Financial Industry Regulatory Authority

Private Securities Offerings Qualifications Examination (Test Series 82)

Study Outline

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Introduction

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

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

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

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

Structure of the Exam

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

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

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

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

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

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

References

Appeal Securities Act Handbook
Aspen Publishers
7201 McKinney Circle
Frederick, MD 21704

The Business of Investment Banking: A Comprehensive Overview
K. Thomas Liaw
John Wiley & Sons, Inc.
One Wiley Drive
Somerset, NJ 08875

Code of Federal Regulations
Title 17 – Commodity and Securities Exchanges
Superintendent of Documents
U.S. Government Printing Office
Washington, DC 20402

Dictionary of Finance and Investment Terms
John Downes and Jordan E. Goodman
Barron's Financial Guides
250 Wireless Boulevard
Hauppauge, NY 11788

How the Bond Market Works
Robert Zipf
Simon & Schuster Company
Two Broadway
New York, NY 10004

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

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

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

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

The Vest Pocket Guide to Stock Brokerage Math
William A. Rini
Simon & Schuster Company
Two Broadway
New York, NY 10004

Publications Available from FINRA at *www.finra.org*

FINRA Rules

NASD Rules

FINRA Sanctions Guidelines

FINRA Notices

1.0
Characteristics Of Corporate Securities

1.1 Equity Securities

1.1.1 Common Stock

1.1.1.1 Ownership in a corporation

1.1.1.2 Rights of stockholders
- Limited liability
- Proportionate ownership
- Transfer rights
- Receive dividends, when declared by board of directors
  - Record date
  - Payable date
- Inspect corporate books
- Subscribe proportionately to any new issue of stock
- Vote at stockholders' meetings
- Protect the corporation against wrongful acts of management
- Restrain radical acts of the corporation
- Residual claims to assets at dissolution
- Statutory voting rights
- Cumulative voting rights
- Preemptive rights
- Contingent voting rights of preferred stockholders
- Proxies
- Voting trusts
  - Trustee
  - Voting trust certificates
  - Beneficial interests
- Non-voting common stock

1.1.1.3 Stock certificate
- Negotiability
  - Endorsements and assignments
- Transfer procedures
  - Transfer agent
  - Registrar
- Fractional shares

1.1.1.4 Value at issuance
- Par value
  - Normally an arbitrary amount
  - Full-paid and non-assessable
  - Low par value

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

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

1.1.2 Preferred Stock

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

1.1.2.2 Asset preference of preferred over common

1.1.2.3 Classes of preferred and degree of preference

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

1.1.2.5 Protective provisions regarding preferred stock

1.1.3 Rights and Warrants

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

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

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

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

1.1.5 International Securities

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

1.2 Corporate Debt Securities

1.2.1 Features of Bonds

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

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

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

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

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

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

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

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

1.2.2 Types of Bonds

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

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

1.2.2.3 Convertible bonds

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

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

1.2.2.3.3 Advantage/disadvantages to issuer of convertible bonds

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

1.2.2.3.4 Conversion ratio or price
Factors affecting initial conversion rate or price
Price of stock at time of issuance
Earnings prospect
Market conditions
Length of conversion period

1.2.2.3.5 Time of conversion
At issuance
Delayed conversion
Expiration at maturity
Expiration prior to maturity

1.2.2.3.6 Protective features relative to:
Stock splits
Change in class of conversion securities
Stock dividends
Issuance of new shares of conversion stock
Merger, consolidation, dissolution

1.2.2.3.7 Factors influencing conversion
Computation of parity relationship
Arbitrages
Forced conversion by issuer
Increased dividend on stock
Call on bonds when market value of stock is higher than redemption price
Granting of substantial subscription rights to stockholders

1.2.2.4 Other types of bonds
1.2.2.4.1 Collateral trust bonds
Secured by pledge of securities as collateral with a trustee

1.2.2.4.2 Equipment trust obligations
Protective covenants

1.2.2.4.3 Guaranteed bonds
Purpose
Forms of guarantee
Interest only
Both principal and interest

1.2.2.4.4 Variable rate (income) bonds
Interest paid only if earned

Use during reorganizations
Long maturities at issuance

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

1.3 Asset-Backed Securities

1.3.1 Mortgage-Backed Securities

1.3.1.1 Securitization of mortgages

1.3.1.2 Agency-issued mortgage-backed securities
Federal National Mortgage Association obligations – (FNMA or Fannie Mae)
Federal Home Loan Mortgage Corporation obligations – (FHLMC or Freddie Mac)
Government National Mortgage Association obligations – (GNMA or Ginnie Mae)
Repayment of interest and principal monthly

1.3.1.3 Corporate-issued mortgage-backed securities
Private label

1.3.1.4 Structured mortgage products
Collateralized mortgage obligations -- usually composed of private mortgages not qualified under VA or FHA
Interest only and principal only
Real Estate Mortgage Investment Conduits (REMICs)
May be "multiple class" with fast/slow pay segments
Payments may be allocated disproportionately among -tranches
REMICs offer certain tax and accounting benefits to issuers

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

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

1.3.3 Other Asset-Backed securities

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

1.3.4 General Features

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

1.4 Investment Companies

General characteristics
Registered under the Investment Company Act of 1940

1.4.1 Closed-End Investment Companies

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

1.4.2 Open-End Investment Companies (Mutual Funds)

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

1.4.3 Exchange traded funds (ETFs)

Registered under the Investment Company Act of 1940

1.4.4 Unit Investment Trusts (UIT)

Registered under the Investment Company Act of 1940
Fixed portfolio
Redeemability

1.4.5 Money Market Fund

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

1.4.6 Securities (funds) Exempt from the Investment Company Act of 1940

Unregistered

Section 3c-7 – Exemption

Hedge funds

Characteristics

Suitability

Due diligence

Private equity funds

Qualified purchasers

1.5 Securities Exchange Act of 1934 (Issuer registration and reporting requirements)

1.5.1 Section 12 — Registration requirements for securities

Registration and periodic reporting requirements for securities of issuers engaged in interstate commerce and exchange listed securities

1.5.2 Section 13 — Periodical and other Reports

Disclosure of beneficial ownership of 5% or more in equity security registered with the SEC

1.6 Trust Indenture Act of 1939 — General Purposes

Necessity of trustee to safeguard the rights of investors in registered debt obligations

Identification of rights and powers of trustee

Full disclosure of information in bond indentures

Participation of trustees in the preparation of indentures

2.0
Regulation of the Market for Registered and Unregistered Securities

2.1 Issuing Corporate Securities

2.1.1 Types of Offerings

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

2.1.2 Underwriting Commitments

2.1.2.1 Types of commitments

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

2.1.2.2 Securities Exchange Act of 1934 and SEC Rules Thereunder

- Section 10 — Regulation of the use of manipulative and deceptive devices
  - Rule 10b-9 — Prohibited representations in connection with certain offerings
- Section 15 — Registration and regulation of brokers and dealers
  - Rule 15c2-4 — Transmission or maintenance of payments received in connection with underwritings

2.1.3 Investigation of Financing Proposals

2.1.3.1 Feasibility study

2.1.3.2 Letter of intent

2.1.3.3 Due diligence — process to evaluate

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

2.1.4 Mechanics of Distributions

2.1.4.1 Role of dealer manager

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

Liabilities of selling group members
Components of spread
Dealer manager fee
Selling group commission
Compensation in the form of warrants of stock

2.1.4.2 Role of the placement agent
Contractual obligation to issuer
Principal
Agency
Positioning private placement offering
Compensation
Offering period limitation
Identification of potential investors
Confidentiality agreement
Indication of interest
Distribution of private placement memorandum
Liabilities of placement agent
Regulatory and legal
Distribution of proceeds

2.1.4.3 NASD Rule 2420 — Dealing with Non-members
Need for issuer to contract separately with non-members
Prohibition on sharing fees under NASD Rule IM-2420(d)

2.1.4.4 Finders
Defined as an un-registered introducer
Prohibited practices
Sales compensation to non-members of a national securities exchange or association registered with the Securities and Exchange Commission
Referrals by non-members of individual clients to broker/dealers in exchange for compensation from broker/dealer

2.1.4.5 SEC Rule 3a4-1 — Associated persons of an issuer deemed not to be brokers

2.1.4.6 NASD Rule 1060(b) — Persons exempt from registration—foreign finders

2.1.5 Pricing of the Issue
Priced according to prevailing:
Market conditions
Industry conditions
Customer demand
Issuer needs

2.1.6 Limitations on Marketing and Advertising for Private vs. Public Offerings
2.1.6.1 Section 2 — Definitions under the Act
2.1.6.1.1 Distribution of information during a publicly-registered underwriting
Rule 134 — Communications not deemed a prospectus
Rule 137 — Definition of "offers", "participates", or "participation" in Section 2(11) in relation to certain publications by persons

independent of participants in a distribution
Rule 138 — Definition of "offer for sale" and "offer to sell" in Sections 2(10) and 5(c) in relation to certain publications
Rule 139 — Definition of "offer for sale" and "offer to sell" in Sections 2(10) and 5(c) in relation to certain publications

2.1.6.2 Section 5 — Prohibitions Relating to Interstate Commerce and the Mails
Rule 135 — Notice of certain proposed offerings
Rule 135A — Generic advertising
Rule 153A — Definition of "preceded by a prospectus" as used in Section 5(b)(2) of the Act, in relation to certain transactions requiring approval of security holders

2.1.6.3 Section 12 — Civil Liabilities Arising in Connection with Prospectuses and

2.1.6.4 Special issues dealing with electronic offerings
SEC Release 34-42728 — Use of Electronic Media

2.2 Trading Corporate Securities

2.2.1 Overview of Securities Markets (publicly traded securities)
2.2.1.1 Dealer Market
Nasdaq tier securities

2.2.1.2 Auction markets
Exchange markets

2.2.1.3 Non-exchange securities in
Non-Nasdaq OTC
Bulletin Board and Pink sheets

2.2.1.4 Third market
Trading in exchange listed securities in OTC market

2.2.1.5 Fourth market
Private transactions between institutional investors without the use of a broker/dealer

2.3 Securities Act of 1933 and SEC Rules Thereunder

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

2.3.1.2 Types of transactions

Section 3(b) — $5,000,000 in any 12 month period by SEC Rule
Regulation A offerings
Purpose
Limitation on size of offering
Limitation on time period

2.3.2 Section 4 -- Exempted transactions

2.3.2.1 Statutory exemptions
Section 4(a)(2) — Transactions by an issuer not involving any public offering
Section 4(6) — Transactions involving offers or sales by an issuer solely to one or more accredited investors up to the Section 3(b) maximum

2.3.2.2 Regulation D — Limited offer and sale of securities without SEC registration under the Securities Act of 1933 (Private offerings exemptions from registration)

2.3.2.2.1 Rule 501 — Definitions and terms used in Regulation D
Accredited investor
Affiliate
Aggregate offering price
Number of purchasers
Executive officer
Issuer
Purchaser representative

2.3.2.2.2 Rule 502 — General conditions to be met
Integration--6 month safe harbor rule
Information requirements
When information must be furnished
Type of information to be furnished
Limitation on manner of offering
Limitations on resale

2.3.2.2.3 Rule 503 — Filing of notice of sale
Filing Form D

2.3.2.2.4 Rule 504 — Exemption for limited offers and sales of securities not exceeding $1,000,000
Exemption
Conditions to be met
Limitation on aggregate offering price

2.3.2.2.5 Rule 505 — Exemption for limited offers and sales of securities not exceeding $5,000,000
Exemption
Conditions to be met
Limitation on aggregate offering price
Limitation on number of purchasers
Disqualification

2.3.2.2.6 Rule 506 — Exemption for limited offers and sales without regard to dollar amount of offering
Exemption
Conditions to be met
Limitation of number of purchasers
Nature of purchasers

2.3.2.2.7 Rule 507 — Disqualifying provision relating to exemptions under Rules 504, 505 and 506

2.3.2.2.8 Rule 508 — Insignificant deviations from a term, condition or requirement of Regulation D

2.4 Securities Exchange Act of 1934 and SEC Rules Thereunder

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

2.4.2 Regulation FD — Disclosure (Issuer obligations)
2.4.2.1 Rule 100 — General rule regarding selective disclosure
2.4.2.2 Rule 101 — Definitions

2.5 Insider Trading Regulations

2.5.1 Insider Trading and Securities Fraud Enforcement Act of 1988
2.5.1.1 Section 3 — Civil penalties of controlling persons for illegal insider trading by controlled persons
2.5.1.1.1 Securities Exchange Act of 1934
Section 15(f) — Policies and procedures to be developed by broker/dealers to prevent misuse of material, non-public information
Section 21(d) — Injunctions and prosecution of offenses
Section 21A — Civil penalties

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

2.5.1.2 Section 4 — Increases in criminal penalties
2.5.1.2.1 Securities Exchange Act of 1934
Section 32(a) — Penalties

2.5.1.3 Section 5 — Liability to contemporaneous traders for insider trading
2.5.1.3.1 Securities Exchange Act of 1934

Section 20A — Liability to contemporaneous traders for insider trading

2.5.2 Securities Exchange Act of 1934 and SEC Rules Thereunder

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

2.5.2.1.1 Rule 10b-3 — Employment of Manipulative and Deceptive Devices (by brokers or dealers)

2.5.2.1.2 Rule 10b-5 — Employment of Manipulative and Deceptive Devices (by individuals)

Insider Trading

Material information

Insiders and non-public information

Insiders and tippees

The Chinese Wall Doctrine

2.5.2.1.3 in Rule 10b5-1 — Trading "on the basis of" material nonpublic information insider trading

2.5.2.1.4 Rule 10b5-2 — Duties of trust or confidence in misappropriation insider trading cases

2.5.3 Sarbanes-Oxley Act (general understanding)

2.6 FINRA/NASD — Regulations

2.6.1 Conduct Rules

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

General prohibitions

Preconditions for sale

General exemptions

Issuer-directed securities

Anti-dilution provisions

Stand-by-purchasers

Undersubscribed offerings

Definitions

2.6.1.2 FINRA Rule 5122—Private placements of securities issued by members

2.6.1.3 Trading standards and practices

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

FINRA Rule 2140 — Interfering with the transfer of customer accounts in the context of employment disputes

FINRA Rule 5240 — Anti-intimidation/coordination

FINRA Rule5270 — Front running policy

FINRA Rule 5280 — Trading ahead of research reports

FINRA Rule 5320 — Prohibition against trading ahead of customer orders

2.6.1.4 FINRA Rule 2241—Research Analysts and Research Reports

3.0
Analyzing Corporate Securities And Investment Planning

3.1 Securities Analysis

3.1.1 Fundamental Analysis

3.1.1.1 Reading financial statements

3.1.1.1.1 The balance sheet

- Assets
  - Current assets
  - Fixed assets
  - Intangible assets
- Liabilities
  - Current liabilities
  - Long-term debt
  - Stockholders equity (net worth)

3.1.1.1.2 The income statement

- Net sales
- Operating expenses
- Selling and administrative expenses
- Depreciation
- Operating income
- Non-operating income
- Total income (EBIT)
- Interest on debt
- (Pre-tax) income (EBT)
- Taxes
- Net income (EAT)

3.1.1.1.3 Importance of footnoted items

- Extraordinary items
- Non-recurring items
- Fully diluted earnings

3.1.1.1.4 Corporate changes affecting financial statements

- New issue of securities
- Exercise of rights or warrants
- Conversion of convertible securities
- Stock dividends and splits
- Cash dividends

3.1.1.1.5 Sources and uses of funds statement

3.1.1.2 Analyzing financial statement

3.1.1.2.1 Working capital

3.1.1.2.2 Profitability ratios

Margin of profit
Earnings per share/Cash flow per share
Price earnings ratio
Dividend payout ratio

3.1.1.2.3 Short-term liquidity measures
Current ratio
Acid test ratio

3.1.1.2.4 Long-term solvency measures
Times interest earned ratio
Preferred dividend coverage
Leverage ratios
Stockholder's equity to total capital
Total debt to total capital

3.1.1.3 Analyzing corporate debt
Bond ratings
Standard and Poor's Corporation
Moody's Investors Service
Protective provisions of the issue
Call provisions
Interest rate risk/yield curve
Times interest earned ratio
Net tangible assets per bond
Yields
Coupon rate (nominal yield)
Current yield
Yield to maturity
Yield to call
Basis points
Special considerations for very low-grade ("junk") bonds
Usually rated lower than BB
Possess very high speculative elements as to the repayment of principal and interest
Often trade more like equities than higher-grade bonds
Credit risk

3.1.1.4 Analyzing equity corporate securities
Book value
Stated
Tangible
Goodwill
Market value

3.1.1.5 Analyzing U.S. Government securities
3.1.1.5.1 U.S. Treasury Securities
Bills
Notes
Bonds
Strips

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

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

3.2 Economics

3.2.1 Business Cycles

3.2.1.1 Phases
Expansion
Peak
Recession
Trough
Depression
Inflation/deflation

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

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

3.2.2 Monetary Policies of the Federal Reserve

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

M1, M2, M3

3.2.2.2 Tools of the Federal Reserve Board
- Open-market operations
- Changes in the discount rate
- Changes in bank reserve requirements
- Margin requirements (Regulations T and U)
- Moral suasion

3.2.2.3 Sequence effects generated by a Fed policy designed to contract (expand) the money supply

3.2.3 Fiscal Policies of the Federal Government

Effects of use of congressional or executive authority to raise/lower federal taxes and/or spending

Effects of budget deficits/surpluses on the economy as a result of changes in fiscal policy

Effects of automatic stabilizers in cushioning economic swings (e.g., changes in private savings rates, welfare transfer payments, unemployment compensation, foreign exchange activity, etc.)

3.2.4 International Economic Factors

3.2.4.1 Currency valuation
- Fluctuation

3.2.4.2 Balance of payments
- Relation between domestic inflation (deflation) and balance of payment deficits (surpluses)

3.3 Investor Suitability

3.3.1 Investment Objectives

3.3.1.1 Principal accumulation
- Amount
- Accumulation period

3.3.1.2 Income
- Current needs
- Amount needed in future
  - Accumulation period
  - Payout period

3.3.2 Financial Status
- Balance sheet
- Income and expenses
- Participation in benefit plans
- Expected changes in financial status

3.3.3 Investment Constraints
- Ability to risk loss of principal
- Ability to risk loss of investment income

Ability to assume purchasing power risk with regard to principal and income

Ability or willingness to hold investments over relatively long periods
Requirements for marketability of securities held
Tax considerations
Investment temperament and investment experience

3.3.4 Legal/regulatory requirements

3.3.4.1 Fiduciary responsibilities
Uniform trust code
ERISA requirements

3.3.4.2 Investment Company Act of 1940
Rule 17a-6 – Exemption of transactions with certain affiliated persons
Rule 17a-7 – Exemption of certain purchase or sale transactions between an investment company and certain affiliated persons thereof

3.3.4.3 Investment Advisors Act of 1940
Section 206 – Prohibited transactions by investment advisors

3.3.4.4 FINRA Rule 2090 – Know Your Customer

3.3.4.5 FINRA Rule 2111 – Suitability

3.3.5 Risk and the Construction of Investment Portfolios

3.3.5.1 Credit risk and portfolio policies

3.3.5.1.1 Definition of credit risk and its effect on future values of income and principal in different types of investments

3.3.5.1.2 Appropriate mix of conservative and speculative securities in a portfolio derived from customer's ability to risk loss of principal and income

3.3.5.1.3 Concentration of investment in a small number of issues vs. diversification

3.3.5.1.4 Concentrated portfolios or portfolios heavily invested in speculative securities require an ability to hold securities during market fluctuations and also require significant investment management talents

3.3.5.2 Interest rate risk and portfolio policies

3.3.5.2.1 Definition of interest rate risk and its effect on future values of income and principal in different types of investments

3.3.5.2.2 Appropriate mix of maturity schedules on debt obligations derived from customer's ability to risk loss of principal and income
Effect of long maturities
Effect of short maturities
Averaging effect on yields of various maturity spacing strategies

3.3.5.3 Purchasing power risk and portfolio policies

3.3.5.3.1 Definition of purchasing power risk and its effect on the constant dollar

value of income and principal in different types of investments

3.3.5.3.2 Need to reconcile investment policies with regard to financial risk with policies designed to minimize loss of purchasing power

3.3.5.3.3 Balanced portfolio of bonds, preferred, common and convertible issues provides downside protection and potential inflation hedge

3.3.5.4 Other risk factors and portfolio policies

3.3.5.4.1 Marketability of securities in the portfolio and customer liquidity needs

3.3.5.4.2 Taxability of securities in the portfolio and customer tax bracket

3.3.5.4.3 Callability of securities in the portfolio and the importance of call protection given customer investment objectives

3.3.5.4.4 Convertibility of securities in the portfolio, the value of the conversion feature and the effect of potential forced conversions on customer objectives

3.3.5.4.5 Economic, social and political risks and their potential effects on customer investments

3.3.5.4.6 Currency rate risk

3.4 Tax Consequences of Securities Transactions

3.4.1 Holding Periods of Securities

3.4.1.1 Closing date determines date of acquisition

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

3.4.2 Tax Basis of Securities

3.4.2.1 Purchases

3.4.2.2 Exchange of securities

3.4.2.3 Stock rights

3.4.2.4 Gifts of securities

3.4.2.5 Inheritance of securities

3.4.3 Tax Treatment of Securities Transactions

3.4.3.1 Definition of a capital gain (loss)

3.4.3.2 Computation of net capital gains (losses)

3.4.3.3 Ordinary income tax treatment of realized net capital gains (fully effective 1/1/88)

3.4.3.4 Deduction of net capital losses from ordinary income

3.4.3.5 Limitation on net capital loss deductions

3.4.3.6 Loss carryover provisions

3.4.4 Tax Treatment of Dividend Income From Corporate Stock

3.4.4.1 Cash dividends

3.4.4.2 Stock dividends (ordinary) and effect on cost basis

3.4.4.3 Stock rights-receipt ordinarily not a taxable event

3.4.4.4 Deductibility of a specified percentage of dividend income received by a corporation from stock holdings in other domestic and certain foreign corporations

3.4.5 Tax Treatment of Interest Income on Debt Obligations

3.4.5.1 Corporate obligations -- ordinary income taxable at federal, state and local levels

3.4.6 Special Tax Features of Bonds

3.4.6.1 Amortization of bond premiums (taxable bonds)
- Election by investor
- Amortized premium equals purchase cost minus value at maturity divided by number of years to maturity (or call)
- Subtract amortized premium from each year's taxable income
- Basis reduced by amount of amortized premium
- Adjustment for bond premiums due to conversion privilege

3.4.6.2 Amortization of bond discounts (taxable bonds)

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

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

3.4.6.4 Accretion of discounts

4.0
Handling Customer Accounts And Industry Regulations

4.1 Account Documentation

4.1.1 New Account Form Information

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

4.1.2 Supplementary Documentation

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

4.2 Transactions in Accounts

4.2.1 Types of Transactions

- Principal
- Agency
- Riskless principal

4.2.2 Private placement documentation

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

4.3 General Regulation of Brokers and Dealers

4.3.1 Regulatory Purposes and Roles of:
Securities Exchange Commission
Self-Regulatory Organizations (FINRA Exchanges, MSRB)
State securities agencies

4.3.2 FINRA/NASD — Regulations
4.3.2.1 By-Laws
Article I — Definitions
Associated Person of a member
Article III — Qualifications of members and associated persons
Section 1 — Persons eligible to become members and associated persons of members
Section 3 — Ineligibility of certain persons for membership or association
Section 4 — Definition of disqualification (statutory disqualification)
Article IV — Membership
Article V — Registered representatives and associated persons

4.3.2.2 General Provisions
0140 — Applicability

4.3.2.3 Membership and Registration Rules
FINRA Rule 1122 — Filing of misleading information as to membership or registration
FINRA Rule 1250 — Continuing Education Requirements
NASD Rules 1000 — Membership application and associated person registration
Rule 1030 — Registration of representatives
Rule 1080 — Confidentiality of examinations

4.3.2.4 Conduct Rules
4.3.2.4.1 FINRA Rule 2020 — Use of Manipulative, Deceptive or Other Fraudulent Devices

4.3.2.4.2 FINRA Rule 2210 — Communications with the Public

4.3.2.4.3 FINRA Rule 3230 — Telemarketing

4.3.2.4.4 FINRA Rule 2150 — Improper Use of Customers' Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts
Improper use
Prohibition Against Guarantees
Sharing in accounts; extent permissible
FINRA Rule 4330 — Customer Protection — Permissible Use of Customers'

Securities
Authorization to Lend Customers' Margin Securities
Requirements for Borrowing of Customers' Fully Paid or Excess
Margin
Securities

4.3.2.4.5 FINRA Rule 3240 — Borrowing From and Lending To Customers

4.3.2.4.6 FINRA Rule 2122 — Charges for services performed

4.3.2.4.7 FINRA Rule 5141 —Sales of Securities in a Fixed Price Offering

4.3.2.4.8 FINRA Rule 3110 — Supervision
Supervisory system
Written procedures
Internal inspections
Written approval
Qualifications investigated
Definitions
Office of supervisory jurisdiction
Branch office

4.3.2.4.9 FINRA Rule 3310 — Anti-money laundering compliance program

4.3.2.4.10 FINRA Rule 5121 — Public Offerings of Securities with Conflicts of
Interest

4.3.2.4.11 FINRA Rule 3280 — Private securities transactions of an associated
person
Written notice
Transactions for compensation
Transactions not for compensation
Definitions
Private securities transaction
Selling compensation

4.3.2.4.12 NASD Rule 3050 — Transactions for or by associated persons

4.3.2.4.13 FINRA Rule 3220 — Influencing or rewarding employees of others

4.3.2.4.14 FINRA Rule 2060 — Use of Information obtained in fiduciary capacity

4.3.2.5 FINRA Procedural Rules
4.3.2.5.1 Rule 8000 — Investigations and Sanctions
4.3.2.5.1.1 Rule 8100 —General provisions
Rule 8110 — Availability of Manual to customers
Rule 8120 — Definitions

4.3.2.5.1.2 Rule 8200 — Investigations
Rule 8210 — Provision of information and testimony and

inspection and copying of books

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

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

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

4.3.2.5.4 Rule 14000 —Code of Mediation procedure

4.3.3 General Administrative Requirements for Broker/Dealers

4.3.3.1 Disclosure requirements

4.3.3.1.1 SEC Rules
Rule 10b-10 — Confirmation of transactions
Rule 15c1-2 — Fraud and misrepresentation
Rule 15c1-3 — Misrepresentation by brokers and dealers as to registration
Rule 15c1-5 — Disclosure of control
Rule 15c1-6 — Disclosure of interest in distributions
Regulation S-P — Privacy of consumer financial information

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

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

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

4.4 Securities Investor Protection Act and SIPC Rules Thereunder

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

Sample Item Formats

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

1. Which of the following best defines the "book value" of a common stock?

   (A) The price at which the shares were originally issued
   (B) The theoretical value per share the stock would have upon corporate liquidation **
   (C) The ratio of price to earnings for stocks
   (D) An accounting figure used in determining dividend distributions

2. On a corporate balance sheet, all of the following would be listed under "current assets" **except**:

   (A) inventory
   (B) cash
   (C) equipment **
   (D) accounts receivable

3. When a stock is held by a broker for a customer in "street name," it means that the stock is:

   (A) Registered in the name of the customer
   (B) In bearer form
   (C) Registered in the name of the broker or its depository **
   (D) Accompanied by stock powers

4. Which of the following securities represents an ownership interest in a public corporation?

   (A) Common stock **
   (B) Common stock warrants
   (C) Corporate bonds
   (D) Debentures