
- Bids vs. offers
  - Round lot/odd lot
- Duration
- Expression of dollar price/yield
- Yield to call
- Yield to maturity

2.0
Mortgage-Backed Securities

2.1 Development/Evolution of Mortgage-Backed Securities

2.1.1 The Underlying Mortgages

2.1.1.1 Definition of mortgage loan
- Collateralized by real estate
- Monthly amortization

2.1.1.2 Traditional mortgage lenders — the institutions that make the loans
- Commercial banks
- Mortgage bankers
- Savings and loan associations

2.1.1.3 Types of mortgage loans
- Commercial
- Project loans
- Residential
  - Conforming vs. non-conforming
  - Conventional
  - FHA/VA
  - Manufactured housing (mobile homes)
  - Multi-family residential (5 or more units)
  - Single-family residential (1 to 4 units)
  - Whole loan

2.1.1.4 Characteristics of mortgage loans
- Adjustable rate (ARM)
  - Caps and floors
    - Periodic
    - Lifetime
  - Convertible vs. nonconvertible
  - Indexed to
    - COFI (Cost of Funds Index)
    - CMT (Constant Maturity Treasury)
    - LIBOR (London Interbank Offered Rate)
  - Initial rates, “teaser rates”
  - Reset parameters
    - Payment reset
    - Interest rate reset
  - Assumable vs. non-assumable
- Fixed rate
- Loan size

Maturities
30-year (fully amortized)
20-year (fully amortized)
15-year (fully amortized)
7-year (balloons)
5-year (balloons)
Others (*e.g.*, 10-year, 20-year, interest only and graduated payments)
Underwriting standards (loan-to-value [LTV] ratio and underwriting ratios)
Mortgage amortization

2.1.2 Securitization of the Mortgages

2.1.2.1 Purposes
Facilitate issuance of mortgages
Meet legislative intent to provide housing
Provide capital for the mortgage industry and liquidity to the housing market

2.1.2.2 Creating pass-through securities
Pooling process
Originator
Seller
Servicer
Paying agent

2.2 Mortgage-Backed Securities — Types, Structure and Features

2.2.1 Pass-Through Securities or Participation Certificates (PC) in a Securitized Pool of Mortgages

2.2.1.1 Ginnie Mae Full Modified Pass-Through Mortgage-Backed Certificates(GNMA I and GNMA II)— composed of VA-guaranteed or FHA insured mortgages
30-year
15-year (midgets)
Adjustable rate mortgages (ARMs)

2.2.1.2 Fannie Mae (FNMA) Mortgage Pass-Through Certificates — composed of qualifying FNMA conventional residential mortgages or some FHA insured mortgages
30-year
15-year (dwarfs)
7-year (balloons)
Adjustable rate mortgages (ARMs)

2.2.1.3 Freddie Mac (FHLMC) Participation Certificates — composed of qualifying FHLMC conventional residential mortgages (Gold PCs and non-Gold PCs)

- 30-year
- 15-year (gnomes)
- 7-year (balloons)
- 5-year (balloons)
- Adjustable rate mortgages (ARMs)

2.2.1.4 Private label

- Underlying mortgages not guaranteed by FNMA, FHLMC or GNMA
- Structures (senior/subordinate, etc.)
- Credit rating

2.2.2 Structured Mortgage Products — Collateralized Mortgage Obligations (CMOs) and Real Estate Mortgage Investment Conduits (REMICs)

- Purpose for creation of CMOs and REMICs
- Private label vs. agency
- Investor preference for specified average life
- Yield curve arbitrage
- Trustees handle all legal documentation and processes for the structure
- Ginnie Mae (GNMA) REMIC Pass-Through Securities
- Fannie Mae (FNMA) REMIC Pass-Through Certificates
- Freddie Mac (FHLMC) Multi-Class Mortgage Participation Certificates

2.2.3 Stripped Mortgage-Backed Securities

- Interest only (IO)
- Principal only (PO)

2.3 Characteristics of Mortgage-Backed Securities

2.3.1 Characteristics Common to All Mortgage-Backed Securities

- Backed by real property
- Credit ratings
- Current face/amortized value
- Factor
- Fixed or floating rate securities
- Maturity profile
  - Average life
  - Stated or final maturity
- Original face value
- Payment delay and payment date
- Pool or series number
- Prepayment of principal
- Trade in the over-the-counter market (OTC)

2.3.2 Unique Characteristics of Specific Mortgage-Backed Securities

2.3.2.1 CMOs and REMICs
- Guarantees (credit quality)
- Payment dates
- Minimum investments
- Classes ("tranches"), such as:
  - Callable
  - Companion/support
  - Floating rate
  - Interest only (IO)
  - Inverse floaters
  - Planned amortization class (PAC)
  - Principal only (PO)
  - Residuals
  - Sequential (plain vanilla)
  - Targeted amortization class (TAC)
  - Z-tranches (accretion bonds or accrual bonds)

2.3.2.2 Pass-through securities (the "collateral market")
- Guarantees
- Minimum investments
- Payment dates/stated delay
- Principal repaid monthly

2.3.2.3 Various coupon/maturity terms
- Weighted average maturity (WAM)
- Weighted average coupon (WAC)
- Weighted average loan age (WALA)

2.3.3 Impact of Interest Rate Changes on Prepayments
- Effect on average life
  - Accelerated prepayment of principal
  - Decelerated prepayment of principal
- Effect on value or price

2.4 The Mortgage-Backed Securities Market

2.4.1 Participants in the Market
- Dealers — primary, secondary
- Federal agencies
- Investors — individual, institutional

2.4.2 The Distribution Process and Secondary Trading

2.4.2.1 Initial distribution
- Pass-through securities — the securitization process is the primary market
- Structured mortgage products (CMOs and REMICs)
- Offering circular

2.4.2.2 The secondary market

2.4.2.2.1 Kinds of transactions
- Principal
- Agent

2.4.2.2.2 Functions of a trader
- Finance the trading position
  - Dollar rolls
  - Bank financing
  - Repos
- Give quotes
- Hedging/arbitrage
- Make markets
- Position trading
- Supply information to salespersons

2.4.2.2.3 Form of trading
- To Be Announced (TBA) trading
  - Direct standard agreement between buyer and seller
  - Contract specifies amount, bond price and delivery date
  - Credit risk/counter party
- Trading of specified pools

2.4.2.2.4 Mechanics of pricing
- Bids vs. offers
- Components of dollar price
- Credit rating
- Determination of yield
- Expression of dollar price /yield
- Identification of pool number
- Knowledge of issue size
- Prepayment speed assumption
- Quotations vs. firm market
- Round lot/odd lot
- Spread relationships

2.4.3 Methods of Comparing Mortgage-Backed Securities

- Application of volatility measures
  - FFIEC — Federal Financial Institutions Exam Council
  - FLUX — Flow Uncertainty Index
- Cash flow spread vs. forward curve
- Cash flow spread vs. spot curve
- Convexity/negative convexity
- Duration
  - Modified
  - Effective
- Geographic distribution
- Indices, resets, caps and floors for floating-rate tranches
- Measuring prepayments
  - Constant Prepayment Rate (CPR)
  - Public Securities Association (PSA) prepayment model
  - Single Monthly Mortality (SMM)
- Option adjusted spread (OAS)
- Priority of cash flows
- Single prepayment rate vs. vector of prepayment rates
- Spread to Treasury curve based on comparable average life
- Timing of cash flows
  - Lock-out period
  - Window period
- Total return
- Use of WAM, WAC, WALA
- Volatility
- Yield to maturity
- Yield on discounted cash flow
- Yield to average life

2.4.4 Methods of Settlement and Delivery

2.4.4.1

- Pass-through securities
  - PSA settlement calendar
  - Delivery of specified pool
  - To be announced (TBA) good delivery
  - 48 hour pool notice
    - Allocation procedures
    - Pool substitution cut-off time
  - Forms of delivery
    - Book entry at the Fed
    - Depository Trust Clearing Corp. (DTC)
    - Physical

2.4.4.2 REMICs and CMOs

- Settlement
  - Regular way (T+3)
  - As otherwise specified
  - Blackout period/due bills
- Delivery
  - Book-entry
  - DTC

3.0
Related Securities and Financial Instruments

3.1 Money Market Instruments

3.1.1 Commercial Paper

- Issuer placed vs. dealer-placed paper
- Maturities (1 day to 270 days)
- Secondary market trading
- Ratings
  - Moody's Investor Services
  - Standard & Poors Corporation
  - Fitch
- Credit supported commercial paper
  - Letter of credit
  - Surety bond
- Asset-backed commercial paper
- Interest bearing/discount

3.1.2 Bankers Acceptances

- Creation of banker's acceptances
- Credit risk
- Issued by domestic or foreign bank
- Issued at a discount
- Maturities (180 days or less)
- Secondary market trading

3.1.3 Certificates of Deposit (CDs)

- Brokered CDs
  - FDIC Insurance
- Methods of calculating interest
- Negotiable/ Jumbo CDs
  - Domestic CDs
  - Eurodollar CDs
  - Yankee CDs
- Secondary market trading
- Settlement
- Various maturities

3.1.4 Repurchase Agreements (Repos) and Reverse Repurchase Agreements

- Types and Maturities
  - Overnight Repo
  - Open Repo/TFN (until further notice)
  - Term Repo
- Collateral

Types of collateral restrictions
Maturity of collateral restrictions
Haircut
Pricing collateral
Short squeeze/“special”
Rights of substitution
Tri-party Repo agreement
Matched/mismatched book
Mark to market
PSA agreement
Settlement

3.2 Other Instruments Affecting the Government Securities Market

3.2.1 Federal Funds

Definition
Fed funds rate
Market/participants
Purpose

3.2.2 Asset-Backed Securities (ABS)

3.2.2.1 Major types
Auto loans
Credit cards
Home equity loans
Collateralized debt obligations (CDOs)
Collateralized loan obligations (CLOs)

3.2.2.2 Impact on the government securities market

3.2.3 Interest Rate Futures

3.2.3.1 Types traded on exchanges
Eurodollar time deposit futures contracts
Credit risk
Euro strips contracts
Treasury Eurodollar (TED) spread
Fed funds futures
Treasury bill futures contracts
Two-year Treasury note futures contract
Five-year Treasury note futures contract
Ten-year Treasury note futures contracts
Treasury bond futures contracts

3.2.3.2 Characteristics

- Actively traded
- Agreement between buyer/seller and an established futures exchange or its clearing house
- Contract specifies that buyer/seller take or make delivery of bonds or cash, at a specified price, at a designated time
- Mark to market
- Safety net characteristics, *i.e.*, exchange protection factors and procedures
- Various expiration dates

3.2.3.3 Pricing

- Basis trading
- Conversion factor
- Terms of contract quotation

3.2.3.4 Impact on the government securities market

- Open interest
- Liquidity

3.2.4 Options on Government Securities

3.2.4.1 Types

- Options on cash instruments
- Options on futures

3.2.4.2 Flexibility of over-the-counter options vs. exchange-traded options

3.2.4.3 Definitions and terminology

- American vs. European style
- At-the-money (ATM)
- Call
- Covered options
- Expiration date
- Implied volatility
- In-the-money (ITM)
- Intrinsic value
- Option
- Out-of-the-money (OTM)
- Premium
- Put
- Strike price
- Time value

4.0
Economic Activity, Government Policy, And The Behavior of Interest Rates

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4.1 Fiscal Policy

4.1.1 Federal Budgetary Practices and Their Impact on the Money and Capital Markets

Federal deficits and surpluses — effects on the economy as a result of changes in fiscal policy
Taxation and spending — effects of congressional or executive authority to raise/lower federal taxes and/or spending
Multiplier effect of government taxing and spending
Lag effects on the economy of government action
Automatic stabilizers — effects in cushioning economic swings
- Changes in private savings rates
- Welfare transfer payments

4.1.2 U.S. Treasury Debt Management Practices

Impact of short-term and long-term financing
Increase/decrease in amounts borrowed
Impact on the average life of debt
Regularity of debt issuance

4.1.3 Effects of Fiscal Policy on the Economy

4.1.3.1 Cyclical expansion
- Effects of tax cuts
- Increased government spending
- Transfer payments

4.1.3.2 Structural contraction
- Effects of tax increases
- Decrease of government spending

4.2 Monetary Policy

4.2.1 Objectives of Federal Reserve Monetary Policy

Price stability
Long-term economic growth in an environment of low inflation (*i.e.*, an inflation rate such that economic plans are not impacted by inflationary expectations)
Low unemployment rate
Steady non-inflationary growth
Humphrey-Hawkins Act

4.2.2 Major Factors Influencing Federal Reserve Monetary Policy

- Economic indices
- Inflation signals and pressures
- Rate of capital formation and investment
- Foreign exchange considerations

4.2.3 Operations of the Federal Reserve

- Role of the Board of Governors
- Role of the Federal Open Market Committee (FOMC)
- Role of the Open Market Trading Desk

4.2.4 Operating Tools Used for Implementing Federal Reserve Policy

- Open market operations
  - Adding and draining reserves (Repos and Reverse Repos)
  - Purchase and sale of securities
- Discount window
- Reserve requirements
  - Federal funds market

4.3 Behavior of Interest Rates

4.3.1 Supply and Demand for Credit Relative to the Business Cycle

- Definition and characteristics of the business cycle
- Public vs. private borrowing needs

4.3.2 Definition and Impact of Economic Indicators

- Business inventories
- Consumer confidence
- Consumer credit
- Consumer Price Index (CPI)
- Gross Domestic Product (GDP)
- Employment Cost Index (ECI)
- Employment data
- Existing home sales
- Housing starts and permits
- Industrial production
- Merchandise trade balance
- National Purchasing Managers Survey (NAPM)
- New home sales
- Producer Price Index (PPI)
- Retail sales
- Weekly jobless claims

4.3.3 Yield Curve Analysis

- Expectations of Fed policy moves and investor positioning on the curve

Impact of economic and financial conditions on shape of the yield curve

4.3.4 Technical Analysis — Definitions

Breakouts
Moving averages
Overbought
Oversold
Resistance levels
Support levels

4.4 Effects of International Factors on the U.S. Treasury Market

4.4.1 Currency Valuation

Appreciation
Depreciation
Exchange rate of U.S. dollar vs. other currencies

4.4.2 Balance of Payments

Current account surpluses/deficits
Impact of foreign monetary and fiscal policy on U.S. rates
Trade surpluses/deficits

5.0
Securities Industry Regulations and Legal Considerations

5.1 Applicable Federal Laws and SEC Rules Thereunder

5.1.1 Securities Act of 1933

Purpose
Section 3 — Government securities exempted from registration
Section 17 — Fraudulent interstate transactions

5.1.2 Securities Exchange Act of 1934

5.1.2.1 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)(12) — Exempted security
- Section 3(a)(41) — Mortgage related security
- Section 3(a)(42) — Government securities
- Section 3(a)(43) — Government securities broker
- Section 3(a)(44) — Government securities dealer
- Section 3(a)(45) — Person associated with a government securities broker or dealer

5.1.2.2 Section 9 — Prohibitions against manipulation of security prices
- Section 9(a)(1) — Misleading appearance of active trading
- Section 9(a)(2) — Inducing purchase or sale by others
- Section 9(a)(3) — Dissemination of information as to rise or fall of security prices
- Section 9(a)(4) — Making false or misleading statements
- Section 9(a)(5) — Dissemination of information for consideration
- Section 9(a)(6) — Pegging, fixing, or stabilizing prices
- Section 9(e) — Liability for unlawful acts or transactions

5.1.2.3 Section 10 — Regulation use of manipulative and deceptive devices
- Rule 10b-3 — Employment of manipulative and deceptive devices (by brokers or dealers)
- Rule 10b-16 — Disclosure of credit terms in margin transactions

5.1.2.4 Section 15(c)(2) — Fraudulent acts or practices and fictitious quotations
- Rule 15c1-2 — Fraud and misrepresentation
- Rule 15c1-3 — Misrepresentation by brokers and dealers as to registration
- Rule 15c2-1 — Hypothecation of customers' securities

5.1.2.5 Section 15C — Government securities brokers and dealers

- Antifraud provisions applicable to issuers as well as to government securities brokers and dealers
- Amendments of 1986 (the Government Securities Act of 1986)
  - Registration of government securities brokers and dealers with the SEC
  - Regulators
    - Treasury Department
    - Securities and Exchange Commission
    - Federal Reserve Bank of New York
    - FINRA
- Amendments of 1993 — Registration/qualification of government securities dealer personnel (only qualified to sell securities issued by the U.S. Government and its agencies; not qualified to sell private label CMOs and REMICs)

5.1.2.6 SEC Regulation S-P — Privacy of consumer financial information

- Treatment of nonpublic personal information about consumers by financial institutions

5.1.3 Insider Trading Regulations

5.1.3.1 Insider Trading and Securities Fraud Enforcement Act of 1988

- Section 3 — Civil penalties of controlling persons for illegal insider trading by controlled persons
- Section 4 — Increases in criminal penalties
- Section 5 — Liability to contemporaneous traders for insider trading

5.1.3.2 Securities Exchange Act of 1934 and SEC Rules Thereunder

- Rule 10b-5 — Employment of manipulative and deceptive devices
  - Insider trading
  - Material information
  - Non-public information
  - Insiders and tippees
- Rule 10b5-1 — Trading “on the basis of” material nonpublic information in insider trading
- Rule 10b5-2 — Duties of trust or confidence in misappropriation insider trading cases

5.1.4 Customer Confirmations

- SEC Rule 10b-10—Confirmations
- FINRA Rule 2232—Customer Confirmations

5.1.5 Books and Records

5.1.5.1 Securities Exchange Act of 1934 and SEC Rules Thereunder

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 Recordkeeping and Reporting of Currency and Foreign Transactions

17f-1 — Requirements for Reporting and Inquiry With Respect to Missing, Lost, Counterfeit or Stolen Securities

5.1.5.2 Books and Records Rules

FINRA Rules

Rule 2268 - Requirements When Using Predispute Arbitration Agreements for Customer Accounts

Rule 4513 – Records of Written Customer Complaints

Rule 4514 – Authorization Records for Negotiable Instruments Drawn From a Customer's Account

NASD Rule 3110(i) - Holding of Customer Mail

5.2 Treasury Department Regulations Governing the Issuance, Sale and Settlement of Government Securities (31 CFR)

5.2.1 Descriptions of Securities (Part 356.5 — all securities with the same CUSIP number are considered the same security)

5.2.2 Bidding, Certifications and Payment (Subpart B)

Noncompetitive and competitive bidding (Section 356.12)

Net long position (Section 356.13)

Submitting bids for customers (Section 356.14)

Certifications (Section 356.15)

Required notification to the Fed (Section 356.24d)

5.2.3 Large Position Reporting Requirement (Section 420)

5.3 FINRA/NASD Rules

5.3.1 FINRA By-Laws

Article III — Qualifications of members and associated persons

Section 4 — Definition of disqualification

Article V — Registered representatives and associated persons

Section 4 — Retention of jurisdiction

Article VII — Powers and authority of the Board of Governors

Section 2 — Authority to cancel or suspend for failure to submit required information

Article XII — Disciplinary proceedings

Article XIII — Powers of Board to impose sanctions

5.3.2 Membership and Registration Rules

NASD Rule 1021(b) — Definition of principals
NASD Rule 1030 — Registration of Representatives
NASD Rule 1031 – Registration Requirements
NASD Rule 1032 - Categories of Representative Registration
General securities representative
Limited representative — government securities
NASD Rule 1041 — Registration Requirements for Assistant Representative
NASD Rule 1060 — Persons exempt from registration
NASD Rule 1080 — Confidentiality of examinations
FINRA Rule 1250 — Continuing Education Requirements

5.3.3 Conduct Rules

5.3.3.1 FINRA Rule 2010 — Standards of commercial honor and principles of trade

5.3.3.2 FINRA Rule 2020 — Use of manipulative, deceptive or other fraudulent devices

5.3.3.3 FINRA Communication With the Public Rules
Rule 2214 – Requirements for the Use of Investment Analysis Tools
Rule 2216 – Communications with the Public About Collateralized Mortgage Obligations (CMOs)

5.3.3.4 FINRA Rule 2210 – Communications with the Public

5.3.3.5 FINRA Rule 3230— Telemarketing

5.3.3.6 FINRA Rule 2269 — Disclosure of Participation or Interest in Primary or Secondary Distribution

5.3.3.7 FINRA Rule 2261 — Disclosure of Financial Condition
Requirement to furnish most recent report of the firm's financial condition

5.3.3.8 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
NASD Rule 2330 — Customers' securities or funds

5.3.3.9 NASD Rule 2340 — Customer account statements
Requirement to send customers monthly and/or quarterly statements on account activity

5.3.3.10 FINRA Rule 3240 — Borrowing From or Lending To Customers

5.3.3.11 NASD Rule 2420 — Dealing with non-members

5.3.3.12 NASD Rule 2440 — Fair prices and commissions
Yield burning

IM-2440-2 — Additional mark-up policy for transactions in debt securities, except municipal securities

5.3.3.13 FINRA Rule 4210 — Margin Requirements
Government securities marginable

5.3.3.14 FINRA Rule 5130 — Restrictions on the purchase and sale of initial equity public offerings

5.3.3.15 NASD Rule 3010 — Supervision
Supervisory system
Written procedures
Written approval
Taping rule
Definitions
Office of supervisory jurisdiction
Branch office

5.3.3.16 FINRA Rule 2060— Use of Information Obtained in Fiduciary Capacity

5.3.3.17 FINRA Rule 3310— Anti-Money Laundering Compliance Program

5.3.4 Responsibilities Relating to Associated Persons, Employees, and Other's Employees

FINRA Rule 3270 — Outside Business Activities of Registered Persons
NASD Rule 3040 — Private securities transactions
Applicability
Written notice
Transactions for compensation
Transactions not for compensation
Definitions
NASD Rule 3050 — Transactions for or by associated persons
FINRA Rule 3220 — Influencing or rewarding employees of others
FINRA Rule 4530 — Reporting Requirements
FINRA Rule 2263 — Arbitration Disclosure to Associated Persons
Signing or Acknowledging Form U4

5.3.5 Trading

FINRA Rule 5210 — Publication of Transactions and Quotations
FINRA Rule 5220 — Offers at Stated Prices
FINRA Rule 5310 — Best Execution and Interpositioning

5.3.6 FINRA Procedural Rules

5.3.6.1 Complaints, investigations and sanctions
Rule 8110 — Availability of Manual to customers
Rule 8120 — Definitions
Rule 8310 — Sanctions for violation of the rules
Rule 8320 — Payment of fines, other monetary sanctions, or costs; summary action for failure to pay
Rule 8330 — Costs of proceedings

5.3.6.2 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 9800—Temporary cease and desist orders

5.3.6.3 Code of Arbitration Procedure

5.3.6.3.1 Part I — Interpretive Material, Definitions, Organization and Authority

IM-12000 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

5.3.6.3.2 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
Rule 13202—Claims involving registered clearing agencies

5.3.6.3.3 Part VIII — Simplified Arbitration and Default Proceedings

Rules 12800 and 13800 — Simplified arbitration
Rules 12801 and 13801 — Default proceedings

5.3.6.4 Rule 14000 — Code of Mediation Procedure

5.4 Securities Investor Protection Act of 1970

5.4.1 Customer Claims

Definition of "separate customer"
Maximum limit on claims for securities
Maximum limit on claims for cash
Valuation of claims
Submission of claims to trustee

5.4.2 SIPC vs. FDIC coverage

General securities firms covered/government securities broker/dealers not covered
Requirement for government securities broker/dealers to disclose their customers are not covered by SIPC — ‘34 Act, 15C(a)(4)

6.0
Customer Considerations

6.1 Customer Accounts

6.1.1 Opening Customer Accounts

6.1.1.1 Account documentation
- Books and Records Rules
  - FINRA 4512 - Customer Account Information
  - FINRA 4515 – Approval and Documentation of Changes in Account Name or Designation
- Customer name and residence
- Whether of legal age
- Reasonable effort to obtain:
  - Tax identification or social security number
  - Occupation of customer and name and address of employer
  - Whether associated person of another FINRA member
- Discretionary account information
  - Name and signature of person(s) authorized to exercise discretion
  - NASD Rule 2510 — Discretionary accounts
  - FINRA Rule 3250 — Designation of accounts

6.1.1.2 Supplementary documentation — definitions
- Credit agreement
- Credit terms disclosure
  - Evidence of authority for:
    - Corporate accounts
    - Partnership accounts
    - Trust accounts
    - Fiduciaries/administrators
    - Investment advisor
- Hypothecation agreement
- Joint account agreement form
  - Joint tenants with right of survivorship
  - Tenants in common
- Loan consent agreement
- Power of attorney
  - Limited authorization
  - Full authorization
  - Discretionary account
  - Joint tenants with rights of survivorship
- W-9 backup withholding form

6.1.1.3 Special requirements for accounts of deceased persons
- Uniform Transfer-on-Death Security Registration Act
- Outstanding orders
  - Cancellation
  - Freeze on assets in account until necessary documents are obtained from administrator or executor of estate

6.1.1.4 Forms of ownership of securities
- Custodial accounts under the Uniform Transfers/Gifts to Minors Act
  - Irrevocability of gift
  - Custodian
  - Shares registered to beneficiary upon attaining majority
- Individual registration
- Joint tenants with right of survivorship
- Tenants in common
- Trust accounts

6.1.1.5 Retirement and tax advantaged plans
- Qualified vs. non-qualified plans
- Rollovers and transfers
- Employer sponsored retirement plans
  - HR10 plans (formerly KEOGH plans)
  - 401(k) plans
  - 403(b) plans
- Individual Retirement Accounts
  - Traditional IRAs
  - Roth IRAs
- ERISA
- Tax advantaged plans
  - 529 college savings plans

6.2 Recommendations to Customers

6.2.1 Investment Objectives of Customers
- Principal appreciation/growth
  - Amount
  - Investment horizon
- Income
  - Current needs
  - Preservation of capital
  - Amount needed in future
    - Accumulation period
    - Payout period

6.2.2 Financial Status of Customers
- Expected changes in financial status
- Income and expenses

Net worth
Participation in benefit plans

6.2.3 Investment Constraints

Ability or willingness to hold investments over relatively long periods
Approximate age of customer
Investment temperament and investment experience
Liquidity and marketability needs
Risk tolerance

6.2.4 FINRA Rule 2111 — Suitability

6.3 Risks and Strategies

6.3.1 Types of Risk

Asset concentration
Call/extension risk
Credit risk
Economic and political risk
Event risk
Inflation
Interest rate risk
Liquidity risk
Market risk
Purchasing power risk
Reinvestment risk

6.3.2 Investment Strategies

Arbitrage techniques
- Barbell
- Butterfly

Dollar cost averaging
Hedged/unhedged positions
Laddering of the portfolio
Market timing
Purchasing on margin
Riding/rolling down the curve
Transactions designed to take advantage of yield differentials in the market

6.4 Account Transactions

6.4.1 Information for Order Entry

Legal requirements (SEC Rule 17a-3)
- Time of entry/execution
- Terms and conditions of the order

Price of execution
If cancelled, a notation to that effect
Whether a discretionary account
Types of orders
Market orders
Specified price orders
AON vs. partial execution

6.4.2 Review Report of Execution against Order Ticket

Report execution to client
Report errors immediately through appropriate firm channels

6.5 Tax Consequences of Securities Transactions

6.5.1 Establishing the Cost Basis of Securities

6.5.2 Determining the Holding Periods of Securities

6.5.3 Tax Treatment of Securities Transactions

Definition of a capital gain/loss
Computation of net capital gains/losses

6.5.4 Wash Sale Rules

Definition of a wash sale
Applicable time period of 30 days prior to and after a sale
Definition of "substantially identical" property

6.5.5 Tax Treatment of Interest Income on U.S. Government and Agency Obligations

Federal taxation
State taxation
Exemption from taxation at state level for direct government obligations and certain agency securities
Other agency securities taxable at state level

6.5.6 Special Tax Features of Securities

Accretion of bond discounts
Accrued interest
Amortization of bond premiums
Original issue discount (OID)

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Sample Question Format

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

Answers

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

1. Which of the following government securities is a direct obligation of the U.S. Treasury?

(A) FHLB
(B) FNMA
(C) SLMA
(D) STRIPS

2. Each of the following is an Agency security EXCEPT:

(A) STRIPS
(B) SLMA
(C) FNMA
(D) FHLB

3. The maximum maturity on a domestic bankers acceptance is:

(A) 30 days
(B) 90 days
(C) 120 days
(D) 180 days

4. Which two of the following are characteristics of Treasury bills?

I. Issued at par
II. Usually very liquid
III. Mature in less than one year
IV. More secure than Treasury bonds

(A) I and III
(B) I and IV
(C) II and III
(D) II and IV

5. If the U.S. balance of payments deficits should decrease, what would be the most likely effect on the dollar and on Treasury bonds?

	Dollar	Bond Yields
(A)	Weaker	Higher
(B)	Stronger	Lower
(C)	Weaker	Lower
(D)	Stronger	Higher