Government Securities Limited Representative Qualification Examination (Test Series 72)

Study Outline

© 2018 FINRA
Introduction

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

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

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Number of Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Government Securities</td>
<td>22</td>
</tr>
<tr>
<td>2</td>
<td>Mortgaged-Backed Securities</td>
<td>25</td>
</tr>
<tr>
<td>3</td>
<td>Related Securities and Financial Instruments</td>
<td>9</td>
</tr>
<tr>
<td>4</td>
<td>Economic Activity, Government Policy and the Behavior of Interest Rates</td>
<td>13</td>
</tr>
<tr>
<td>5</td>
<td>Securities Industry Regulations and Legal Considerations</td>
<td>15</td>
</tr>
<tr>
<td>6</td>
<td>Customer Considerations</td>
<td>16</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Structure of the Examination

The examination is composed of 100 multiple-choice questions covering all of the materials in the following outline in accordance with the subject-matter distribution shown above. Candidates will be allowed 3 hours to complete the examination. A candidate must correctly answer 70 percent of the questions to receive a passing grade. 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/qualification-exams](http://www.finra.org/industry/qualification-exams)
There are also sample Series 72 test questions written in the various formats. They do not mirror the difficulty level of the actual test questions or the subject matter distribution of the test itself. Their use is merely to familiarize the candidate with the styles of multiple-choice questions used in the Series 72 Examination.

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

Please Note: Candidates are responsible for keeping abreast of changes made to the applicable rules and regulations, as the examination is updated when new rules are introduced and/or amended.
1.0
Government Securities

1.1 Types and characteristics of Government Securities

1.1.1 Direct Obligations of the U.S. Treasury

1.1.1.1 Treasury securities — Benchmark that is the source of credit, marketability and liquidity for other financial markets
   Full faith and credit of the United States
   Treasury bills
   Treasury notes
   Treasury bonds
   Separate Trading of Registered Interest and Principal of Securities (STRIPS)
   Treasury inflation-indexed securities (also referred to as TIPS)

1.1.1.2 Non-marketable Treasury instruments
   United States Savings Bonds (Series EE and I)
   SLGS (State and Local Government Series)

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

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

1.1.2.2 Agencies with securities having explicit backing (full faith and credit) of the U.S. Government
   Government National Mortgage Association (GNMA or Ginnie Mae)
   Private Export Funding Corporation (PEFCO)
   Small Business Administration (SBA)

1.1.2.3 Agencies with securities that do not have explicit backing of the U.S. Government
   Federal Agricultural Mortgage Corporation (FAMC or Farmer Mac)
   Federal Farm Credit Banks (FFCB)
   Federal Home Loan Banks (FHLB)
Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac)
Federal National Mortgage Association (FNMA or Fannie Mae)
Financing Corporation (FICO)
Resolution Funding Corporation (Refcorp)
Tennessee Valley Authority (TVA)

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

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

1.1.4 Maturity and Denominations of Various Government Securities

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

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

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

1.1.8 **Methods of Settlement and Delivery**

Settlement
- Regular
- Cash
- When issued
- Delayed
  - Corporate settlement
  - Skip Day
- Accrued interest
- Financing positions under delayed settlement

Forms of delivery
- Book entry only
- Fully registered

1.2 **The Market for Government Securities**

1.2.1 **Participants in the Market and the Role of Each**

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

1.2.2 **Functions of a Trader**

- Financing the trading position
- Bank financing
- Repurchase Agreements (REPOs)
- Securities borrowing and lending
- Give quotes
- Hedging/arbitrage
- Make markets
- Position trading
Securing collateral for delivery/reverse repos
Supply information to salespersons

1.2.3 New Issues

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

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

1.2.4 The Secondary Market

1.2.4.1 Kinds of transactions
   Principal
   Agent

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

1.2.4.3 Methods of comparing bond prices
   Bids vs. offers
      Round lot/odd lot
   Duration
   Expression of dollar price/yield
   Yield to call
   Yield to maturity
2.0
Mortgage-Backed Securities

2.1 Development/Evolution of Mortgage-Backed Securities

2.1.1 The Underlying Mortgages

2.1.1.1 Definition of mortgage loan
   Collateralized by real estate
   Monthly amortization

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

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

2.1.1.4 Characteristics of mortgage loans
   Adjustable rate (ARM)
   Caps and floors
   Periodic
   Lifetime
   Convertible vs. nonconvertible
   Indexed to
   COFI (Cost of Funds Index)
   CMT (Constant Maturity Treasury)
   LIBOR (London Interbank Offered Rate)
   Initial rates, “teaser rates”
   Reset parameters
   Payment reset
   Interest rate reset
   Assumable vs. non-assumable
   Fixed rate
   Loan size
Maturities
- 30-year (fully amortized)
- 20-year (fully amortized)
- 15-year (fully amortized)
- 7-year (balloons)
- 5-year (balloons)
Others (e.g., 10-year, 20-year, interest only and graduated payments)
Underwriting standards (loan-to-value [LTV] ratio and underwriting ratios)
Mortgage amortization

2.1.2 Securitization of the Mortgages

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

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

2.2 Mortgage-Backed Securities — Types, Structure and Features

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

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

2.2.1.2 Fannie Mae (FNMA) Mortgage Pass-Through Certificates — composed of qualifying FNMA conventional residential mortgages or some FHA insured mortgages
- 30-year
- 15-year (dwarfs)
- 7-year (balloons)
- Adjustable rate mortgages (ARMs)
2.2.1.3 Freddie Mac (FHLMC) Participation Certificates — composed of qualifying FHLMC conventional residential mortgages (Gold PCs and non-Gold PCs)
   - 30-year
   - 15-year (gnomes)
   - 7-year (balloons)
   - 5-year (balloons)
   - Adjustable rate mortgages (ARMs)

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

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

2.2.3 Stripped Mortgage-Backed Securities
   - Interest only (IO)
   - Principal only (PO)

2.3 Characteristics of Mortgage-Backed Securities

2.3.1 Characteristics Common to All Mortgage-Backed Securities
   - Backed by real property
   - Credit ratings
   - Current face/amortized value factor
   - Fixed or floating rate securities
   - Maturity profile
     - Average life
     - Stated or final maturity
   - Original face value
   - Payment delay and payment date
   - Pool or series number
   - Prepayment of principal
   - Trade in the over-the-counter market (OTC)
2.3.2 Unique Characteristics of Specific Mortgage-Backed Securities

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

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

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

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

2.4 The Mortgage-Backed Securities Market

2.4.1 Participants in the Market
 Dealers — primary, secondary
 Federal agencies
 Investors — individual, institutional
2.4.2 The Distribution Process and Secondary Trading

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

2.4.2.2 The secondary market
2.4.2.2.1 Kinds of transactions
   Principal
   Agent

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

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

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

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

2.4.4 Methods of Settlement and Delivery

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

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

Delivery
- Book-entry
- DTC
3.0 Related Securities and Financial Instruments

3.1 Money Market Instruments

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

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

3.1.3 Certificates of Deposit (CDs)
Brokered CDs
   FDIC Insurance
   Methods of calculating interest
Negotiable/ Jumbo CDs
   Domestic CDs
   Eurodollar CDs
   Yankee CDs
Secondary market trading
Settlement
Various maturities

3.1.4 Repurchase Agreements (Repos) and Reverse Repurchase Agreements
Types and Maturities
   Overnight Repo
   Open Repo/TFN (until further notice)
   Term Repo
Collateral
3.2 Other Instruments Affecting the Government Securities Market

3.2.1 Federal Funds
   Definition
   Fed funds rate
   Market/participants
   Purpose

3.2.2 Asset-Backed Securities (ABS)

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

3.2.2.2 Impact on the government securities market

3.2.3 Interest Rate Futures

3.2.3.1 Types traded on exchanges
   Eurodollar time deposit futures contracts
   Credit risk
   Euro strips contracts
   Treasury Eurodollar (TED) spread
   Fed funds futures
   Treasury bill futures contracts
   Two-year Treasury note futures contract
   Five-year Treasury note futures contract
   Ten-year Treasury note futures contracts
   Treasury bond futures contracts
3.2.3.2 Characteristics
Actively traded
Agreement between buyer/seller and an established futures exchange or its clearing house
Contract specifies that buyer/seller take or make delivery of bonds or cash, at a specified price, at a designated time
Mark to market
Safety net characteristics, i.e., exchange protection factors and procedures
Various expiration dates

3.2.3.3 Pricing
Basis trading
Conversion factor
Terms of contract quotation

3.2.3.4 Impact on the government securities market
Open interest
Liquidity

3.2.4 Options on Government Securities

3.2.4.1 Types
Options on cash instruments
Options on futures

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

3.2.4.3 Definitions and terminology
American vs. European style
At-the-money (ATM)
Call
Covered options
Expiration date
Implied volatility
In-the-money (ITM)
Intrinsic value
Option
Out-of-the-money (OTM)
Premium
Put
Strike price
Time value
4.0
Economic Activity, Government Policy, And
The Behavior of Interest Rates

4.1 Fiscal Policy

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

4.1.2 U.S. Treasury Debt Management Practices
Impact of short-term and long-term financing
Increase/decrease in amounts borrowed
Impact on the average life of debt
Regularity of debt issuance

4.1.3 Effects of Fiscal Policy on the Economy
4.1.3.1 Cyclical expansion
   Effects of tax cuts
   Increased government spending
   Transfer payments

4.1.3.2 Structural contraction
   Effects of tax increases
   Decrease of government spending

4.2 Monetary Policy

4.2.1 Objectives of Federal Reserve Monetary Policy
Price stability
Long-term economic growth in an environment of low inflation (i.e., an inflation rate such that economic plans are not impacted by inflationary expectations)
Low unemployment rate
Steady non-inflationary growth
Humphrey-Hawkins Act
4.2.2 Major Factors Influencing Federal Reserve Monetary Policy
   - Economic indices
   - Inflation signals and pressures
   - Rate of capital formation and investment
   - Foreign exchange considerations

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

4.2.4 Operating Tools Used for Implementing Federal Reserve Policy
   - Open market operations
     - Adding and draining reserves (Repos and Reverse Repos)
     - Purchase and sale of securities
   - Discount window
   - Reserve requirements
   - Federal funds market

4.3 Behavior of Interest Rates

4.3.1 Supply and Demand for Credit Relative to the Business Cycle
   - Definition and characteristics of the business cycle
   - Public vs. private borrowing needs

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

4.3.3 Yield Curve Analysis
   - Expectations of Fed policy moves and investor positioning on the curve
Impact of economic and financial conditions on shape of the yield curve

4.3.4 Technical Analysis — Definitions
  Breakouts
  Moving averages
  Overbought
  Oversold
  Resistance levels
  Support levels

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

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

4.4.2 Balance of Payments
  Current account surpluses/deficits
  Impact of foreign monetary and fiscal policy on U.S. rates
  Trade surpluses/deficits
5.0
Securities Industry Regulations and Legal Considerations

5.1 Applicable Federal Laws and SEC Rules Thereunder

5.1.1 Securities Act of 1933

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

5.1.2 Securities Exchange Act of 1934

5.1.2.1 Section 3 — Certain Definitions Under the Act
Section 3(a)(4) — Broker
Section 3(a)(5) — Dealer
Section 3(a)(10) — Security
Section 3(a)(12) — Exempted security
Section 3(a)(41) — Mortgage related security
Section 3(a)(42) — Government securities
Section 3(a)(43) — Government securities broker
Section 3(a)(44) — Government securities dealer
Section 3(a)(45) — Person associated with a government securities broker or dealer

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

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

5.1.2.4 Section 15(c)(2) — Fraudulent acts or practices and fictitious quotations
Rule 15c1-2 — Fraud and misrepresentation
Rule 15c1-3 — Misrepresentation by brokers and dealers as to registration
Rule 15c2-1 — Hypothecation of customers’ securities
5.1.2.5 Section 15C — Government securities brokers and dealers
Antifraud provisions applicable to issuers as well as to government securities brokers and dealers
Registration of government securities brokers and dealers with the SEC
Regulators
Treasury Department
Securities and Exchange Commission
Federal Reserve Bank of New York
FINRA
Amendments of 1993 — Registration/qualification of government securities dealer personnel (only qualified to sell securities issued by the U.S. Government and its agencies; not qualified to sell private label CMOs and REMICs)

5.1.2.6 SEC Regulation S-P — Privacy of consumer financial information
Treatment of nonpublic personal information about consumers by financial institutions

5.1.3 Insider Trading Regulations

5.1.3.1 Insider Trading and Securities Fraud Enforcement Act of 1988
Section 3 — Civil penalties of controlling persons for illegal insider trading by controlled persons
Section 4 — Increases in criminal penalties
Section 5 — Liability to contemporaneous traders for insider trading

5.1.3.2 Securities Exchange Act of 1934 and SEC Rules Thereunder
Rule 10b-5 — Employment of manipulative and deceptive devices
Insider trading
Material information
Non-public information
Insiders and tippees
Rule 10b5-1 — Trading “on the basis of” material nonpublic information in insider trading
Rule 10b5-2 — Duties of trust or confidence in misappropriation insider trading cases

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

5.1.5 Books and Records
5.1.5.1 Securities Exchange Act of 1934 and SEC Rules Thereunder
Rule 17a-3 — Records to be Made by Certain Exchange Members, Brokers, and Dealers
Rule 17a-4 — Records to be Preserved by Certain Exchange Members, Brokers and Dealers
Rule 17a-8 — Financial Recordkeeping and Reporting of Currency and Foreign Transactions
17f-1 — Requirements for Reporting and Inquiry With Respect to Missing, Lost, Counterfeit or Stolen Securities

5.1.5.2 Books and Records Rules
FINRA Rules
Rule 2268 — Requirements When Using Predispute Arbitration Agreements for Customer Accounts
Rule 3150 — Holding of Customer Mail
Rule 4513 — Records of Written Customer Complaints
Rule 4514 — Authorization Records for Negotiable Instruments Drawn From a Customer’s Account

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

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

5.2.2 Bidding, Certifications and Payment (Subpart B)
Noncompetitive and competitive bidding (Section 356.12)
Net long position (Section 356.13)
Submitting bids for customers (Section 356.14)
Certifications (Section 356.15)
Required notification to the Fed (Section 356.24d)

5.2.3 Large Position Reporting Requirement (Section 420)

5.3 FINRA/NASD Rules

5.3.1 FINRA By-Laws
Article III — Qualifications of members and associated persons
  Section 4 — Definition of disqualification
Article V — Registered representatives and associated persons
  Section 4 — Retention of jurisdiction
Article VII — Powers and authority of the Board of Governors
  Section 2 — Authority to cancel or suspend for failure to submit required information
Article XII — Disciplinary proceedings
Article XIII — Powers of Board to impose sanctions
5.3.2 Membership and Registration Rules
FINRA Rule 1210 – Registration Requirements
FINRA Rule 1210.05 – Rules of conduct for taking examinations and
    confidentiality of examinations
FINRA Rule 1220(a)(1) – Definition of Principal
FINRA Rule 1220(b) – Definition of Representative and Representative
    Registration Categories
FINRA Rule 1230 – Associated persons exempt from registration
FINRA Rule 1240 — Continuing Education Requirements
NASD Rule 1041 — Registration Requirements for Assistant
    Representative

5.3.3 Conduct Rules
5.3.3.1 FINRA Rule 2010 — Standards of commercial honor and principles of
    trade
5.3.3.2 FINRA Rule 2020 — Use of manipulative, deceptive or other fraudulent
    devices
5.3.3.3 FINRA Communication With the Public Rules
    Rule 2214 – Requirements for the Use of Investment Analysis
        Tools
    Rule 2216 – Communications with the Public About Collateralized
        Mortgage Obligations (CMOs)
5.3.3.4 FINRA Rule 2210 – Communications with the Public
5.3.3.5 FINRA Rule 3230— Telemarketing
5.3.3.6 FINRA Rule 2269 — Disclosure of Participation or Interest in Primary
    or Secondary Distribution
5.3.3.7 FINRA Rule 2261 — Disclosure of Financial Condition
    Requirement to furnish most recent report of the firm’s financial
    condition
5.3.3.8 FINRA Rule 2150 — Improper Use of Customers’ Securities or Funds;
    Prohibition Against Guarantees and Sharing in Accounts
        Improper Use
        Prohibition Against Guarantees
        Sharing in Accounts; Extent Permissible
    FINRA Rule 4330 — Permissible Use of Customers’ Securities
        Authorization to Lend Customers’ Margin Securities
        Requirements for Borrowing of Customers’ Fully Paid or Excess
        Margin Securities
5.3.3.9 NASD Rule 2340 — Customer account statements
    Requirement to send customers monthly and/or quarterly statements
    on account activity
5.3.3.10 FINRA Rule 3240 — Borrowing From or Lending To Customers
5.3.3.11 FINRA Rule 2040 — Payments to Unregistered Persons
5.3.3.12 FINRA Rule 2121 — Fair prices and commissions
5.3.3.13 FINRA Rule 4210 — Margin Requirements
   Government securities marginable
5.3.3.14 FINRA Rule 5130 — Restrictions on the purchase and sale of initial equity public offerings
5.3.3.15 FINRA Rule 3110 — Supervision
   Supervisory system
   Written procedures
   Written approval
   Definitions
   Office of supervisory jurisdiction
   Branch office
   FINRA Rule 3170—Tape Recording of Registered Persons by Certain Firms
5.3.3.16 FINRA Rule 2060— Use of Information Obtained in Fiduciary Capacity
5.3.3.17 FINRA Rule 3310— Anti-Money Laundering Compliance Program

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

   FINRA Rule 2263 — Arbitration Disclosure to Associated Persons
   Signing or Acknowledging Form U4
   FINRA Rule 3210 — Accounts At Other Broker-Dealers and Financial Institutions
   FINRA Rule 3220 — Influencing or rewarding employees of others
   FINRA Rule 3270 — Outside Business Activities of Registered Persons
   FINRA Rule 3280 — Private Securities Transactions of an Associated Person
   FINRA Rule 4530 — Reporting Requirements

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

5.3.6 FINRA Procedural Rules

5.3.6.1 Complaints, investigations and sanctions
   Rule 8110 — Availability of Manual to customers
   Rule 8120 — Definitions
   Rule 8310 — Sanctions for violation of the rules
   Rule 8320 — Payment of fines, other monetary sanctions, or costs; summary action for failure to pay
   Rule 8330 — Costs of proceedings
5.3.6.2 Code of Procedure
Rule 9100 — Application and purpose
Rule 9200 — Disciplinary proceedings
Rule 9300 — Review of disciplinary proceeding by National Adjudicatory Council and FINRA Board; application for SEC review
Rule 9500 — Other proceedings
Rule 9800 — Temporary cease and desist orders

5.3.6.3 Code of Arbitration Procedure

5.3.6.3.1 Part I — Interpretive Material, Definitions, Organization and Authority
IM-12000 and IM-13000 — Failure to act under provisions of code of arbitration procedure for customer/industry disputes
Rules 12105 and 13105 — Agreement of the parties

5.3.6.3.2 Part II — General Arbitration Rules
Rule 12200 — Arbitration under an arbitration agreement or the rules of FINRA
Rule 12201 — Elective arbitration
Rule 12202 — Claims against inactive members
Rules 12204 and 13204 — Class action claims
Rule 12205 — Shareholder derivative actions
Rule 13200 — Required arbitration
Rule 13201 — Statutory employment discrimination claims
Rule 13202 — Claims involving registered clearing agencies

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

5.3.6.4 Rule 14000 — Code of Mediation Procedure

5.4 Securities Investor Protection Act of 1970

5.4.1 Customer Claims
Definition of “separate customer”
Maximum limit on claims for securities
Maximum limit on claims for cash
Valuation of claims
Submission of claims to trustee

5.4.2 SIPC vs. FDIC coverage
General securities firms covered/government securities broker/dealers not covered
Requirement for government securities broker/dealers to disclose their customers are not covered by SIPC — ‘34 Act, 15C(a)(4)
6.0
Customer Considerations

6.1 Customer Accounts

6.1.1 Opening Customer Accounts

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

6.1.1.2 Supplementary documentation — definitions
Credit agreement
Credit terms disclosure
Evidence of authority for:
- Corporate accounts
- Partnership accounts
- Trust accounts
- Fiduciaries/administrators
- Investment advisor
Hypothecation agreement
Joint account agreement form
- Joint tenants with right of survivorship
- Tenants in common
Loan consent agreement
Power of attorney
- Limited authorization
- Full authorization
- Discretionary account
- Joint tenants with rights of survivorship
W-9 backup withholding form
6.1.1.3 Special requirements for accounts of deceased persons
Uniform Transfer-on-Death Security Registration Act
Outstanding orders
Cancellation
Freeze on assets in account until necessary documents are obtained from administrator or executor of estate

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

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

6.2 Recommendations to Customers

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

6.2.2 Financial Status of Customers
Expected changes in financial status
Income and expenses
Net worth
Participation in benefit plans

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

6.2.4 FINRA Rule 2111 — Suitability

6.3 Risks and Strategies

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

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

6.4 Account Transactions

6.4.1 Information for Order Entry
Legal requirements (SEC Rule 17a-3)
Time of entry/execution
Terms and conditions of the order
Price of execution
If cancelled, a notation to that effect
Whether a discretionary account

Types of orders
Market orders
Specified price orders
AON vs. partial execution

6.4.2 Review Report of Execution against Order Ticket
Report execution to client
Report errors immediately through appropriate firm channels

6.5 Tax Consequences of Securities Transactions

6.5.1 Establishing the Cost Basis of Securities

6.5.2 Determining the Holding Periods of Securities

6.5.3 Tax Treatment of Securities Transactions
Definition of a capital gain/loss
Computation of net capital gains/losses

6.5.4 Wash Sale Rules
Definition of a wash sale
Applicable time period of 30 days prior to and after a sale
Definition of “substantially identical” property

6.5.5 Tax Treatment of Interest Income on U.S. Government and Agency Obligations
Federal taxation
State taxation
Exemption from taxation at state level for direct government obligations and certain agency securities
Other agency securities taxable at state level

6.5.6 Special Tax Features of Securities
Accretion of bond discounts
Accrued interest
Amortization of bond premiums
Original issue discount (OID)
## References

<table>
<thead>
<tr>
<th>Title</th>
<th>Author/Editors</th>
<th>Publisher/Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advances in the Fixed Income Modeling and Risk Management</td>
<td>Frank J. Fabozzi, ed.</td>
<td>John Wiley and Sons, Inc. 111 River Street, Hoboken, NJ 07030</td>
</tr>
<tr>
<td>Basics of Mortgage-Backed Securities</td>
<td>Joseph Hu, Frank J. Fabozzi Associates</td>
<td>858 Tower View Circle, New Hope, PA 18938</td>
</tr>
<tr>
<td>Code of Federal Regulations, Title 31</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dictionary of Finance and Investment Terms</td>
<td>John Downes and Jordan E. Goodman</td>
<td>Barron’s Educational Series, Inc. 250 Wireless Boulevard, Hauppauge, NY 11788</td>
</tr>
<tr>
<td>The Federal Reserve System-Purposes and Functions</td>
<td>The Board of Governors of the Federal Reserve System</td>
<td>Washington, DC</td>
</tr>
<tr>
<td>Floating Rate Securities</td>
<td>Frank J. Fabozzi and Steven Mann</td>
<td>John Wiley and Sons, Inc. 111 River Street, Hoboken, NJ 07030</td>
</tr>
<tr>
<td>Government Securities Manual</td>
<td></td>
<td>Bond Market Association 360 Madison Avenue, New York, NY 10017</td>
</tr>
<tr>
<td>GSE Debt Securities, 2002</td>
<td></td>
<td>Bond Market Association 360 Madison Avenue, New York, NY 10017</td>
</tr>
<tr>
<td>How SIPC Protects You</td>
<td>Securities Investor Protection Corporation</td>
<td>805 15th Street, N.W., Suite 800, Washington, DC 20005</td>
</tr>
<tr>
<td>How the Bond Market Works</td>
<td>Robert Zipf,</td>
<td>New York Institute of Finance, New York, NY</td>
</tr>
<tr>
<td>Inside the Yield Book</td>
<td>Sidney Homer and Martin L. Leibowitz</td>
<td>Bloomberg Press (on-line service) <a href="http://www.ordering1.us/bloombergbooks.com">www.ordering1.us/bloombergbooks.com</a></td>
</tr>
<tr>
<td>Instruments of the Money Market</td>
<td>Federal Reserve Bank of Richmond</td>
<td>701 East Byrd Street, Richmond, VA 23219</td>
</tr>
</tbody>
</table>
Sample Question Format

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

Answers
1. (D)
2. (A)
3. (D)
4. (B)

1. Which of the following government securities is a direct obligation of the U.S. Treasury?
   (A) FHLB
   (B) FNMA
   (C) SLMA
   (D) STRIPS

3. The maximum maturity on a domestic bankers acceptance is:
   (A) 30 days
   (B) 90 days
   (C) 120 days
   (D) 180 days

2. Each of the following is an Agency security EXCEPT:
   (A) STRIPS
   (B) SLMA
   (C) FNMA
   (D) FHLB

4. If the U.S. balance of payments deficits should decrease, what would be the most likely effect on the dollar and on Treasury bonds?
   Dollar          Bond Yields
   (A) Weaker      Higher
   (B) Stronger    Lower
   (C) Weaker      Lower
   (D) Stronger    Higher