



# **Corporate Securities Qualification Examination (Test Series 62)**

## **Study Outline**

**Copyright © 2007. Financial Industry Regulatory Authority, Inc  
All rights reserved.**

## Introduction

---

The FINRA Corporate Securities Limited Representative Qualification Examination (Series 62) is used to qualify individuals seeking registration with FINRA under By-Laws Article III, Section 2, and the Membership and Registration Rules. Registered representatives in this category of registration may trade common and preferred stocks, corporate bonds, rights, warrants, closed-end investment companies, money-market funds, privately issued mortgage-backed securities, other asset-backed securities, and REITS. This category, by itself, does not allow a registered representative to trade municipal securities, direct participation programs, other securities registered under the Investment Company Act of 1940, variable contracts, nor options. Candidates seeking to trade these latter products must also register in one or more of FINRA's other limited representative categories, or as General Securities Registered Representatives.

This study outline can assist FINRA member firms in preparing candidates to sit for the Series 62 Examination. Members may use it to structure or prepare training material and to develop lecture notes and seminar programs. This outline can also be used by the individual candidate as a training aid. The outline and the test are divided into the four sections listed below along with the number of questions in each section.

<b>Section</b>	<b>Description</b>	<b>Number of Questions</b>
1	Types and Characteristics of Securities and Investments	25
2	The Market for Corporate Securities	40
3	Evaluation of Securities and Investments	14
4	Handling Customer Accounts and Securities Industry Regulations	36
<b>Total</b>		<b>115</b>

### Structure of the Examination

The examination is composed of 115 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 2 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.

Information about qualifications exams may be found at [www.finra.org/Industry/Compliance/Registration/QualificationsExams/RegisteredReps/Qualifications/index.htm](http://www.finra.org/Industry/Compliance/Registration/QualificationsExams/RegisteredReps/Qualifications/index.htm)

There are also sample Series 62 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 62 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.

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

## References

---

### **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

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

John Downes and Jordan E. Goodman  
Barron's Educational Series, Inc.  
250 Wireless Boulevard  
Hauppauge, NY 11788

### **Economics**

Paul A. Samuelson  
McGraw-Hill Book Company  
1121 Sixth Avenue, #383  
New York, NY 10020

### **Financial Analyst Handbook, Vol. I**

Summer N. Levine, Ed.  
Dow Jones-Irwin  
1824 Ridge Road  
Homewood, IL 60430

### **The Handbook of Fixed Income Securities**

F.J. Fabozzi and I.M. Pollacks, Eds.  
Dow Jones-Irwin  
1824 Ridge Road  
Homewood, IL 60430

### **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

### **The Interpretation of Financial Statements**

B. Graham and C. McGolrich  
Harper & Row Publishers, Inc.  
10 East 53rd Street  
New York, NY 10022

### **Introduction to Brokerage Operations Department Procedures**

New York Institute of Finance  
Two Broadway  
New York, NY 1000

### **Modern Securities Transfers**

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

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

William A. Rini  
Simon & Schuster Company  
Two Broadway, 5th Floor  
New York, NY 10004

### **Resales of Restricted Securities**

J. William Hicks  
Clark Boardman Callahan  
375 Hudson Street  
New York, NY 10014

### **Securities Credit Transactions**

#### **Regulations X, T and U**

Board of Governors of the Federal Reserve System  
Constitution Avenue at 20th Street, NW  
Washington, DC 20002

**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

**Securities Transfer Principles and Procedures**

Martin Torosian  
New York Institute of Finance  
Two Broadway  
New York, NY 10004

**The Stock Market, 7th Edition**

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

*Publications available from FINRA at [www.finra.org](http://www.finra.org)*

*FINRA Rules*

*NASD Rules*

*FINRA Notices*

*FINRA Sanctions Guidelines*

*Smart Bond Learning Center*

*Publications available from NASDAQ at [www.nasdaqtrader.com](http://www.nasdaqtrader.com)*

*NASDAQ Manual*

*Head Trader Alerts*

## 1.0

### Types and Characteristics of Securities and Investments

---

#### 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

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 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
    - Origination of warrants
    - Warrant exercise terms
    - Valuation of warrants
    - Warrant leverage
- 1.1.4 American Depositary Receipts/American Depositary Shares Global Depositary Receipts/Global Depositary Shares**
  - 1.1.4.1 Origin and nature of ADRs/ADSs and GDRs and GDSs

Sponsored vs. non-sponsored

- 1.1.4.2 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
- 1.1.4.3 Shareholders' rights to demand delivery of the underlying shares
- 1.1.4.4 Relationship to ordinary shares

### **1.1.5 International Securities**

- 1.1.5.1 Securities denominated in foreign currency versus those denominated in U.S. dollars
- 1.1.5.2 Relationship to ADRs/ADSs and GDRs and GDSs
- 1.1.5.3 Eurobonds

### **1.1.6 Other Investment Vehicles**

- 1.1.6.1 Exchange traded funds (ETFs)
  - Characteristics
  - Suitability
- 1.1.6.2 Real estate investment trusts (REITS)
  - Real Estate Investment Trust Act
  - Organizational requirements
  - Asset composition
  - Sources of income
  - Interest on obligations secured by real property
  - Capital structure
  - Tax requirements of the REIT
- 1.1.6.3 Hedge funds
  - Characteristics
  - Suitability

## **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
  - Call features
- 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 Types of covenants
  - Bond
    - Indenture
    - Financial
    - Default
      - Impact of default covenant
  - Covenant analysis
- 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 bondholders
- 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 condition
    - 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 Equipment trust obligations
    - Protective covenants
  - 1.2.2.4.2 Income bonds
    - Interest paid only if earned
    - Use during reorganizations
    - Long maturities at issuance
  - 1.2.2.4.3 Zero coupon bonds
    - Issued at steep discount from par
    - Reinvestment risk to investor eliminated
    - 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

### **1.2.3 Debt Retirement**

- 1.2.3.1 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
  
- 1.2.3.2 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
  
- 1.2.3.3 Redemption of bonds
  - Prior notice required
  - Partial calls
    - Bonds to be redeemed drawn by lot by trustee
  - Amortization through a sinking fund
  
- 1.2.3.4 Refunding of bonds
  - Direct exchange vs. sale of new issue
  - Refunding prior to maturity
  - Extension of maturity

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

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

- 1.3.1.1 Securitization of mortgages
  - Provide capital for the mortgage industry and liquidity to the housing market
  - Facilitate issuance of mortgages
  - Meet legislative intent to provide housing
  
- 1.3.1.2 Agency issued mortgaged-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)
  
- 1.3.1.3 Corporate-issued mortgage-backed securities
  - Private label

- 1.3.1.4      Structured mortgage products—Collateralized Mortgage Obligations (CMOs) — usually composed of private mortgages not qualified under VA or FHA   Real Estate Mortgage Investment Conduits (REMICs)
  - “Multiple class” with fast/slow pay segments/tranches
  - Payments may be allocated disproportionately among segments/tranches
  - Segments/tranches may take the legal form of debt or shares of beneficial interest
  - REMICs offer certain tax and accounting benefits to issuers
  
- 1.3.1.5      General characteristics of mortgage backed securities
  - Represent undivided interest in a pool of debt obligations or equities
  - Underlying asset documents held by a custodian or trustee
  - Interest and dividend collection serviced by the custodian or trustee
  - Repayment of interest and principal monthly
  - Backed by real property
  - Credit ratings
  - Current face/amortized value
  - 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)
  
- 1.3.1.6      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
  
- 1.3.2      **Other Asset-Backed Securities**
  - Auto loan backed obligations
  - Credit card debt backed securities
  - Home equity loan backed securities
  - Collateralized debt obligations (CDOs)
  
- 1.4      **Investment Companies**
  - 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  
Determining the net asset value (NAV)  
Reduced sales charges/quantity discounts  
Breakpoint sales  
Redemption of mutual fund shares

#### **1.4.3 Money Market Funds**

Sold by prospectus  
Mutual funds which only invest in very short-term debt securities and money market instruments  
Structured such that one share usually equals \$1 NAV  
Used often by broker/dealer firms to “sweep” customer credit balances into an “interest bearing” account automatically  
Registered under the Investment Company Act of 1940 and subject to the advertising and sales literature restrictions therein  
Some funds offer “check” writing features for fund redemption payments to be made to third parties  
Funds usually provide periodic statements to account holders independent of the brokers required statements  
Fund shares not held by the broker/dealer not covered by SIPC and not insured by FDIC

#### **1.4.4 Unit Investment Trusts (UIT)**

Fixed portfolio  
Redeemability

### **1.5 U.S. Government and Agency Securities**

#### **1.5.1 U.S. Treasury Securities**

Bills  
Notes  
Bonds  
STRIPs  
Non-marketable U.S. Treasury instruments  
U.S. Savings Bonds  
State and local government series (SLGS)

#### **1.5.2 U.S. Agency Securities**

Agency securities having explicit backing (full faith and credit) of the U.S. Government  
Government National Mortgage Association (GNMA or Ginnie Mae)  
Tennessee Valley Authority (TVA)  
Small Business Administration (SBA)  
Private Export Funding Corporation (PEFCO)  
Agency securities that **do not** have an explicit backing of the U.S. Government

Federal Agricultural Mortgage Corporation (FAMC or Farmer Mac)  
Federal Home Loan Banks (FHLB)  
Federal Home Loan Mortgage Association (FNMA or Fannie Mae)  
Federal Farm Credit Bank (FFCB)

### **1.5.3 Characteristics of Government Securities**

- 1.5.3.1 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
- 1.5.3.2 Methods of settlement and delivery
  - Settlement
    - Regular
    - Cash
    - When issued
    - Delayed
  - Accrued interest
  - Forms of delivery
    - Book entry only
    - Fully registered
- 1.5.3.3 Methods of quotations
  - Current yield
  - Day count method
  - Discount basis/Bond equivalent yield
  - Dollar price
  - Money market equivalent yield
  - Value of a basis point (.0001 or .01%)
  - Yield to call
  - Yield to maturity
  - Yield/spread relationship
  - Quotations vs. firm market
- 1.5.3.4 Principal and interest
- 1.5.3.5 Maturity and denominations of various Government securities
- 1.5.3.6 Stripped securities
  - Definition
  - Mechanics of creating and trading
  - Types
    - Treasury STRIPS (Separate Trading of Registered Interest and Principal of Securities)
    - Agency stripped securities

## **1.5.4 The Market for Government Securities**

- 1.5.4.1 Participants in the market
  - Federal Reserve
  - Fiscal agents
  - Primary dealers
  - Government securities dealers
  - Government securities brokers and inter-dealer brokers
  - Investors, retail and institutional
  
- 1.5.4.2 Primary market
  - 1.5.4.2.1 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
  
  - 1.5.4.2.2 Primary market for Agency securities
    - Selling group
      - Discount note program
      - Debenture program
    - Negotiated
    - Competitive bidding
  
- 1.5.4.3 Secondary market
  - 1.5.4.3.1 Types of transactions
    - Principal
    - Agent
  - 1.5.4.3.2 When-issued trading
  - 1.5.4.3.3 Methods of comparing bond prices
    - Bids vs. offers
    - Expression of dollar price/yield

## **1.6 Derivatives/Structured Products (General understanding)**

- Options
- SWAPs
- Futures

## 2.0

# The Market for Corporate Securities

---

### 2.1 Issuing Corporate Securities

#### 2.1.1 Types of issuer

##### 2.1.1.1 SEC Rule 405 — Definitions of terms

- Ineligible issuer
- Unseasoned reporting issuer (not primary S-3 eligible)
- Seasoned issuer (primary S-3 eligible)
- Well-known seasoned issuer (“WKSI”)

##### 2.1.1.2 Issuer organizations

- C corporations
- S corporations
- Limited liability companies
- Limited partnerships
- Trusts
- Master limited partnerships
- REITs

##### 2.1.1.3 Issuer-related liabilities

- SEC Rule 175 — Liability for certain statements by issuers
- SEC Rule 3b-6 — Liability for certain statements by issuers

##### 2.1.1.4 Disclosure of control relationships

###### 2.1.1.4.1 Securities Exchange Act of 1934

- Rule 15c1-5 — Disclosure of control
- Rule 15c1-6 — Disclosure of interest in distributions
- Regulation FD — Fair disclosure
  - Requirement that when an issuer discloses material nonpublic information to certain persons (such as, securities market professionals and holders of the issuer's securities who may well trade on the basis of the information), it must make public disclosure of that information
  - Enhancement of existing prohibitions against insider trading

###### 2.1.1.4.2 FINRA Rules

- FINRA Rule 2262 — Disclosure of Control Relationship with Issuer
- FINRA Rule 2269 — Disclosure of Participation or Interest in Primary or Secondary Distribution

#### 2.1.2 Types of Offerings

##### 2.1.2.1 Public offerings

- New issues and over allotment (Green shoe)
- Limitations on overselling
- Primary
- Secondary

- 2.1.2.2 Private placements
  - Private investments in public equities (PIPEs)
    - Primary
    - Secondary
  - Regulation D — Limited offer and sale of securities without SEC registration under the Securities Act of 1933
    - Accredited investor
    - Calculation of numbers of purchasers
    - Purchaser representative
    - General conditions to be met
      - Limitation on manner of offering
      - Limitations on resale
  - Required documentation and determinations
    - Documents necessary for electronic private placement offerings
      - Documentation of customer authorization
      - Limitation of access
    - Determination of qualified institutional buyer (QIB) or accredited investor status
    - Private placement memorandum
- 2.1.2.3 Rule 144A — Private resales of securities to institutions
- 2.1.2.4 Regulation S — Offers and sales made outside the United States without registration under the Securities Act of 1933
- 2.1.3 Exempted Securities and Exempted Transactions**
  - 2.1.3.1 Rule 147 — “Part of an issue”, “person resident” and “doing business within” for purposes of Section 3(a)(11)
    - Transactions covered
      - Part of an issue
      - Nature of the issuer
      - Offerees and purchasers, person resident
      - Limitation on resales
      - Precautions against interstate offers and sales
  - 2.1.3.2 Regulation A offerings
    - Purpose
    - Limitation on size of offering
    - Limitation on time period
    - Filed at regional SEC office
    - Preliminary offering circular
    - Offering circular
      - Delivery requirements
        - Prior to or concurrent with a written offer to sell
        - No later than 48 hours prior to mailing sales confirmation
    - Currency of offering circular
    - Tombstone advertisements
  - 2.1.3.3 Rule 144 — Persons deemed not to be engaged in a distribution and therefore not underwriters
    - Transactions covered

- Sales of control securities
- Sales of restricted securities
- Availability of financial information
- Holding period (applies to restricted securities only)
- Quantity limitations
- Manner of sale
- Form 144 filing requirements
- 2.1.3.4 Section 4(1) Transactions by any person other than an issuer, underwriter or dealer
- 2.1.3.5 Section 4(3) Transactions by a dealer
- 2.1.3.6 Section 4(4) Broker's transactions
- 2.1.4 Shelf Distributions**
- 2.1.4.1 Rule 415 — Delayed or continuous offering and sale of securities (shelf distribution)
  - Form S-1 filing requirements
  - Issuers may register to sell limited amounts of securities on a delayed basis for up to two years
- 2.1.4.2 Rule 405 — Definition of terms
  - Automatic shelf registration statement
- 2.1.5 Mergers and Acquisitions**
- 2.1.5.1 Rule 145 — Reclassification of securities, mergers, consolidations, and acquisitions of assets
  - Transactions within the rule
  - Communications not deemed a "prospectus" or "offer to sell"
  - Persons and parties deemed to be underwriters
  - Resale provisions for persons and parties deemed to be underwriters
  - Definition of "person"
- 2.1.5.2 Form S-4 requirement
- 2.1.5.3 Regulation M-A — Mergers and acquisitions
- 2.1.6 Securities Distribution**
- 2.1.6.1 Types of underwriting commitments
  - 2.1.6.1.1 Firm commitment
    - Competitive bid or negotiated
  - 2.1.6.1.2 Standby commitment
    - All or none
    - Best efforts
    - Mini-max
    - Market-out clauses
  - 2.1.6.1.3 Securities Exchange Act of 1934 and SEC Rules Thereunder

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

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

- 2.1.6.2 Due diligence — process to evaluate financing proposal
  - Letter of intent
  - Financial data
  - Industry data
  - Operational data of issuer
  - Management and employee relations
  - Research, product development, and expansion
- 2.1.6.3 Commitment committee
- 2.1.6.4 Underwriting syndicate
  - Role of the syndicate manager
  - Liability of syndicate members
  - Duration of the syndicate
  - Agreement among underwriters
    - Authorization of manager to execute final underwriting contract
    - Negotiated during waiting period prior to effectiveness of registration statement
  - Formation of underwriting group
  - Blue Sky provisions
- 2.1.6.5 Underwriters' compensation
  - Establishing underwriters' retention
  - Components of underwriters' spread
  - Management fee
  - Underwriter's fee
- 2.1.6.6 Mechanics of distributions
  - 2.1.6.6.1 Formation of the selling group
    - Handled by managing underwriter
    - Type of selling group
    - Selling group agreement
      - Retention
      - Designations
    - Liabilities of selling group members vs. underwriters' liabilities
    - Selling group concession or reallowance
    - Compensation in the form of warrants of stock
    - Allocation of new issues
    - Issuer directed shares
    - Payment and delivery instructions
    - Prohibitions against trading in the underwritten security during period of distribution
    - Underwriting agreement
  - 2.1.6.6.2 Role of the placement agent
    - Role of the placement agent

- Contractual obligation to issuer
- Identification of potential investors
- Liabilities of the placement agent
- Distribution of proceeds
- 2.1.6.6.3 Finders
- 2.1.6.6.4 SEC Rule 3a4-1 — Associated persons of an issuer deemed not to be brokers
- 2.1.6.7 Pricing of the issue
  - Determined just prior to effective date of registration
  - Indications of interest
  - Priced according to prevailing:
    - Market conditions
    - Industry conditions
    - Issuer needs
- 2.1.6.8 Syndicate settlement
  - Pro-rata distribution of managing underwriter’s short position losses among syndicate members
  - Closing of books
  - NASD Rule 11880 — Settlement of syndicate accounts
    - Definitions
    - Final settlement
    - Settlement of underwritten public offerings
- 2.1.6.9 Securities distribution rules
  - 2.1.6.9.1 Stabilization
    - SEC Regulation M — Anti-manipulation rules concerning securities offerings
      - Rule 100 — Definitions of “stabilization” and “stabilizing
      - Rule 104 — Stabilizing and other activities in connection with an offering
    - NASDAQ Rules
      - Rule 4200(b)(36) — Stabilizing bid
      - Rule 4614 — Stabilizing bids
      - Rule 4624 — Penalty bids and syndicate covering transactions
  - 2.1.6.9.2 Tender offers
    - SEC Rule 13e-4 — Tender offers by issuers
      - Schedule 13E-4 Filing requirement
    - SEC Rule 14e-1 — Unlawful tender offer practices
    - SEC Rule 14e-3 — Transactions in securities on the basis of material, non-public information in the context of tender offers
    - SEC Rule 14e-4 — Prohibited transactions in connection with partial tender offers
    - SEC Rule 14e-5 — Prohibiting purchases outside of a tender offer
  - 2.1.6.9.3 FINRA/NASD rules
    - FINRA Rule 5110 — Corporate financing rule — underwriting terms and arrangements

FINRA Rule 5121 — Public offerings of securities with conflicts of interest  
FINRA Rule 5122—Private placements of securities issued by members  
FINRA Rule 5141 — Sales of a security in a fixed price offering  
FINRA Rule 5160 — Disclosure of Price and Concessions in Selling Agreements  
FINRA Rule 5130 — Restrictions on purchase and sale of initial equity public offerings

**2.1.7 Issue/Deal-Related Communications** (Distribution of information during an underwriting)

- 2.1.7.1 Prospectus requirements
- Rule 134 — Communications not deemed a prospectus
  - Rule 135 — Notice of certain proposed offerings
  - Rule 135A — Generic advertising
  - 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
  - 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
  - Rule 163—Exemption from Section 5(c) of the Act for certain communications by or on behalf of well-known seasoned issuers
  - Rule 163A—Exemption from Section 5(c) of the Act for certain communications made by or on behalf of issuers more than 30 days before a registration statement is filed
  - Rule 164—Post-filing free writing prospectuses in connection with certain registered offerings
  - Rule 168—Exemptions from Sections 2(a)(10) and 5(c) of the Act for certain communications of regularly released factual business information and forward-looking information
  - Rule 169—Exemptions from Sections 2(a)(10) and 5(c) of the Act for certain communications of regularly released factual business information
  - Rule 172—Delivery of prospectus
  - Rule 174 — Delivery of prospectus by dealers; exemptions under Section 4(3) of the Act
  - Rule 427 — Contents of prospectuses used after nine months
  - Rule 430 — Prospectus for use prior to effective date
  - Rule 430A — Rule 430—Prospectus for use prior to effective date
  - Rule 430B — Prospectus in a registration statement at the time of effectiveness
  - Rule 433 — Conditions to permissible post-filing free writing prospectuses
    - Well-known seasoned issuers
    - Non-reporting and unseasoned issuers
  - Rule 460 — Distribution of preliminary prospectus
  - Section 10 — Information Required in Prospectus
    - Prospectus used more than nine months

- Summary prospectus
  - Purpose of the prospectus
    - Relation to registration statement
    - Timeliness of information
    - Permits investor to make an informed decision
  - Rule 15c2-8 — Delivery of prospectus
    - Preliminary prospectus
    - Final prospectus
    - Delivery to associated persons
    - Delivery to other broker/dealers by managing underwriter
- 2.1.7.2 Registration statements
  - Section 7 — Information required in registration statement
  - Section 8 — Taking effect of registration statements
    - Amendments to registration statements prior to and after effective date
    - Stop orders
      - Form SB-1/SB-2 filing requirement
  - Regulation S-K — Content of non-financial statements portions of registration statements under the Securities Act of 1933 and other documents required under the Securities Exchange Act of 1934
  - Regulation S-X — Financial statements required to be filed as part of registration under Sections 12, 13 and 14 of the Securities Act of 1933
- 2.1.7.3 Special issues dealing with electronic offerings
  - SEC Release 34-42728 — Use of electronic media
- 2.1.8 Research Analysts and Research Reports**
  - 2.1.8.1 SEC Regulation AC — Analyst certification
  - 2.1.8.2 NASD Rule 2711 — Research analysts and research reports
    - Restrictions on relationship with research department
    - Restrictions on communications with the subject company
      - Prohibition on participation in road shows
    - Restrictions on research analyst compensation
    - Prohibition of promise of favorable research
    - Restrictions on publishing research reports and public appearances; termination of coverage
    - Restrictions on personal trading by research analysts
      - Quiet periods relating to public offerings
    - Disclosure requirements
    - Annual attestation of research supervisory procedures
    - Prohibition of retaliation against research analysts
- 2.1.9 Liabilities Resulting from Offering Communications**
  - 2.1.9.1 Section 11 — Civil liabilities on account of false registration statement
    - Civil liabilities of issuers and underwriters relative to accuracy and completeness of information contained in registration statement
    - Non-approval by an absence of any guarantees on the part of the SEC relative to accuracy and completeness of registration statement

- 2.1.9.2 Section 12 — Civil liabilities arising in connection with prospectuses and communications
  - Rule 159 — Information available to purchaser at time of contract of sale
  - Rule 412 — Modified or superseded documents
- 2.1.9.3 Section 15 — Liability of controlling persons
- 2.1.9.4 Section 17 — Fraudulent interstate transactions
- 2.1.9.5 Section 23 — Unlawful representations

## **2.2 Trading Corporate Securities**

### **2.2.1 Overview of Markets Regulated by FINRA**

- 2.2.1.1 NASDAQ securities
  - 2.2.1.1.1 NASDAQ tier securities
    - NASDAQ Capital markets securities (SmallCap)
    - NASDAQ Global market securities (NNM)
    - NASDAQ Global select market securities
  - 2.2.1.1.2 Preferred securities
  - 2.2.1.1.3 Convertible debt
  - 2.2.1.1.4 ADRs and International securities
- 2.2.1.2 Over-the-counter securities
  - Pink Sheets and other similar trading facilities ([www.pinksheets.com](http://www.pinksheets.com))
  - Third market
    - Trading in exchange listed securities in OTC market
    - Consolidated tape reporting requirement
  - Fourth market
    - Private transactions between institutional investors without the use of a broker/dealer
- 2.2.1.3 OTC Bulletin Board
  - Allows participants to enter, update, retrieve quotation information on non-NASDAQ OTC stocks on real-time basis
    - Displays firm quotations
    - Displays unpriced indications of interest
  - FINRA Rule 6500 — OTC Bulletin Board service
    - Rule 6510 — Applicability
    - Rule 6520 — Operation of the service
    - Rule 6530 — OTCBB-eligible securities
- 2.2.1.4 NASDAQ Market Center Requirement
  - 2.2.1.4.1 Execution services
    - Rule 4751 — Definitions
    - Rule 4755 — Order entry parameters
    - Rule 4756 — Entry and display of quotes and orders
    - Rule 4757 — Book processing
    - Rule 4758 — Order routing
    - Rule 4761 — Adjustment of open quotes and/or orders

- 2.2.1.4.2           Alternative Trading Systems
  - SEC Regulation ATS
  - Electronic communications networks (ECNs)
- 2.2.1.5            FINRA marketplace rules regarding display, transaction reporting and order tracking obligations
- 2.2.1.5.1          FINRA Alternative Display Facility
  - Rule 6230 — Use of alternative display facility data systems
  - Rule 6240 — Prohibition from locking or crossing quotations in NMS stocks
  - Rule 6220 — Definitions
- 2.2.1.5.2          Trade Reporting Facility (TRF)
  - Function of the Trade Reporting Facility
  - A vehicle for reporting off-exchange transactions in equity securities
- 2.2.1.5.3          Other FINRA transaction reporting obligations rules
  - Rule 6550 — Transaction reporting in OTC Bulletin Board service
  - Rule 6622 — Transaction reporting in over-the-counter equity securities
  - Rule 6643 — Transaction reporting in direct participation programs
- 2.2.1.5.4          Trade Reporting and Compliance Engine rules (TRACE Rules)
  - Rule 6710 — Definitions
  - Rule 6730 — Transaction Reporting
- 2.2.1.5.5          Trade Comparison Service (TRACS)
  - Rule 7110 — Definitions
  - Rule 7130 — Trade Report Input
- 2.2.1.5.6          FINRA Order Audit Trail Systems
  - Rule 7410 — Definitions
  - Rule 7420 — Applicability
  - Rule 7430 — Synchronization of member business clocks
  - Rule 7440 — Recording of order information
  - Rule 7450 — Order data transmission requirements
- 2.2.1.5.7          FINRA clearing and comparison rules
  - Rule 7210A/7310 — Definitions
  - Rule 7220A/7320 — Trade reporting participation requirements
    - Mandatory participation for clearing agency members
    - Participant obligations
      - Access
      - System participant obligations
      - Clearing broker obligations
  - Rule 7230A/7330 — Trade report input
  - Rule 7340A/7340 — Trade report processing
- 2.2.1.6            Requirements for NASDAQ market makers and other market center participants
- 2.2.1.6.1          FINRA Rules
  - FINRA Rule 5250 — Payments for Market Making

- FINRA Rule 6250 — Quote and order access requirements
- FINRA Rule 6271 — Registration as an ADF market maker or an ADF ECN
- FINRA Rule 6274/6350A—Clearance and settlement
- FINRA Rule 6275 — Withdrawal of quotations
- FINRA Rule 6540 — Requirements applicable to market makers
  - Permissible quotation entries (one-sided quotes)
  - Impermissible quotation entries
  - Voluntary termination of registration
  - More than one trading location
  - Clearance and settlement
- 2.2.1.6.2 NASDAQ Rules
  - Rule 4611 — NASDAQ market center participant registration
  - Rule 4612 — Registration as a NASDAQ market maker
    - Membership requirement
    - Minimum net capital requirements
  - Rule 4619 — Withdrawal of quotations and passive market making
- 2.2.1.6.3 Market Hours
  - FINRA/NASDAQ Rules 6273/4617 — Normal business hours
  - FINRA Rule 2265 — Extended hours trading risk disclosure
- 2.2.1.6.4 SEC Regulation M — Anti-manipulation rules concerning securities offerings
  - Rule 103 — Passive market making in NASDAQ stocks
- 2.2.1.6.5 Determination of spread
  - Financial condition of issuer
  - Size of issue
  - Activity in issue
  - Market conditions
- 2.2.1.6.6 Types of customer business
  - Retail
  - Institutional
- 2.2.1.7 Quotation requirements (general knowledge)
  - FINRA Rule 5210 — Publication of transactions and quotations
  - FINRA Rule 5220 — Offers at stated prices
  - FINRA Rule 6430 — Recording of quotation information
  - FINRA Rule 6440 — Submission of Rule 15c2-11 information on non-exchange-listed securities
  - FINRA Rule 6450 — Minimum quotation size requirements for OTC equity securities
  - FINRA Rule 6272/NASDAQ Rule 4613—Character of quotations
    - Quotation requirements and obligations
  - SEC Rule 15c2-7 — Identification of quotations
  - SEC Rule 15c2-11 — Initiation or resumption of quotations with specified information

- 2.2.1.8 Trading and Market halts
  - 2.2.1.8.1 Trading halts
    - FINRA Rule 5260 — Prohibitions on Transactions, Publication of Quotations, of Publications of Indications of Interest During Trading Halts
    - FINRA Rule 6120/NASDAQ Rule 4120 — Trading halts
      - Authority to initiate trading halts
      - Procedure for initiating a trading halt
      - NASDAQ IM-4120-1 — Disclosure of material information
    - FINRA Rule 6460 — Trading and quotation halt in OTC equity securities
  - 2.2.1.8.2 Market halts
    - Agreement between NASDAQ and NYSE (circuit breakers)
    - NASDAQ Rule 4121 — Market closing
- 2.2.1.9 Anti-competitive Trading Practices (21a Report)
  - Collusion
  - Price/size/spread convention
  - Intimidation
  - Harassment
  - FINRA Rule 5240 — Anti-intimidation/coordination
- 2.2.2 Exchange Markets**
  - 2.2.2.1 Listing criteria (general understanding)
  - 2.2.2.2 The auction market
    - Trading post
    - Floor broker (member)
    - Role of the designated market maker (DMM) [specialist]
      - Maintains the limit order book
      - “Stops” stock
      - Agent vs. principal functions of the DMM [specialist]
      - Maintains an orderly market
    - Automated trading systems (DOT, PACE, AUTO, AMOS, SCOREX)
    - Types of orders
    - Block trading
  - 2.2.2.3 Consolidated tape network
    - Reports all executions of exchange-listed securities, regardless of where the transactions occurred
    - Use of the tape for price information
    - Reports of third market activity
- 2.3 Securities Exchange Act of 1934 (Secondary-Market)**
  - 2.3.1 Regulation M — Anti-manipulation Rules Concerning Securities Offerings**
    - Rule 101 — Activities by distribution participants
    - Rule 102 — Activities by issuers and selling security holders during a distribution

- 2.3.2 Section 3 — Certain Definitions Under the Act**
  - Section 3(a)(38) — Market maker
  - Section 3(a)(39) — Statutory disqualification
- 2.3.3 Regulation NMS — Regulation of the National Market System**
  - 2.3.3.1 Rule 600 — NMS security designation and definitions
    - Block size
    - Electronic communications network
    - Exchange market maker
    - Exchange-traded security
    - NMS security/stock
    - OTC market maker
    - Quotation size
  - 2.3.3.2 Rule 604 — Display customer limit orders
    - Specialists and OTC market makers
  - 2.3.3.3 Rule 605 — Disclosure of order execution information
  - 2.3.3.4 Rule 606 — Disclosure of order routing information
  - 2.3.3.5 Rule 607 — Customer account statements
  - 2.3.3.6 Rule 612 — Minimum pricing increments
- 2.3.4 Section 12 — Registration Requirements for Securities**
  - Registration requirements for securities trading in the secondary market
- 2.3.5 Section 13 — Periodical and Other Reports**
  - Disclosure of beneficial ownership of 5% or more in equity security registered with the SEC
- 2.3.6 Penny Stock Rules**
  - Rule 3a51-1 — Penny stock
  - Rule 15g-1 — Exemptions for certain transactions
  - Rule 15g-2 — Risk disclosure document relating to the penny stock market
  - Rule 15g-3 — Broker or dealer disclosure of quotations and other information relating to the penny stock market
  - Rule 15g-4 — Disclosure of compensation to brokers or dealers
  - Rule 15g-5 — Disclosure of compensation to associated persons in connection with penny stock transactions
  - Rule 15g-6 — Account statements for penny stock customers
  - Rule 15g-9 — Sales practice requirements for certain low-priced securities
- 2.4 FINRA/NASD — Conduct Rules**
  - 2.4.1 Trading Standards and Practices**
    - FINRA Rule 2010—Standards of commercial honor and principles of trade
    - NASD IM-2110-3 — Frontrunning policy
    - FINRA Rule 5280 — Trading ahead of research reports

**2.4.2 FINRA Rule 5320 — Prohibition Against Trading Ahead of Customer Orders**

**2.4.3 NASD Rule 2320 — Best Execution and Inter-positioning**

**2.4.4 FINRA Rule 5290 — Order Entry and Execution Practices**

**2.4.5 Day Trading Accounts**

FINRA Rule 2130 — Approval procedures for day-trading accounts

FINRA Rule 2270 — Day-trading risk disclosure statement

NASD Rule 2520(f)(8)(B) — Day trading

Definition of pattern day trader

Definition of day trading buying power

Special requirements for pattern day traders

## 3.0 Evaluation of Securities and Investments

---

### 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

Internal rate of return (IRR)

Non-operating income

Earnings before interest and taxes (EBIT)

Interest on debt

(Pre-tax) income (EBT)

Earnings before interest, taxes, depreciation, and amortization (EBITDA)

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

- Cash flow from depreciation or deferred taxes
- Current ratio
- Net current assets
- Retained earnings
  
- 3.1.1.2.2 Profitability ratios
  - Discounted cash flow analysis
  - Dividend payout ratio
  - Earnings per share/Cash flow per share
  - Inventory valuation (FIFO, LIFO)
  - Margin of profit
  - Price earnings ratio (P/E)
  - Return on equity (ROE)
  - Return on investment (ROI)
  - Weighted average cost of capital (WACC)
  
- 3.1.1.2.3 Short-term liquidity measures
  - Acid test ratio
  - Quick 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
    - Net debt to EBITDA
  
- 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
  - Debt to equity ratio
  - Interest coverage ratio
  - 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
  - Price to book value ratio
    - Stated
    - Tangible
  - Goodwill
  - Market value
  - Stock volatility—beta

### **3.1.2 Technical Analysis**

- 3.1.2.1 Used in timing of transactions
- 3.1.2.2 Basic chart patterns and terms
  - Trading channels
  - Uptrend
  - Downtrend
  - Support levels
  - Resistance levels
  - Gaps
  - Accumulation/distribution
  - Consolidation
  - Overbought
  - Oversold
  - Advanced-decline lines
  - Short interest ratio
  - Odd lot index
  - Moving averages
- 3.1.2.3 Market indices
  - Broad-based
  - Narrow-based

### **3.1.3 Special Situations**

- Tender offers
- Riskless arbitrage
- Risk arbitrage

## **3.2 Economics**

### **3.2.1 Business Cycles**

- 3.2.1.1 Phases
  - Expansion
  - Peak
  - Recession
  - Trough
  - Depression
  - Inflation/deflation
- 3.2.1.2 Business cycle indicators

Leading economic indicators  
Coincident economic indicators  
Lagging economic indicators

3.2.1.3 Definition and impact of economic indicators

Business inventories  
Consumer confidence  
Consumer credit  
Consumer price index (CPI)  
Gross domestic product (GDP)  
Components of GDP  
Employment cost index (ECI)  
Employment data  
Existing home sales  
Housing starts and permits  
Industrial production  
Merchandise trade balance  
National income (NI)  
Components of NI  
New home sales  
Producer price index (PPI)  
Retail sales  
Weekly jobless claims

**3.2.2 Monetary Policies of the Federal Reserve (Central Banks)**

3.2.2.1 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

3.2.2.2 Major factors influencing Federal Reserve monetary policy

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

3.2.2.3 Supply of money and interest rates

Relation to level of economic activity  
Relation to prices of and return on securities investments  
M1, M2, M3

3.2.2.4 Tools of the Federal Reserve Board

Open-market operations  
Repurchases and reverse repurchases  
Purchases and sales of U.S. Treasury securities  
Changes in the discount rate  
Changes in bank reserve requirements  
Federal funds

Margin requirements (Regs T and U)  
Moral suasion

3.2.2.5 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

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

3.2.4.2 Balance of payments

Current account surpluses/deficits

Impact of foreign monetary and fiscal policy on U.S. rates

Trade surpluses/deficits

**3.3 Investment Planning and Investor Suitability**

**3.3.1 Investment Objectives**

3.3.1.1 Principal accumulation

3.3.1.2 Income

3.3.1.3 Preservation of capital

3.3.1.4 Growth/aggressive growth/ speculation

3.3.1.5 Tax advantage

**3.3.2 Investment Considerations**

Ability to risk loss of principal

Ability to risk loss of investment income

Ability to assume purchasing power risk with regard to principal and income  
Ability or willingness to hold investments over relatively long periods/time horizon

Requirements for marketability of securities held

Tax considerations

Investment temperament and investment experience

**3.3.3 Financial Status**

Balance sheet

Income and expenses

Participation in benefit plans  
Expected changes in financial status

**3.3.4 Investment Strategies**

Dollar cost averaging  
Hedged/unhedged positions  
Laddering of the portfolio  
Market timing  
Leveraging  
    Purchasing on margin  
    Selling short

**3.3.5 Regulatory Requirements**

- 3.3.5.1 NASD Rule 2310 — Recommendations to customers (suitability)
  - IM-2310-2 — Fair dealing with customers
    - Recommending speculative low-priced securities
    - Excessive trading activity
    - Fraudulent activity
    - Recommending purchases beyond customer capability
  - Fair dealing with customers with regard to derivative products or new financial products
  - IM-2310-3 — Suitability obligations to institutional customers
- 3.3.5.2 FINRA Rule 2114 — Recommendations to customers in OTC equity securities
- 3.3.5.3 FINRA Rule 2060 — Use of information obtained in fiduciary capacity

**3.3.6 Risk and the Construction of Investment Portfolios**

- 3.3.6.1 Credit risk and portfolio policies
  - 3.3.6.1.1 Definition of credit risk and its effect on future values of income and principal in different types of investments
  - 3.3.6.1.2 Appropriate mix of conservative and speculative securities in a portfolio derived from customer's ability to risk loss of principal and income
  - 3.3.6.1.3 Concentration of investment in a small number of issues vs. diversification
  - 3.3.6.1.4 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
- 3.3.6.2 Interest rate risk and portfolio policies
  - 3.3.6.2.1 Definition of interest rate risk and its effect on future values of income and principal in different types of investments
  - 3.3.6.2.2 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
- 3.3.6.3 Purchasing power risk and portfolio policies
  - 3.3.6.3.1 Definition of purchasing power risk and its effect on the constant dollar value of income and principal in different types of investments

- 3.3.6.3.2 Need to reconcile investment policies with regard to financial risk with policies designed to minimize loss of purchasing power
- 3.3.6.3.3 Balanced portfolio of bonds, preferred, common, and convertible issues provides downside protection and potential inflation hedge
- 3.3.6.4 Other risk factors and portfolio policies
  - 3.3.6.4.1 Marketability of securities in the portfolio and customer liquidity needs
  - 3.3.6.4.2 Taxability of securities in the portfolio and customer tax bracket
  - 3.3.6.4.3 Callability of securities in the portfolio and the importance of call protection given customer investment objectives
  - 3.3.6.4.4 Convertibility of securities in the portfolio, the value of the conversion feature and the effect of potential forced conversions on customer objectives
  - 3.3.6.4.5 Economic, social and political risks and their potential effects on customer investments
  - 3.3.6.4.6 Currency rate risk

**3.3.7 Policies with Respect to Buying and Selling Securities**

- 3.3.7.1 Active policies
  - Attempt to time transactions to coincide with expected major market movements
  - Attempt to reconfigure portfolio structure to coincide with market preferences
  - Purchase securities on margin
  - Unhedged option, financial futures, and short selling strategies
  - Risk arbitrage techniques
- 3.3.7.2 Passive policies
  - Pursue investment strategy without close regard to market price swings
  - Time diversification techniques (i.e., dollar cost averaging, constant ratio plans, etc.)
  - Spacing of bond maturities and recycling funds from matured issues in line with original maturity schedule
  - Transactions designed to take advantage of yield differentials in the market
  - Hedged option, financial futures, and short selling strategies

**3.3.8 Retirement and Tax Advantaged Plans**

- 3.3.8.1 Individual retirement plans
  - Individual Retirement Accounts (IRAs)
    - Traditional IRAs
    - Roth IRAs
- 3.3.8.2 Employer-sponsored retirement plans
  - HR10 plans (formerly KEOGH plans)
  - Simplified employee pension plans (SEP)
  - 401(k) plans
  - 403(b) plans
  - Defined benefit plans
  - Defined contribution plans
  - Profit sharing
  - Payroll deduction plans

- 3.3.8.3 Retirement plan terms
  - ERISA
  - Vesting
  - Non-discrimination tests
  - Fiduciary
  - Custodian
  - Sponsor
  - Roll-over
  - Qualified
- 3.3.8.4 Deferred compensation plans
- 3.3.8.5 Tax Advantaged Plans
  - Section 529 College Savings Plans

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

#### **3.4.1 Identification of Securities**

- 3.4.1.1 Relationship between accurate identification of securities and determination of cost basis
- 3.4.1.2 FIFO — required method of securities identification when investors cannot identify transacted shares
- 3.4.1.3 “Identified shares” method
- 3.4.1.4 Importance of retaining trade confirmations and/or other written notices in order to establish identification

#### **3.4.2 Holding Periods of Securities**

- 3.4.2.1 Trade date determines date of acquisition
- 3.4.2.2 Trade 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

#### **3.4.3 Tax Basis of Securities**

- 3.4.3.1 Purchases
- 3.4.3.2 Exchange of securities
- 3.4.3.3 Stock dividends
- 3.4.3.4 Stock rights
- 3.4.3.5 Gifts of securities
- 3.4.3.6 Inheritance of securities
- 3.4.3.7 Need to refer to published capital changes for exact identification of tax basis of particular securities affected by various distributions

- 3.4.4 Tax Treatment of Securities Transactions**
- 3.4.4.1 Definition of a capital gain (loss)
- 3.4.4.2 Computation of net capital gains (losses)
- 3.4.4.3 Ordinary income tax treatment of realized net capital gains
- 3.4.4.4 Deduction of net capital losses from ordinary income
- 3.4.4.5 Limitation on net capital loss deductions
- 3.4.4.6 Loss carryover provisions
- 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
- 3.4.5.2 U.S. Government and Agency obligations
  - Federal taxation
  - Exemption from taxation at state level for direct government obligations and certain agency securities
  - Other agency securities taxable at state level
- 3.4.5.3 State and municipal obligations
  - Ordinary exempt from Federal taxation
  - Federal taxation of “private activity bonds”
  - Possible exemption from taxation in issuer state
  - Possible taxation in investor’s state of domicile
- 3.4.6 Tax Treatment of Dividend Income From Corporate Stock**
- 3.4.6.1 Cash dividends
- 3.4.6.2 Stock dividends (ordinary) and effect on cost basis
- 3.4.6.3 Stock rights-receipt ordinarily not a taxable event
- 3.4.6.4 Deductibility of a specified percentage of dividend income received by a corporation from stock holdings in other domestic and certain foreign corporations
- 3.4.7 Tax Treatment of Unearned Income of Minor Children**
- “Net unearned income” taxed at highest parental rate
- 3.4.8 Wash Sale Rules**
- 3.4.8.1 Definition of a wash sale
  - Applicable time period of 30 days prior to and after a sale
- 3.4.8.2 Definition of “substantially identical” property including derivative securities
  - Case-by-case determination by IRS
  - General guidelines
- 3.4.8.3 Basis of substantially identical securities increased by amount of disallowed loss

**3.4.9 Special Tax Features of Bonds**

3.4.9.1 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

3.4.9.2 Amortization of bond discounts (taxable bonds)

3.4.9.2.1 Discounted money market obligations  
Interest income recognized at redemption or when sold

3.4.9.3 Effect of accrued interest on bond income and cost basis at purchase and sale

3.4.9.4 Accretion of discounts

**3.4.10 Tax Deductions Available to Investors for Fees, Services, and Other Expenses Related to Investments**

3.4.10.1 Deductible against ordinary income to the extent such expenses exceed 2% of "adjusted gross income"

3.4.10.2 Deductibility of interest on margin accounts  
Necessity to make credits to the account sufficient to absorb interest charges for the taxable year  
Interest attributable to carrying tax exempt securities or for personal use not deductible  
Investment interest limitations

## 4.0

### Handling Customer Accounts and Securities Industry Regulations

---

#### 4.1 Client Accounts

##### 4.1.1 Types of Accounts

4.1.1.1 Cash

4.1.1.2 Margin (general account)

#### 4.2 Account Documentation

##### 4.2.1 Customer Information

4.2.1.1 Identification data

Full name

Address and telephone number(s)

Social Security or tax identification number

Citizenship

Whether of legal age

Net worth

Income

Power of attorney

Occupation, employer, type of business

Whether associated with a FINRA member firm

Signature of registered representative introducing the account

Signature of principal/supervisor who accepts the account

4.2.1.2 **FINRA/NASD Rules — Books and Records**

FINRA Rule 4512 — Customer Account Information

FINRA Rule 4515 — Approval and Documentation of Changes in Account

Name or Designation

NASD Rule 3110(b) — Marking of Customer Order Tickets

##### 4.2.2 Supplementary Documentation

Name and signature of person(s) with authority to create activity in account

Limited authorization

Full authorization

Discretionary accounts — required documentation and approval

SEC Rule 15c1-7 — Discretionary accounts

NASD Rule 2510 — Discretionary accounts

Joint account agreement form

Tenants in common

Joint tenants with rights of survivorship

Custodial accounts under the Uniform Gifts/Transfers to Minor Act

Irrevocability of gift

Custodian

Appointed by donor

Successor custodians

- Legal ownership vested in minor
- Securities registered to beneficiary upon attaining majority
- Must be cash account — no margin
- Securities in account cannot be pledged
- Reinvestment of cash proceeds, dividends and interest within reasonable period
- Use of custodial property for support of minor
- Determination of qualified institutional buyer (QIB) or accredited investor status
- QIB certification letter
  - Representation letter regarding purchaser eligibility standards (representations and warranties letter)
- Subscription agreement
- Investor questionnaire
- Customer identification program (CIP) documentation
- Evidence of authority for:
  - Corporate accounts
  - Partnership agreement
  - Trust agreement/summary of trustee power
  - Guardianship account
- W-9 backup withholding form

#### **4.2.3 Special Requirements for Accounts of Deceased Persons**

- 4.2.3.1 Uniform Transfer-on-Death Security Registration Act
- 4.2.3.2 Outstanding orders
  - Cancellation
  - Freeze on assets in account until necessary documents are obtained from administrator or executor of estate
- 4.2.3.3 Death of a joint tenant
  - Presentation of death certificate and inheritance tax waiver before assets in account are released
- 4.2.3.4 Death of tenant-in-common
  - Freeze on assets and acceptance of orders until instructions are received from survivor(s) and executor or administrator of decedent's estate together with necessary inheritance tax waivers
- 4.2.3.5 Death of a partner
  - Required authority from surviving partners before executing any further orders
- 4.2.3.6 Death of principal on power of attorney
  - Termination of the power

#### **4.3 Transactions in Accounts**

##### **4.3.1 Entering an Order**

- Designation of account (customer or firm)
- Registered representative identifier
- Originating office identifier (if applicable)

- Security description (symbol)
- Number of shares or bonds
- Where traded (NYSE, AMEX, NASDAQ, etc.)
- Time of execution
- Buy
- Sell
  - Long
  - Short
- Lender's privileges
  - Return of securities
  - Marking to the market
  - Interest on bonds loaned
  - Cash dividends
  - Stock dividends
  - Subscription rights
- Closing the contract (receipt and delivery of securities)
  - Deliver out securities to lender
  - Purchase securities in market and deliver to lender
  - Profit or loss on transaction

**4.3.2 Types of Transactions**

- Principal
- Agency
- Riskless principal
- Cross
- Dual agency
- Bought through or sold through another broker

**4.3.3 Types of Orders**

- Market orders
- Limit orders—protection and display
- Stop orders
- At-the-opening
- Stipulations
  - Day
  - Good-till-canceled (open)
  - Market not held

**4.3.4 Settlement Instructions If Not Established When Account Was Opened**

- Regular way
- Cash
- Next day delivery
- With prospectus
- Seller 30, 60, 90 days
- Delayed delivery (unspecified)
- COD (delivery versus payment)
- SEC Rule 15c6-1 — Settlement cycle

**4.3.5 Records of Customer Transactions (Confirmations)**

- SEC Rule 10b-10 — Confirmation of transactions
  - When sent to customers

## FINRA Rule 2232 — Customer confirmations

### **4.3.6 Short Sales**

- 4.3.6.1 Special considerations for short sale transactions
  - Execution of short sales
    - Margin accounts only
  - Borrowing securities for short sales
    - Securities held by executing broker/dealer for margin accounts of customers
    - Borrowing from other broker/dealers or institutional investors
    - List of available securities must be less than 24 hours old
- 4.3.6.2 Securities Exchange Act of 1934 and SEC Rules Thereunder
  - Regulation M
    - Rule 105 — Short selling in connection with a public offering
  - Regulations SHO
    - Rule 200 — Definition of “short sale”
    - Rule 203 — Borrowing and delivery requirements
- 4.3.6.3 NASD Rule 3210 — Short sale delivery requirements

### **4.4 Customer Delivery/Payment**

#### **4.4.1 Securities Must be Delivered With Proper:**

- Endorsements
- Assignments
- Stock powers
- Coupons attached (if applicable)

#### **4.4.2 Payments by Check**

- Checks should normally be made payable to the broker/dealer or clearing broker
- Checks paid to customers will be payable to the broker/dealer or clearing broker
- Checks paid to customers will be payable to the registration on the securities certificate, or in the case of bearer securities, to the name of the customer’s account as it is carried in the records of the broker/dealer

#### **4.4.3 Special Considerations With Respect to Foreign Securities**

### **4.5 Extensions of Credit in the Securities Industry**

#### **4.5.1 Regulatory Requirements under Regulation T of the Federal Reserve Board; FINRA Rule 4210 – Margin Requirements**

- Definition of margin securities
- Initial margin
  - Cash deposit
  - Loan value of margin securities
- Short sales
  - Cash deposit
  - Loan value of securities deposited in lieu of cash

- Mixed margin account
  - Adjusted debit (credit) balance
  - Equity
- Special memorandum account
  - Excess equity
  - Buying power
- Margin deficiency
- Adjusted debit balance
- \$1,000 Rule
- Prohibition against liquidations in lieu of deposits
- Frozen accounts
- FINRA and Exchange initial equity requirements
  - Transactions greater than \$2000
  - Transactions less than \$2000
- Maintenance margin requirements
  - Long
  - Short

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

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

- Securities and Exchange Commission
- Federal Reserve Board
- Self-Regulatory Organizations (FINRA, exchanges, MSRB)

### **4.6.2 Investment Advisors Act of 1940**

- Section 206 — Prohibited transactions by investment advisors

### **4.6.3 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

### **4.6.4 Compliance and Ethics**

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

##### **4.6.4.1.1 Section 3 — Civil penalties of controlling persons for illegal insider trading by controlled persons**

- 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
- Investment Advisers Act of 1940
  - Section 204 — Annual and other reports
  - Section 204A — Prevention of misuse of non-public information

##### **4.6.4.1.2 Section 4 — Increases in criminal penalties**

- Securities Exchange Act of 1934
  - Section 32(a) — Penalties

- 4.6.4.1.3 Section 5 — Liability to contemporaneous traders for insider trading  
Securities Exchange Act of 1934  
Section 20A — Liability to contemporaneous traders for insider trading
- 4.6.4.2 Sarbanes-Oxley Act (general understanding)
- 4.6.4.3 Securities Exchange Act of 1934 and SEC Rules Thereunder
  - 4.6.4.3.1 Section 9(a)(1) - (a)(6) — Prohibition against manipulation of security prices
  - 4.6.4.3.2 Section 10 — Regulation of the use of manipulative and deceptive devices
    - Rule 10b-1 — Prohibition of use of manipulative or deceptive devices or contrivances with respect to certain securities exempted from registration
    - Rule 10b-3 — Employment of manipulative and deceptive devices by brokers or dealers
    - 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
      - 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
      - Rule 10b-18 — Purchases of certain equity securities by the issuer and others
- 4.6.4.3.3 Section 15 — Registration and regulation of brokers and dealers
  - Rule 15c1-1 — Definitions
  - Rule 15c1-2 — Fraud and misrepresentation
  - Rule 15c1-3 — Misrepresentation by brokers, dealers and municipal securities dealers as to registration
  - Rule 15c1-8 — Sales at the market
  - Rule 15c1-9 — Use of pro forma balance sheets
  - Rule 15c2-1 — Hypothecation of customers’ securities
  - Rule 15c3-2 — Customers’ free credit balances
- 4.6.4.3.4 Section 17 — Accounts and records, reports, examinations of exchanges, members, and others
  - Rule 17a-8 — Recordkeeping and reporting of currency and foreign transactions
  - Rule 17f-1 — Missing, lost, counterfeit, or stolen securities reporting
  - Rule 17f-2 — Fingerprinting of securities industry personnel
- 4.6.4.3.5 Regulation S-P — Privacy of consumer financial information  
Treatment of nonpublic personal information about consumers by financial institutions

- 4.6.5 FINRA/NASD — Regulations**
- 4.6.5.1 FINRA By-Laws
  - Article I — Definition of “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 4 — Definition of disqualification (statutory disqualification)
  - Article V — Registered representatives and associated persons
- 4.6.5.2 Membership and Registration Rules
  - NASD Rule 1000 — Membership, registration and qualifications requirements
    - FINRA Rule 1122 — Filing of misleading information as to membership or registration
  - NASD Rule 1030 — Registration of representatives
  - NASD Rule 1080 — Confidentiality of examinations
  - NASD Rule 1120 — Continuing education requirements
- 4.6.5.3 FINRA/NASD Conduct Rules
  - 4.6.5.3.1 FINRA Rule 2020 — Use of manipulative, deceptive or other fraudulent devices
  - 4.6.5.3.2 NASD Rule 2210 — Communications with the public
    - Definitions
      - Advertisement
      - Sales literature
      - Public appearance
      - Independently prepared reprint
    - Approval and recordkeeping
    - Filing requirements and review procedures
    - Content standards
      - Standards applicable to all communications with the public
      - Standards applicable to advertisements and sales literature
    - IM-2210-1 — Guidelines to Ensure that Communications with the Public are not Misleading
    - IM-2210-4 — Limitations on use of FINRA’s name and any other corporate name owned by FINRA
    - IM-2210-6 — Requirements for the use of investment analysis tools
    - IM-2210-8 — Communications with the public about collateralized mortgage obligations (CMOs)
  - 4.6.5.3.3 NASD Rule 2211 — Institutional sales material and correspondence
    - Definitions
      - Correspondence
      - Institutional sales material
      - Institutional investor
      - Existing retail customer
      - Market letter
    - Approval and recordkeeping
    - Spot-check procedures

Content standards applicable to institutional sales material and correspondence

- 4.6.5.3.4 NASD Rule 2212 — Telemarketing
- 4.6.5.3.5 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 permissibleNASD 2330 – Customers’ securities or funds
  - General Provisions
  - Authorization to lend
  - Segregation and identification of securities
  - IM-2330 — Segregation of customers’ securities
- 4.6.5.3.6 FINRA Rule 3240 — Borrowing From or Lending To Customers
- 4.6.5.3.7 NASD Rule 2410 — Net prices to persons not in investment banking or securities business
- 4.6.5.3.8 NASD Rule 2440 — Fair prices and commissions
  - IM-2440-1 — Mark-up policy
  - IM-2440-2 — Additional mark-up policy for transactions in debt securities, except municipal securities
- 4.6.5.3.9 FINRA Rule 2124 — Net Transactions with Customers
- 4.6.5.3.10 NASD Rule 3010 — Supervision
  - Supervisory system
  - Written procedures
    - Taping rule
  - Internal inspections
  - Review of transactions and correspondence
  - Qualifications investigated
  - Applicant’s responsibility
  - Definitions
    - Office of supervisory jurisdiction
    - Branch office
- 4.6.5.3.11 FINRA Rule 3310 — Anti-money Laundering Compliance Program
- 4.6.5.3.12 FINRA Rule 3270 — Outside business activities of registered persons
- 4.6.5.3.13 NASD Rule 3040 — Private securities transactions of an associated person
  - Applicability
  - Written notice
  - Transactions for compensation
  - Transactions not for compensation
  - Definitions
    - Private securities transaction

## Selling compensation

- 4.6.5.3.14 NASD Rule 3050 — Transactions for or by associated persons
- 4.6.5.3.15 FINRA Rule 3220 — Influencing or rewarding employees of others
- 4.6.5.3.16 Disclosure Requirements
  - FINRA Rule 2261 — Disclosure of Financial Condition
    - Requirement to furnish most recent report of the firm’s financial condition
  - FINRA Rule 2263 — Disclosure to associated persons when signing Form U4
  - FINRA Rule 2264 — Margin Disclosure Statement
  - FINRA Rule 2267 — Investor education and protection
- 4.6.5.3.17 Reporting Requirements
  - FINRA Rule 4530— Reporting Requirements
  - NASD Rule 2340 — Customer account statements
    - Requirement to send customers monthly and/or quarterly statements on account activity
    - Delivery versus payment/receive versus payment (DVP/RVP) accounts
  - Books and Records
    - FINRA Rule 2268—Requirements When Using Pre-dispute Arbitration Agreements for Customer Accounts
    - FINRA Rule 4511— General Requirements
    - FINRA Rule 4513— Records of Written Customer Complaints
    - FINRA Rule 4514— Authorization Records for Negotiable Instruments Drawn from a Customer’s Account
    - NASD Rule 3110(i) — Holding of Customer Mail
- 4.6.5.4 FINRA Procedural Rules
  - 4.6.5.4.1 Investigations and Sanctions
    - 4.6.5.4.1.1 Rule 8100 — General provisions
      - Rule 8110 — Availability of Manual to customers
      - Rule 8120 — Definitions
    - 4.6.5.4.1.2 Rule 8200 — Investigations
      - Rule 8210 — Provision of information and testimony and inspection and copying of books
    - 4.6.5.4.1.3 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
  - 4.6.5.4.2 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

4.6.5.4.3 FINRA Arbitration and Mediation Rules  
4.6.5.4.3.1 Code of Arbitration Procedure  
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  
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  
Part VIII —

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

4.6.5.4.3.2 Rule 14000 — Mediation Rules

4.6.5.4.4 Uniform Practice Code  
Rule 11100 — Scope of Uniform Practice Code  
Rule 11130 — When, as and if issued/distributed contracts  
Rule 11140 — Transactions in securities “ex-dividend,” “ex-rights” or  
“ex-warrants”  
Rule 11320 — Dates of delivery  
Rule 11550 — Assignments and powers of substitution; delivery of  
registered securities  
Rule 11574 — Certificate in name of deceased person, trustee, etc.  
Rule 11620 — Computation of interest  
Rule 11810 — “Buying-in”  
Rule 11820 — “Selling-out”  
Rule 11890 — Clearly erroneous transactions  
Procedures for declaring a transaction void  
Rule 11900 — Clearance of corporate debt securities

4.6.5.5 Customer Account Transfer Rules  
FINRA Rule 2140 — Interfering with the transfer of customer accounts in  
the context of employment disputes  
NASD Rule 11870 — Customer account transfer contracts

## **4.7 Securities Investor Protection Act and SIPC Rules Thereunder**

### **4.7.1 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

Responsibility of SIPC appointed trustees

## SAMPLE QUESTION FORMATS

---

The questions and answers that follow are similar in format and content to those found 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. (B)
2. (B)
3. (C)
4. (C)

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. When an underwriter agrees to act on a “firm commitment” basis, which two of the following are TRUE?
  - I. The underwriting firm acts as a dealer.
  - II. The underwriting firm acts as a broker.
  - III. The underwriting firm agrees to buy only those securities it can sell.
  - IV. The underwriting firm agrees to buy the entire issue.
  - (A) I and III
  - (B) I and IV
  - (C) II and III
  - (D) II and IV
  
3. 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
  
4. 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