

CH1 (3-5)

- Banking department does not make a secondary market for new issues, **market makers** make secondary markets for new issues
- Disputes between firms and RR's or firms and clearing corporations must go to **arbitration**

CH2 (6-8)

- Duplicate account statements must be sent if an employee of a member firm opens an account at another financial institution
- Member firms must send duplicate account statements to FINRA if the customer is also an employee of FINRA
- Broker-dealers – duplicate account statements, investment advisors – no duplicate account statements
- When opening account for employee of FINRA, member firm must send duplicate account statements
- RR's cannot borrow/lend to customers that are accredited investors, personal relationships and outside business relationships are allowed for lending/borrowing

CH3 (15-20)

- For capital gains/losses 3,000 a yr can be used to subtract from income, the rest must be taken into the next year
- Husband or wife may give lifetime tax-free gift of unlimited amount to a spouse, any person may give gift to any other person for max of 14k without being taxed
- Dividends paid on stock that are held for more than 60 days are taxed at long-term capital gains rate of 20%, (max tax rate), if stock held less than 60 days, dividends are taxed as ordinary income, the corporate dividend exclusion allows a corporation to exclude 70% of dividend income from taxation that it receives from other corporations

- When making investment recommendations to customers the most important considerations are that the security could be recommended to some investors and it may be a good investment for specific customers, producing profits are not as important as suitability qualities
- Losses in any capital assets can offset capital gains, capital assets are: stocks, bonds, options, municipal securities, real estate, and interests/shares in partnerships
- Dividends from real estate investment trusts are taxed as ordinary income
- Even highest tax bracket investors get taxed max of 20% for long-term capital gains
- Regressive taxes are flat
- Spouses do not pay estate taxes or gift taxes when passed to one another

CH4 (7-10)

- For inactive brokerage accounts, statements must be sent quarterly, active ones – monthly
- Custodian is not allowed to use a minor's account to cover positions in his own account
- In a non-discretionary account, the customer does not need to provide the time and/or price for the order to be filled, the security, long/short and #of shares is what is required
- DVP order, delivery vs payment or RVP order, receipt vs payments can only be executed with the name of the customer's agent and account number
- SIPC provides maximum protection of \$500,000 for each customer/each different account title
- SIPC, net equity in an account is covered (long mkt value – debit balance), in this example, client covered for 400K of securities, client permitted to pay off debit balance and receive full value of securities
- The term wrap account refers to fee arrangement where one fee ranging from 1-3% annually is charged, fee used to cover admin, portfolio mgmt. and transaction costs
- Under UTMA when minor reaches age of majority, account must be transferred, third-party trading authorization can be granted if minor wants custodian to continue management

- Account transfers to another broker must be completed within 3 business days
- Two unrelated individuals as tenants in common can establish a joint account
- In a partnership account, if a partner dies, the assets of the account are frozen until proper legal documents are received
- In discretionary accounts, customer approval is not necessary when acting in the best interest of the client, a principal or supervisor is required to approve the transaction in writing and then it can be executed without contacting the customer
- If a customer wants to hold securities in an account under his street name the securities must be segregated from BD's securities
- If a corporation requests to open an account a corporate resolution must be provided
 - Risk disclosures – options and penny stocks
 - Hypothecation agreement & corporate charter – required for a margin account
- Nondiscretionary account authority – only able to fill the price if customer specifies long/short, the security and the specific amount
- Broker-dealers are required to maintain error accounts, used to hold securities transactions that were executed in error
- In a discretionary account, the customer does not need to be notified at all, only the principal/supervisor needs to approve the transaction and customer must provide written authorization when opening account
- AML programs must have annual testing, ongoing employee training, and an individual designated and made known to FINRA, no blueprint is supplied by SEC or FINRA
- SIPC protection provides 500K protection per account – current equity = margin account balance – debit balance = equity in account
- The SIPC is a nonprofit corporation that was created by an act of Congress in 1970, insures customer's account for up to 500K per account in securities, 250K in cash

- When opening an account, name of RR needed along with signature of approving manager/partner
- If somebody is on the OFAC list the Treasury Department should be contacted immediately
- A DVP is when the dealer delivers securities to customer's bank in exchange for cash
- RVP is when dealer receives securities from bank in exchange for cash
- SIPC provides 250K cash coverage and 500K security coverage per brokerage account
- If client is on OFAC list, federal law enforcement authorities must be contacted immediately
- All joint accounts use only one SSN

CH5 (5-8)

- When securities are inherited, the recipient's cost basis is the market value of the securities at the time of the deceased's death
- Options are not created by an issuer of securities, they are created and issued by the Options Clearing Corporation (OCC)
- When wash sale rule is activated, investor must add the loss to the new cost of the stock regardless of where it is purchased (ex. 4 point loss must be added to cost if buying)
- Shareholder approval is required for stock splits, nothing is required for dividends
- Short sales are treated as short term capital gains regardless of the timeframe in which the short occurred because position must be covered and then delivered the next day
- To still be included in a dividend, the earliest a stock can be sold is two business days before the dividend is issued
- Treasury stock are shares that are issued but not outstanding, has no voting rights and doesn't receive dividends
- Transfer agents are responsible for keeping records and issuing stock certificates, not making sure outstanding shares do not exceed authorized shares

- Corporations can exclude 70% of taxes from dividend income in other companies and 80% if they own more than 20% of a business
- To be entitled to a dividend, the stock only needs to be purchased the day before
- Dividends are paid after taxes
- Preferred shareholders do not have voting rights
- Heirs of securities are always considered to have long-term gains
- Warrants have the longest expiration dates
- Yankee bonds are foreign issued bonds subject to withholding taxes (foreign)
- One of the main reasons warrants are issued is to reduce the interest rate on an issue of debentures
- Take 2 days off the record date to figure out dividend eligibility

CH6 (6-9)

- Underwriting syndicate makes commitment to purchase entire offering from issuer, if syndicate cannot resell the offering it may suffer a loss
- Green shoe clause allows syndicate to purchase additional shares from issuer if there is high demand and not enough shares up to 15% of initial offering
- According to Rule 144, an affiliated person of a company must hold unregistered (restricted stock) for at least six months before being sold
- A standby underwriting is when the underwriter agrees to buy all the shares not subscribed to in an offering to help assure the issuing corporation is able to raise capital required, the underwriter either receives a fee or gets the unsubscribed shares at a discount
- A shelf registration under Rule 415 allows the bond issuing corporation to buy back the bonds quickly and be as liquid as possible

- Rule 144A of the Securities Act of 1933 allows privately owned securities to be resold to a Qualified Institutional Buyer (QIB) without the volume and holding period restrictions being met, QIB's are required to have at least \$100mm of investable assets
- Commercial paper does not have to be registered under the Securities Act of 1933 if the maturity is 270 days or less
- Amount of restricted securities that may be sold in any 90 day period is the greater of 1% of outstanding shares or the avg weekly volume from the past 4 weeks
- In an IPO a firm acts as an agent when it takes no responsibility for unsold shares
- Firm must wait 40 days to issue research on an IPO it was syndicate manager in and 25 days if it was a syndicate member or selling group member
- After an IPO, prospectuses must be issued to purchasers for 25 days
- Audited financial statements must be provided to qualify as a QIB (qualified institutional buyer)
- Rule 145 applies to mergers, acquisitions, consolidations etc
- Prospectuses for companies filing IPO's that are not listed on an exchange must be sent out for 90 days

CH7 (7-10)

- Electronic communication networks (ECNs) are used to obtain automatic execution by retail and institutional investors
- Sellers must report trades in NASDAQ stocks within 10 seconds to FINRA
- Interpositioning occurs when a broker dealer executes an order by placing itself between another broker dealer and the market
- According to SEC rules, a customer may not tender short (borrowed) shares, a tender offer is when an entity offers to buy a corporation's shares at a premium to the current market price
- The name given to a market where institutions trade with other institutions is the fourth market

- Regular way settlements for government securities and options is the next business day, all other securities settle in three business days
- The settlement date on a transaction is three business days following the trade date
- Regulation T requires payment by customers for purchases in two business days following the settlement date
- Rules of the SRO require settlement between the buying and selling brokers in three business days from the trade date
- Regulation NMS banned the execution of buy orders which are at a price above the lowest ask and sell orders which are at a price below the highest bid, regulation NMS does not apply to securities subject to manual execution or debt securities, Regulation NMS requires broker-dealers to provide its clients with the best available price for listed equities
- Stock dividends must be adjusted for price paid
- Regular way settlement for stock transactions is three business days, settlement takes place at the buyer's premises
- GTC orders are reduced by the amount of the dividend when the stock sells ex-dividend
- Designated market makers (DMM's) are not allowed to accept not-held orders
- DMM's may only place on their books GTC and day orders, not market orders
- Institutional block traders are not allowed to trade on the floor of the NYSE, they may forward orders to the floor from the firm's trading desk but may not be on the floor physically
- Companies delisted from the NYSE or NASDAQ may be quoted but not listed on the OTC bulletin board or the OTC Pink Market and are generally firm quotes
- Stock transactions are settled on third business day unless there is a holiday where market is closed
- Brokers do not have discretion when a stop order is activated, the order must be executed immediately at the market price

- Don't know (DK) trades occur when contrabrokers disagree or have conflicting details of a trade
- Businesses cannot write options on themselves
- If a brokerage firm makes an error and confirms a cheaper purchasing price than executed, the customer must pay the actual higher price and cannot cancel the order
- An at the-opening order is an order placed for execution at the opening price of the day, if it is not executed then it is cancelled
- 15 – 15.50 5 x 8 means the market maker is obligated to buy 500 shares at \$15 and obligated to sell 800 shares at \$15.50, market maker is allowed to buy/sell more but obligated to this minimum
- SEC act of 1934 prohibits insiders from making short swing profits, short swing profit is profit made on stock held by insiders for less than six months, if the president sold stock two months after being purchased, the company could sue for recovery of the profit,
- Under Rule 144, the six-month holding period applies only to restricted stock, since the shares were purchased on the open market they are considered control stock
- Electronic Communication Network (ECN) orders are still subject to SRO regulations, commissions are still the same, but there may be limited ability to execute transactions (limit orders only) and some only accept certain types of orders
- An order at the market on the close means the order is executed at the closing offer price
- Dark pools allow institutional investors and high frequency traders to trade anonymously
- Immediate or Cancel orders (IOC) allow a limit order to be filled partially and then cancelled if some is not executed
- A 7% decline triggers a 15-minute trading halt (level I), a 13% decline (level II) triggers the second 15-minute halt, a 20% decline (level III) halts trading for the remainder of the day
- Transactions in listed securities between FINRA members in the over-the-counter market are considered third-market transactions

- Trade Reporting and Compliance Engine (TRACE) was created to provide greater transparency in the corporate bond market, it is a reporting system
- Tipper is somebody who has inside information and gives it to somebody else to trade on
- The Consolidated Quotation System (CQS) provides subscribers with bid/asked quotations for securities listed on national exchanges, including quotes from OTC market makers in those securities (third market)
- Convertible bonds are regular way settlements (T+3), mutual funds settle the same day and options and treasuries settle the next day (T+1)
- Level I of NASDAQ indicates the inside market for the security listed
- Regulation FD applies to issuers of securities, it requires that material, non-public information disclosed to analysts or other investors be made public, if the disclosure is intentional the info must be immediately disclosed to the public, if it is unintentional disclosure must be made within 24 hours
- It is violation of the federal law to tender stock that has been borrowed in a short margin account because it does not belong to the customer
- Broker-dealers act as principals when buying for or selling from inventory
- When a MM stops stock, the price is guaranteed
- When a stock sells ex-rights, the MM reduces the orders in the book that were entered below the market (buy limits, sell stops)
- Stock transactions in cash and margin accounts settle in 3 business days
- A matched order is also known as painting the tape and means creating artificial volume by buying and selling a security amongst market manipulators
- On a sell ticket, the original purchase price of the stock is not listed
- SEC act of 1934 provided for the regulation of credit and exchanges and created the SEC

- When a broker dealer buys a security from a market maker (dealer) on behalf of a customer it is acting as a broker (agent), if it buys for its own account it is acting as a dealer (principal)
- Under the custody of securities action (SEC Rule 15c3-3), a brokerage firm must buy in securities within 10 business days from settlement
- Registered representatives of a broker dealer are not permitted to trade on the floor
- The Consolidated Quotation System (CQS) displays quotations on all common stock, preferred stock, warrants, and rights that are listed on the NYSE and the OTC market (third market), non NASDAQ stocks do not appear on the CQS
- A new issue that is registered for sale is shown on the NASDAQ system on the effective date
- A position trader is responsible for maintaining a broker-dealer's inventory as well as trading the firm's account
- FINRA does not disseminate bond transaction information for Rule 144A securities
- Rule 144A is a SEC rule that modified a two year holding period requirement on privately placed securities to permit qualified institutional buyers to trade the securities amongst themselves
- Securities bought or sold for cash or cash trades have same-day settlements
- Transactions in listed securities between FINRA members in the OTC market are considered third market transactions
- Orders that are entered below the market (buy limit, sell stop, sell stop-limit) are automatically reduced when stock sells ex-dividend
- Highest bid and lowest offer is considered the inside market (Level I NASDAQ)
- Broker-dealer acts as principal when buying for or selling from inventory

CH8 (10-15)

- Bonds with the same yield that pay interest annually / semi-annually have different total returns, the semi-annual bond will have a higher total return because there is a reinvestment and compounding of interest assumption
- Term bonds are quoted using the dollar pricing method, serial bonds are priced using the ytm basis
- A sinking fund is used by an issuer to set aside funds that will be used for the purpose of redeeming a corporation's bonds prior to / at maturity
- Term issues is when all bonds mature in the same date and year, there is usually money put into a sinking fund with this to retire the bonds early, term bonds have stable interest payments and the principal is paid on one maturity date
- Serial bonds have different maturity dates with lesser amounts of debt outstanding as time goes by, they have declining interest payments and principal amounts
- Random selection is the method used to call term bonds
- Municipal term bonds are quoted based on a dollar price
- When a bond is registered as to principal only, the bonds have been issued in the name of the owner with bearer coupons attached
- Capital risk is the risk of the investor losing the principal
- Compound accreted value is equal to the original value of the bond plus the annual accretion as of the call date, this is calculated with zero-coupon bonds that are called early
- When pricing a bond, the coupon, settlement date and maturity are required
- Treasury bonds are quoted in 32nds of a point, corporate bonds 8ths of a point
- The yield to maturity on bonds selling at a discount is higher than the nominal yield, yield to maturity on bonds selling at a premium is lower than the nominal yield
- With a sharp decline in interest rates, long term discount bonds will had the largest gain in price

- Nominal yield is the coupon rate
 - With a discount bond – nominal yield is the least, then current yield then ytm
 - Premium bond – nominal yield is greatest then current yield then ytm

CH9 (8-10)

- Long term CD's have a maturity of more than one year, the securities are traded in the secondary market and changes in interest rates cause price fluctuations, if sold prior to maturity a CD investor can have a gain / loss, long-term CD's are issued by banks and can be sold by any type of broker-dealer, the FDIC provides protection for up to \$250K
- Eurodollars are U.S. dollars on deposit in foreign banks
- There is no secondary market for federal funds, repos, or U.S. savings bonds, there is a secondary market for commercial paper, Eurodollar CD's and Banker's acceptances (BAs)
- The conversion ratio of a bond is calculated by dividing the par value of the bond (\$1,000) by the conversion price, ex \$40. $1000/40 = 25$. Then taking the conversion ratio (25) and multiplying it by the market price of the common stock ex. \$30. ($30 \times 25 = 750$). In this example, the bond sells at discount because the stock is below the conversion price. If the stock was at \$45, then the parity price of the bond with the stock would be $45 \times 25 = 1,125$. This is selling at a premium. Always find the conversion ratio first and work from there, the conversion ratio is key to solving convertible bond problems.
- Conversion ratio = par value (\$1,000) / conversion price
- A P-1 (prime 1) bond is the highest rating that Moody's assigns to commercial paper, intermediate ratings are P-2, P-3 and speculative is NP (not prime) for commercial paper
- Reverse convertible securities are short-term notes issued by banks that pay a coupon rate above prevailing market rates, they are considered structured products because in addition to the higher coupon rate, the investor may be required to purchase shares of an underlying asset at a fixed

price, the issuer pays a higher coupon rate because it has an option to sell a security to an investor if the price falls below a specified value known as the knock-in level

- When the stock on a convertible bond is at a premium to parity, and the bond is trading at par an arbitrage opportunity exists
- Income bond interest is only paid if the corporation has sufficient income
- A nondilutive feature in a convertible bond requires that the conversion features are adjusted if there is a stock split or dividend announced, the conversion ratio is increased and the conversion price reduced, the new conversion ratio is calculated by taking the dividend yield as a % of the conversion ratio and adding it (30 ratio with 10% dividend would move the ratio to 33). The new conversion price is the par value of the bond divided by the new conversion ratio ($1,000 / 33$).
- In the liquidation of a corporation, bank loans are paid first, then accounts payable, then subordinated debentures, then preferred stock, then common stock
- For brokered CD's the SIPC covers the buyers if the broker goes bankrupt and the FDIC insures them if the bank goes bankrupt
- Negotiable CDS are traded in the secondary market in minimum denominations of 100K but typically trade in 1mm denominations, they are issued by commercial banks and secured by the bank's credit
- Reverse convertible securities give above market rate coupons
- A long-term step-up CD offers an investor an interest rate that is initially lower than current market rates will pay. The rate is then adjusted upward at predetermined intervals established by the offering bank. They are traded in the secondary market and interest rate changes cause the value to fluctuate
- Banker's acceptance's (Bas) help facilitate foreign trade
- ADR's permit the trading of foreign stocks in the U.S.

- Commercial paper with 270 days or less to maturity are not required to register with SEC and securities initially offered outside the U.S. (Eurodollar bonds) are also exempt from SEC registration
- Step-down long term CD offers an investor an interest rate that is higher than current market rates and lowers the subsequent interest rates, long term CD's have maturities longer than 1 year
- Issuers of the callable bonds are allowed to recall them, investors have no ability to call back the principal
- For a zero-coupon security, the accreted value of the bond is used to calculate the capital gain (if any), the yearly accretion added is treated as interest income for the year
- Eurodollar bonds are denominated in USD only and can be traded in the U.S. after seasoning period of 40 days
- A repurchase agreement (repo) is a form of a collateralized loan, a dealer sells securities to another dealer/investor and agrees to buy them back at a specific time and price
- Banker's acceptances are used to facilitate foreign trade, they are considered time drafts that are collateralized by a bank, it is the only instrument used to finance foreign trade
- It is possible for CD's to be callable
- In a repurchase agreement, t-bills are usually sold by a dealer, and the seller agrees to repurchase them at a higher price,
- a reverse repurchase agreement is when a dealer purchases securities and agrees to sell them back
- structured products are not insured by the FDIC, structured products are built around a fixed income instrument and a derivative product
- when a bond increases in value by 1 point, this is \$10 per \$1,000 par value
- bonds and fixed income products offered by corporations are taxed at the federal and state level

CH10 (8-11)

- Collateralized mortgage obligations (CMOs) – pay monthly income to investors made up of interest, which is taxable and principal which is tax-free. Due to the structure of a CMO, a fluctuating amount of principal is returned monthly and not at maturity which makes CMO's different from most other fixed income instruments, CMO's are considered asset backed because they are backed by a pool of bonds, loans and various other assets
- 1 point on a bond equals a \$10 gain
- Treasury notes are exempt from state taxes, not federal taxes, T-Bills are purchased at a discount
- Weekly auctions for T-bills are held each Monday, these are 13 and 26 week T-Bills, settlement is on the Thursday of the same week
- The SBA is the Small Business Administration and is not involved in the housing market, SBA is a federal agency involved in providing financial assistance to small businesses
- To calculate interest payments and income when a bond is bought, take the number of days interest was accrued and divide by 365 days in a year. (ex $80/365 = 21.9\%$). Then take this percentage and multiple by the annual coupon payment (ex $6\% / \$600 = \131.50). This is the amount of interest the buyer pays to the seller. When interest is collected by the new owner, this amount is subtracted to find the taxable interest income for the year.
- Federal Farm Credit Banks issue notes that are structured like T-Bills. (issued at discount, non-interest bearing). The bonds issued are interest bearing. Interest on these is exempt from state tax, but is subject to federal taxation
- In a CMO, the tranche with the longest maturity and last to receive interest and principal payments is the Z-tranche
- Treasury bills and bankers' acceptances (Bas) are sold at discounts and are purchased without paying accrued interest
- Federal National Mortgage Association (FNMA) bonds are not backed by the federal government

- The PSA Model was created to calculate the prepayment rate for mortgage-backed securities
- 3 and 6 month T-Bills are auctioned weekly
- Government National Mortgage Association (GNMA / Ginnie Mae) are backed by US government, Federal Home Loan Mortgage Corporation (FHMLC / Freddie Mac) is not backed by US govt
- Federal Farm Credit System is composed of: Banks for Cooperatives, Federal Intermediate Credit Banks and Federal Land Banks
- Student Loan Marketing Association (SLMA / Sallie Mae) is not backed by US govt and is privately owned
- Payments for treasury notes are due the next business day and they have next day settlements
- The planned amortization class (PAC) tranche is a type of CMO that is designed for more risk averse investors and has the least prepayment risk, the PAC tranche has top priority and receives payments first
- CMO's cannot be compared to any other type of investment because of their unique characteristics, this applies to any communication with the public
- Sallie Mae (student loan marketing association / SLMA) provides liquidity to student loan makers by purchasing the federally sponsored loans and lends funds directly to educational institutions, it does not issue securities
- Federal Home Loan Bank issues two types of securities: discount notes with maturities less than one year, and consolidated bonds with maturities up to 30 years
- 4 week T-bill is auctioned each week on Tuesday and is issued Thursday, 13 and 26 week T-bills are auctioned weekly on a Monday and issued on Thursday
- With a CMO, pre-payment risk occurs when interest rates fall because the holders will want to refinance or repay at a faster rate
- Federal Intermediate Credit Bank (FICB) makes agricultural loans to farmers

- Government sponsored enterprise securities are not guaranteed by the government
- The bond equivalent yield of a T-Bill is always higher than its discount yield
- A STRIP is a type of zero coupon bond, bonds with the most interest rate risk are the ones with the longest maturity and lowest coupon payments
- Cash settlement for all securities takes place on the date the trade was placed
- Value of .25 in bonds is equivalent to \$2.50 per 1,000 par value (1.00 is \$10, remember that)

CH11 (18-22)

- Revenue bond issues can be called in a catastrophe call provision (fire etc) or if there is a change in the status of the tax issuer and the bonds become taxable
- Municipal bond swaps may be executed to establish a loss, increase cash flow, improve maturities, improve yield and/or improve quality, the process involves selling one bond and using the proceeds to buy another bond
- Normally defined benefit plans (pension funds / 401k's) would not purchase municipal bonds because there would be no benefit from the tax exemption
- The additional bonds test sets a minimum level of coverage of debt service for interest and principal for all outstanding bonds and for future debt, the test protects original bondholders against the dilution of the debt service coverage
- Double-barreled municipal bond is backed by two sources of income, revenues of a project and taxes of a municipality, and can be paid from the revenues of a project and is also a general obligation of a municipal government
- 10 mills equals .01 / 1%, use this to calculate property taxes based on the assessed value
- Direct Pay Build America Bonds (BABs) are a type of municipal bond that pays taxable interest but the treasury will reimburse 35% of the interest paid on the bonds to the issuer, which reduces the cost of borrowing

- Private activity bonds are usually subject to the Alternative Minimum Tax (AMT) and are used to finance the construction of a facility that will be used by a private corporation, private activity bonds are generally revenue bonds
- The formula for the debt service coverage ratio is net revenues divided by the annual debt service, $\text{annual gross revenues} - \text{expenses} / \text{debt service} = \text{the annual debt service ratio}$
- Bank qualified municipal bonds may only issue up to 10mm annually which is done to encourage commercial banks to purchase these bonds, commercial banks are permitted to deduct 80% of the interest cost paid to depositors on the funds used to purchase the bonds
- To find the taxable equivalent yield, divide the municipal rate by $100 - \text{tax bracket}$
- Net yield of a taxable bond = $100 - \text{tax bracket} * \text{nominal yield}$
- Debt per capita is used when analyzing a general obligation bond and is not considered for a revenue issue
- Variable-rate demand obligations (VRDOs) are long term securities with short-term trading features, they have a put feature that permits the holder to sell the securities back to the issuer or third party, the interest rate on a VRDO is reset by the dealer at a rate that allows securities to be sold at par value
- Auction rate securities (ARSs) do not have a put feature, if the auction fails, the investor may not have immediate access to his funds. ARSs use an auction process to reset the interest rate on the securities.
- A turnpike authority would typically only issue revenue bonds
- Overlapping debt involves only general obligation bonds and not revenue bonds
- Auction rate securities should not be recommended to investors needing access to funds in a short period of time because if an auction fails, the investor may not have immediate access to his funds, auction rate securities are long-term securities

- A municipal bond issued at a discount is accreted (not amortized) for tax purposes on a constant yield method
- Municipal bonds purchased at a premium are amortized (not accreted) each year based on a constant yield method
- Municipal bond investors can obtain reduced interest-rate risk by investing in issues with different maturities
- The interest on private activity bonds is subject to federal income tax
- Flow of funds provision details the manner which the funds backing a municipal revenue bond will be applied
- Revenue bonds are issued by authorities and agencies created by state and local governments
- School district bonds do not have a flow of funds provision because they are general obligation bonds
- Industrial revenue bonds should not be invested in if the investor seeks safety of principal, they are secured by a lease agreement with a corporation and are only as secure as the corporation
- State GO's are usually of high quality, GNMA is secured by the U.S. government, equipment trust bonds are backed by the equipment
- A bid order is placed when the holder indicates he wants to continue to hold the security only if the rate is set at or above a specified rate, if the rate sets below the holder is required to sell the securities subject to her bid
- Tax anticipation notes (TANs) are typically interest-bearing securities and trade with accrued interest
- When a bond is purchased at a premium, the premium must be amortized over its life. If the price is 105, there is a 5 point premium. This premium must be amortized over the amount of time it was held before being sold (5 years). It must be amortized 1 point per year (5/5). The cost basis is then the original cost – amortized premium (5) so the cost basis would be 100 in this example

- Debt service expenses are not deducted when arriving at net revenues for an airport etc
- General obligation (GO) bonds require voter approval, ad valorem and real estate taxes are GO bonds
- Special tax bonds are financed by a tax other than ad valorem, such as cigarettes, liquor, gas etc and do not require voter approval
- Certificate of participation (COP) are revenue bonds backed by a lease payment and does not require voter approval
- The securities issued by states are only tax exempt at the state and local level if the investor is a resident
- Securities issued by the govt are exempt from state and local taxes but federal taxes must be paid
- Federal Home Loan Bank (FHLB) securities are taxable at the federal level but exempt from state and local
- Securities issued by Puerto Rico are triple tax exempt through a special act of congress (exempt from federal, state and local)
- Standard and Poor's best rating for notes is SP-1 and worst rating is SP-3
- When solving municipal bond yield problems first find equivalent taxable yield to figure out which bond pays the best after tax interest
 - $\text{Equivalent taxable yield} = \text{municipal bond yield} / (1 - \text{investor's tax bracket})$
- Yankee bonds are subject to federal taxes
- Money put aside for the betterment and improvement of the facility is placed in the renewal and replacement fund
- The renewal and replacement fund is used to hold money for the improvement of a facility
- When analyzing the credit strength of a municipal issuer, the current financial status and capability of the fiscal officers are important considerations to be made along with the state of the local economy

- A tax swap is the sale and purchase of bonds or other securities to realize a capital loss that can be offset against a capital gain
- The federal tax exemption on the interest earned on an industrial revenue bond is not available if the holder is a substantial user of the facility
- The amount of accrued interest is not a factor in a municipal bond purchase or sale
- Direct Pay Build America Bonds (BABs) allow a municipality to issue a bond with a higher interest rate, but pay the same equivalent tax-free rate, the Treasury reimburses 35% of the interest payment which results in a net borrowing cost (NBC) of $\text{taxable rate} * (1 - .35)$
- Convert municipal bonds to equivalent taxable yields, whichever yield is higher is the better of the two if no taxable bonds beat the yield
- When a failed auction occurs, the holder must continue to hold the securities and the interest rate is set to the max rate allowed in the program documents, this rate is normally higher than a rate that would have cleared a successful auction
- The corporation that uses the facility that was built by the industrial development revenue bond becomes the party that is backing the bonds, the credit rating of these bonds is dependent on that corporation
- A parity bond is where two or more issues of revenue bonds have the same claim against revenue or are backed by the same pledged revenues
- A double-barreled bond is backed by a source of revenue and the full faith and credit of the issuing municipality that has taxing power, ie General Obligation (GO) bond issuer
- General obligation bonds require voter approval, not revenue bonds
- Certain municipal private activity bonds are taxable if an investor is subject to the alternative minimum tax

- Moral obligation bonds are municipal revenue bonds that are payable by the state if revenues from a project do not satisfy the debt service payment requirements, in order for the state to service the debt, approval of the state legislature is required
- At maturity, the discount on a municipal bond is subject to taxation as ordinary income, a bond is at a discount when the nominal yield (coupon rate) is less than the yield to maturity (YTM)
- Direct Pay Build America Bonds may not be used to finance refunds, private activity bonds and working capital
- The ratio of the amount of net overall debt is not useful when analyzing the credit risk of an issuer of revenue bonds, it is useful for GO bonds (general obligation)
- Moody's municipal note ratings – MIG 1 is best, MIG 3 is lowest
 - Aaa is Moody's highest rating for bonds
- School districts use real estate taxes, traffic and other types of fines to pay interest on the general obligation bonds that have been issued
- General obligation bonds are considered safer than revenue bonds
- Revenue bonds are issued to construct and operate some type of revenue producing facility, ie power plants, transit systems, turnpikes, colleges etc, general obligation bonds are issued to finance public schools (elementary and high schools) and to pay general expenses of running a municipality ie police and firefighters
- An original issue discount (OID) is when the discount on the bond is considered interest and the interest is tax-exempt
- For a non OID, or secondary market discount, the discount is reported as ordinary income and taxable
- A prospectus is a disclosure document for issues that are registered under the SEC act of 1933,
- Municipal revenue bonds are exempt from disclosure documents and the SEC act of 1933

- All protective covenants for a revenue bond are found in the bond's indenture, rights and obligations of issuers and bondholders are included as well
- A syndicate agreement is a contract among underwriters that define their working relationship and addresses priority of orders and sharing of the underwriting spread
- The official notice of sale contains the information and procedures necessary for syndicates that wish to bid on a competitive issue of bonds
- Variable-rate demand obligation (VRDO) bonds can be redeemed prior to maturity on any date the interest rate on the obligation is reset; rates can be reset on a monthly, weekly or daily basis. The obligation is redeemed at par value plus accrued interest
- Municipal revenue bonds do not have maturity schedules that coincide with the usefulness of the facility being built, the bonds mature prior to the useful life of a facility ending, municipal revenue bonds do not have debt limitations, general obligation bonds do have debt limitations, revenue bonds can be issued by states, political subdivisions etc and the interest and principal paid is from the revenue received from the operations of the facility
- A catastrophe call allows an issuer to call an entire bond issue in situations that are beyond its control, such as condemnation, natural disasters etc
- **Municipal zero-coupon bonds**
- Certificates of participation (COPs) are lease financing agreements, issued typically in the form of a tax-exempt municipal revenue bond, this financing technique provides long-term funding through a lease that does not legally constitute a loan which eliminates the need for a public referendum or vote
- Standard & Poor's best rating for notes is SP-1 and worst is SP-3, best for bonds –AAA, worst D
- Grant anticipation notes are short-term municipal notes issued on the expectation of receiving grant money, usually from the federal government

- When analyzing revenue bonds, rate covenants are very important because it is an agreement made by the issuer to keep rates high enough to cover maintenance and operating charges and to meet annual debt service requirements
- When a municipal bond is purchased at a discount in the secondary market, the investor must treat the discount as ordinary income at maturity, an original issue discount (OID) has no federal tax liability
- Industrial development revenue bonds are issued by a local municipal government to build factories or other commercial properties. The plant or property is leased by the municipality to the corporation, the interest is paid from lease rental payments made by the corporation, the credit rating of the bond depends on the credit of the corporation and not the municipal government that issued the bonds
- Tolls, concessions and lease rental payments are not used to pay general obligation bonds, they are used to pay revenue bonds, general obligation bonds use fines, taxes etc to pay interest
- Ad valorem tax is based on property values
- Bank-qualified municipal bonds allow banks to deduct 80% of the interest cost paid, to qualify municipalities may not issue more than \$10mm annually
- **Alternative minimum tax bonds**
- **Private activity bonds**
- **Moral obligation bonds**
- The additional bonds test helps examine what would happen to the coverage of revenue bonds when more bonds are issued, it sets a minimum level of coverage of debt service for interest

CH12 (12-15)

- The system used to report municipal security transactions is called the Real-Time Transaction Reporting System (RTRS), this system is operated by the Municipal Securities Rulemaking Board (MSRB)
- There are four types of orders that can be placed with a syndicate
 - Presale order – placed before syndicate purchases issue from issuer
 - Group order – situation where all members of the syndicate share in the profit
 - Designated order – placed by a large institution that designates two or more members to receive credit for the sale
 - Member order – order placed by members for their customers
- If a municipal bond is identified as ex-legal then the municipal bond can be delivered without a legal opinion
- To calculate accrued interest on a bond use the amount of days from last coupon payment (every 6 months from maturity date) divided by 360 (approx. days in a yr) times the yearly interest dollar amount
- A summary of an official statement is considered advertising because it is prepared by the municipal representative and therefore it must be approved by a municipal principal
- A municipal representative must be registered before doing transactions with customers, to become qualified the individual must pass a qualifying exam and serve a 90-day apprenticeship, the person may only act as an apprentice for a maximum of 180 days
- The Bond Buyer computes and publishes the following indices: the 20-Bond Index, the 11-Bond Index, the Revenue Bond Index (Revdex)
- The total of all new issues scheduled to be sold during the upcoming 30 days is the visible supply and not considered an index

- The purchase of a new issue prior to settlement with the issuer is best classified as a when-issued transaction, this covers the period of a new issue of municipal securities from the original date of sale by the issuer to the delivery of securities to the underwriter
- To price a bond, the coupon, settlement date and maturity are required, the number of bond years is not required and is only used to determine the net interest cost when an underwriting is bidding on a new issue
- A discount bond is priced to maturity
- Municipal securities principals are required by the MSRB (municipal securities rulemaking board) to approve all transactions in municipal securities
- A municipal securities principal does not need to approve an official statement (OS).
- An OS is prepared by an issuer of municipal securities
- Municipal security issuers are not subject to MSRB rules
- Municipal bond confirmations must disclose: whether the bonds are subject to the alternative minimum tax (AMT), whether the bonds are issued as original discount securities and whether the bonds are subject to federal income tax, nothing about the state income tax must be disclosed
- The MSRB requires that the yield that must be disclosed on a client's confirmation is the yield to worst, it is the lower yield between the YTM and the yield to call, if a callable bond is trading at a discount then the YTM is the lower and worse of the two
- When a bond is purchased at a discount the yield to call is higher than the YTM
- When a bond is purchased at a premium, the YTM is higher than the yield to call
- A bond purchased with a premium must make the premium amortized over the holding period of the bond, the longer the premium bond is held, the higher their effective yield because the premium is amortized in lesser amounts

- Regulatory agencies for municipal securities:
 - Broker-dealers – SEC or FINRA
 - Federal Banks – Comptroller
 - State Banks that are members of FRB – FRB
 - FDIC for member banks of FDIC
- MSRB rules require municipal securities principals to approve:
 - Memos in response to customer complaints
 - Opening of accounts
 - Advertisements used for seminars
 - Correspondence to customers
 - All transactions and frequently review discretionary accounts
- Municipal bonds must be delivered in increments of 1,000 to a max of 100,000
 - They must have an imprinted or attached legal opinion
- Municipal bond insurance guarantees the timely payment of principal and interest, if the bond has 5 years to maturity, the insurance agency must make the 10 interest payments and return the principal at maturity
- The SEC and FINRA both have the ability to discipline a broker-dealer for fraudulent securities activities, the MSRB does not have this authority
- The 30-day visible supply is all municipal bonds that are expected to be brought to market in the next 30 days, this number is computed daily and includes all offers, it does not include short-term notes or auction rate securities
- Western Account – a divided account where the member is responsible for its own participation in the syndicate
- Eastern Account – an undivided account where any unsold bonds are the responsibility of the entire syndicate

- The two methods of underwriting municipal securities are negotiated and competitive, competitive is a bidding process and negotiated is an agreement made
- Municipality's official statement contains
 - Project feasibility
 - Financial statements and audits
- Notice of sale contains
 - Amount of good faith deposit
 - Expenses to be borne by the purchaser or issuer
- In an Eastern account if bonds are unsold, the dealer is responsible for the % that they originally sold and agreed upon
- Prior to first use of a municipal security, the principal must approve advertising (abstracts of official statements), research reports, municipal issues are not required to provide red herrings
- The issuer's bond counsel writes the legal opinion of the bond, this legal opinion states that the interest is exempt from federal taxation, approval is not required from any regulatory agencies
- Nominal quotes are given for informational purposes only, a dealer that does not wish to buy or sell securities must provide nominal quotes
- The placement ratio is the new amount of issues sold, compared to those offered for sale as of the close of business each Friday and is reported in The Bond Buyer's
 - It is a way to gauge the amount of bonds that have been underwritten recently on a new-issue basis, it is the percentage of new bonds that were sold compared to those that were originally available for sale
- The visible supply is the total par value of all negotiated and competitive issues scheduled to come to market during the next 30 days
- The 20-Bond Index is the average yield on 20 selected municipal bonds

- A municipal bond that sells at a premium and is callable at par is calculated to the call date not the final maturity date because the call date is the lower of the two
- Dealers are required to quote the lower of the yield to call or the YTM
 - If the bond is selling at a discount, the bond is quoted on a YTM basis
 - If the bond sells at a premium and is callable at a premium, the yield may be quoted at whichever is lower – the final maturity date or call date
- An apprentice at a municipal securities firm is allowed to execute transactions with other firms but not with customers, apprentices serve for a minimum of 90 days
- If a municipal dealer gives another dealer a quote of par for a block of municipal bonds, the dealer must allow the trade to be executed at par
- If municipal bonds are missing a legal opinion or have mutilated coupons then the delivery of the bonds can be rejected
- Accrued interest is calculated from the last interest payment date up to but not including the settlement date. The settlement date is 3 days after the purchase (add 2 days), each month is worth 30 days and 360 day calendar schedule year. If the interest was last paid April 1 and bond was bought June 30, it would be 92 days
- All information that relates to bidding for a municipal bond is found in the notice of sale
- Nominal quotes on municipal securities must be identified as such, if they are not identified, this is a violation of MSRB rules
- $\frac{3}{4}$ of a point on a municipal bond is \$7.50 quotes are usually per \$1,000, 1 point = \$10
- The 11-Bond Index contains general obligation bonds that have an average S&P rating of AA+ and an average Moody's rating of Aa1
- The 20-Bond Index has an average rating from the S&P of AA and from Moody's of Aa2
- In a new municipal offering the issuer does not receive all of the proceeds, the fee is charged within the offering, the selling concession fee is included within the total takedown, the manager

fee charged by the underwriting syndicate must be added, if there is a total \$10 fee per bond and 50,000 bonds are issued, the issuer will receive \$49.5mm of the total \$50mm

- The municipal bond counsel does not determine the underwriting concession, they do however, prepare legal opinions, validate the issues and examine treasury arbitrage restrictions so that the issuer does not violate tax laws
- A municipal securities broker-dealer may use a broker's broker to help sell the bonds and to keep the identity of its client confidential

Q&A Notes – Exam 1

- Electronic Communication networks (ECNs) are trading systems that are designed to match buyers with sellers. They can be used by both institutional and retail investors. A benefit is immediate automatic execution if matching orders can be found. Broker-dealers use this system to execute orders sent to them by clients
- Transactions in NASDAQ stocks must be reported to FINRA by the seller within 10 seconds of the trade
- Shareholder equity = common stock + paid-in capital + retained earnings
- Foreign dividends and interest paid to a U.S investor are subject to a withholding tax by the country from which they were paid
- Broker-dealers are required to report transactions in municipal securities to the Real-Time Transaction Reporting System (RTRS), the RTRS is operated by the MSRB – Municipal Securities Rulemaking Board
- When a company owns 25% or more of outstanding shares of another public company, they are exempt from paying taxes on 80% of dividends received from the stock
- The four types of orders that can be placed with a syndicate are:
 - Presale order – any order that is placed before the syndicate purchases the issue from issuer

- Group order – all members of the syndicate share the profits which allows all members to benefit
 - Designated order – placed by large institutions which designates two or more members to receive credit for the sale
 - Member order – order placed by members for their customers
- Municipal bonds are expected to be delivered with a legal opinion, unless they are ex-legal at the time of purchase
- When a company owns 25% or more of the outstanding shares of another company, they only have to pay taxes on 20% of the dividend income, the other 80% is tax free
- Periodic Payment Variable Annuities – the pay-in period of a variable annuity is when a client is continually purchasing accumulation units, once the payout period of the annuity begins the accumulation units are exchanged for a fixed number of annuity units, the monthly payout is determined by the performance of the separate account
- The registration provisions of the SEC Act of 1933 apply if the securities being sold are listed on the NASDAQ or NYSE, they do not apply to municipal securities, antifraud provisions of the SEC Act of 1933 apply to all securities, even municipals
- Oil and gas direct participation programs (DPP's) are not suitable for an investor that is concerned with the alternative minimum tax (AMT), because oil and gas DPP's have the possibility of substantial tax writeoffs which would lead to an AMT
- The Bond Buyer (**INDEXES**) computes and publishes a number of indices, these include:
 - 20 Bond Index – avg yield on 20 selected municipal bonds with 20 yr maturities
 - 11 Bond Index – avg yield on 11 selected municipal bonds with 20 yr maturities
 - Revenue Bond Index (Revdex) – avg yield on 25 revenue bonds with 30 yr maturities
- Subordinated debenture bonds are unsecured bonds – this means they are not backed by any specific collateral of the issuer, they are only secured by the full faith and credit of the issuer

- Yankee Bonds – yankee bonds are issued by foreign corporations and governments, are dollar denominated and trade in the U.S. markets
 - Interest paid to a US investor on a foreign security is subject to withholding tax by the issuing country
 - The broker-dealer will send the investor a form that will report the gross amount of interest and the amount of tax withheld by the foreign government if the investor has securities subject to a foreign tax
- Section 457 Plans – qualified retirement plan used by many public sector workers, it grows on a tax deferred basis and is subject to the same contribution limits as the 401k and 403b
- Retirement plans
 - 401k – used by for profit employees
 - 403b – used by nonprofit employees
 - 457 plan – used by local government workers
- Section 529 plan – state-sponsored higher education savings plan that may be opened by an investor
- Municipal bond swaps may be executed to establish a loss, increase cash flow, improve maturities, improve yield and improve credit quality
- To write a covered put option in a cash account, the customer must have cash in the account equal to the total exercise value of the contracts
- If a put writer is short the underlying stock, the put is considered covered for margin purposes but this transaction may only be written in a margin account, not a cash account
- Long-Term Certificates of Deposits (CDs)
 - Long-term CDs have a maturity of more than a year
 - Changes in interest rates cause price fluctuations because they are traded in the secondary market

- If a CD investor sells before maturity, they will record a gain or loss depending which way interest rates have moved since the purchase
 - Long-term CDs are issued by banks
 - Long-term CDs may be sold by any broker-dealer
 - FDIC provides protection for up to 250K
- Simplified Employee Pension Plan (SEP IRA)
 - Does not allow the employee to make contributions
 - Funded by employer contributions only
- Keogh plans
 - Allow employees to make non-deductible contributions to their accounts
- Custodian Bank
 - Responsible for the safekeeping of securities owned by a mutual fund
- Options Agreements not returned within 15 days of account approval
 - Must be returned by the customer within 15 days of the approval of the account
 - If it is not returned no new positions may be opened
 - Only existing positions may be closed
- Foreign currency spot transaction settlements
 - Usually settle in 2 business days
- Treasury bonds
 - Quoted in 32nds of a point
 - Difference between 98.1 and 98.7 = $6/32$
 - $\$1.87 - 1 \text{ full point} = \10 with par value of 1,000
- Underwriting syndicate
 - Makes a financial commitment in the distribution of a new issue of securities
 - Makes a commitment to the issuer to purchase the entire offering

- If the syndicate cannot resell the offering at the public offering price, it may suffer a loss
- Selling group
 - Does not run the risk of losses if securities do not sell
 - Participates in sale of new issues (IPO's)
- Exchange Traded Notes (ETNS)
 - Type of unsecured debt security
 - Carry issuer risk that is tied to the creditworthiness of the financial institution backing the note
- Variable Life Insurance Policy
 - Cash value fluctuates in relation to the performance of the separate account
 - Death benefits may never fall below a set minimum
 - Poor performance by the separate account could cause the cash value of the policy to decline to zero
 - Premiums are fixed for the life of the policy
 - Life insurance companies may not raise expense charges under the expense guarantee clause within the policy
- Green Shoe Clause
 - Underwriting agreement that allows syndicate to sell more of an issue than was originally available
- When a call is covered, there is no margin requirement, when a call is written, the premium must be subtracted from margin requirement which decreases required cash holding in account
- Pension funds would not include municipal bonds in their portfolios, the only exception would be Build America Bonds (BABs) which are taxable municipal bonds, they would not include these securities because the accounts are already tax-deferred, this goes with any tax-deferred retirement plan

- Sales breakpoint of a mutual fund
 - Minimum dollar amount (not share amount) where a volume discount is given when purchasing shares of a mutual fund, the percentage charge declines when certain dollar amounts are met
- Substantial or material value
 - Any gift that **exceeds \$100**
- Marking-to-market
 - Adjusting contract prices to the current market price of open contracts to determine if additional cash is required
 - This occurs when a customer is short uncovered options or short stock that moves against him
- Penny stock
 - Sells for less than \$5
 - Not listed on NASDAQ or NYSE
 - Quoted on OTC bulletin board or OTC pink market
- Penny stock rules do not apply under following conditions
 - Customer defined as existing customer which is a person who has maintained an account with a broker-dealer for more than a year or has previously engaged in 3 or more transactions involving penny stocks (active trader)
 - Not recommended or unsolicited transactions
 - Transactions by a broker-dealer that is not a market maker in the security
 - Transactions by an institutional accredited investor
- In a limited partnership, the maximum allowable underwriting compensation for a public offering is 10% of the gross proceeds, including all items of compensation

- When shorting securities under \$5 a share the minimum maintenance requirement is the greater of \$2.50 a share or the full market value of the short position, IE shorting a security at \$3 a share, the minimum maintenance requirement is \$3, shorting a security at \$2.15, minimum maintenance requirement is \$2.50
- Eurodollars – U.S. dollars on deposit in foreign banks
- Interpositioning – when a broker-dealer executes an order for a customer by placing itself between another broker-dealer and the market
- Registered Options Principal (ROP) – responsible for the firm's option activity compliance, ROP's perform audits, establish guidelines for options retail communications, review material including method of allocation on exercise notices
- Net asset value and redemption price are synonymous, net asset value of a mutual fund is the price an investor may sell it back to the fund (redeem)
- If a registered representative recommends to a client the purchase of a variable annuity and the client agrees, the rr must document and sign the recommendation and then forward it to the Office of Supervisory Jurisdiction (OSJ) of the member firm, the principal of the OSJ must review the application to determine suitability, the principal must make a decision on the application within seven business days of receipt and must document and sign the approval/rejection
- Direct Participation Program (DPP) – the major disadvantage of being a limited partner within a DPP is the lack of liquidity, also in a DPP the investor has no control of management
- When callable bonds are called for redemption, the investor receives the call price, if an investor has 5,000 worth of bonds and the bonds are callable at 101, the investor would receive 5,050, (101 means 1,010 per bond x 5 at 1,000 par = 5,050)
- The most riskiest bonds are ones with the lowest coupons and longest maturity dates, 30 yr STRIPS are most risky because STRIPS are zero-coupon bonds

- Advance bond refunding – proceeds from the sale of a new bond issue will be used to retire the existing bond issue, the proceeds go into an escrow account and then are used
- Risk disclosure on trading options is required to be sent by the brokerage firm to its customer **prior to or at the time** the account is approved for options trading
- When more bonds are going to be issued by a firm, the additional bonds test is used frequently, the additional bonds test sets a minimum level of coverage of debt service for interest and principal for all outstanding bonds and for future debt, it protects original bondholders from dilution of debt service coverage,
- Rate covenants – insure that rates will increase in line with costs
- Feasibility studies – conducted to insure the proper need of the project being developed
- The term when-issued covers the period of a new issue of municipal securities from the original date of sale by the issuer to the delivery of securities to the underwriter
- There are no secondary markets for federal funds, savings bonds or repurchase agreements, secondary market does exist for commercial paper
- REIT's do provide ample liquidity but they do not provide protection against rising interest rates because the share value will usually decrease as other newly issued REIT's become available with more attractive rates
- Double barreled municipal securities are backed by two sources of income – these are usually the revenue from the project and the taxes of the municipality, they are also a general obligation of a municipal government
- Fourth market – when institutions trade with other institutions – ie – mutual fund buys stock from the portfolio of another insurance company
- Variable annuities are most suitable for investors that seek long-term, tax-deferred income for retirement, tax-deferred are more advantageous when the investor is currently in a higher tax bracket and will be in a lower one by retirement, variable annuities are not suitable for short-term

needs, these are not suitable for retirement investment plans because they are already tax deferred, if a client withdraws proceeds of the variable annuity prior to age 59.5 a 10% tax penalty must be paid

- Property tax is calculated by multiplying the **assessed value** by the millage rate, 10 mills = 1%, 1 mil is equal to 1/10 of a percent = .001
- When pricing a bond 3 inputs needed – coupon, settlement date, maturity date
- If a put option is exercised, the writer is required to purchase 100 shares
- Regular way settlement for options and government securities is the next business day
- All other securities settle in 3 business days besides options and government securities
- When a RR discusses 529 plans:
 - Risks and costs involved must be discussed
 - Disclaimer stating that prior to investing customer should read the official statement
 - Disclaimer stating client should check with home state to learn if it offers tax benefits
- Maximum loss an uncovered put writer can suffer is premium – strike price (21 strike, \$2 premium, \$1900 max loss per contract)
- The auction for 13 and 26 week TBills is held every Monday, settlement is Thursday of the same week
- According the Rule 144, an affiliated person must hold unregistered stock for at least 6 months before it can be sold
- If a customer gives a buy/sell order, specifies the number of shares and security then the RR can place the order the same day with no further approval
- When exercised, stock index options settle in cash on the next business day, equity options settle in 3 business days
- To diversify a bond portfolio, the price of the bonds do not impact diversification
- Discount bonds are always priced to maturity, premium bonds are priced at call date

- Accumulation Units, Variable Annuities – accounting measure used to determine an owner's interest in the separate account during the accumulation/pay-in phase
 - The value varies based on the performance of the separate account
- Inflation is a negative in the stock market because interest rates should rise which is bad for economic activity
- When selling stock to a customer, the broker bases the markup on the lowest offer on the NASDAQ system
- Build America Bonds (BABs) – municipal bond that pays taxable interest but the Treasury reimburses 35% of the interest paid on the bonds to the issuer, which helps the municipal issuer to compete with corporate issuers
- Progressive taxes are considered graduated
- The conversion ratio of convertible bonds is calculated by dividing the par value by the conversion price (ie conversion price = \$40) $1000/40 = 25$
 - To find its fair value bond wise you do $\$25 * \$40 = 1,000$, this is how to calculate whether bond is fair value or premium/discount to parity
- Owner of calls and writer of puts are entitled to receive the dividend of a company if options are exercised prior to ex-dividend date
- The total contributions to a Coverdell Education IRA are capped at 2,000 per year

Q&A Notes Exam 2

- When securities are inherited by somebody who dies, the recipient's holding period is considered long-term regardless, the cost basis is the value of the security at the time of the death
- Closed End Investment Funds
 - Sell at their market values plus a commission
- Open Ended Investment Funds (Mutual Funds)
 - Sell at the offering price which is the net asset value (NAV) plus a sales charge
- Business Development Companies (BDC)
 - Raise capital by selling securities to investors, they are similar in structure to closed end investment companies
 - The money BDC's raise is used to invest in private companies
 - Most BDC's trade on exchanges which help provide investors with liquidity
 - They are structured as regulated investment companies and are not taxed if they distribute at least 90% of their income to investors
 - Investment in a BDC is similar to buying stock in a publicly traded private equity firm
- RAW LAND
 - Has the potential for capital appreciation without producing taxable income
 - Not eligible for depreciation deductions or tax credits
 - Investment in raw land is considered speculative
- Standby Underwriting
 - Underwriter agrees to buy all of the shares not subscribed
 - Assures issuing corporation will have ability to raise the capital needed
- FIDELITY BOND
 - Provides insurance to a broker-dealer in the event of a fraud judgment against the broker-dealer

- PRIVATE ACTIVITY BONDS
 - Issued to finance construction of a facility that is used by a private corporation
 - Interest earned on these bonds is subject to alternative minimum tax (AMT)
- PROCEEDS OF AN OPTIONS SALE FOR TAX PURPOSES
 - Strike – premium
- General Partner
 - Member of the LP who assumes liability for the debts of the entity and is concerned with its overall management
- DEBT SERVICE COVERAGE RATIO
 - Net revenues / annual debt service
 - Annual gross revenue – expenses /annual debt service
- DETERMINING EQUITY IN MARGIN ACCOUNT
 - Long market value (LMV) + Credit balance (CR) – debit balance (DR) – short market value (SMV)
- Official Statement (OS)
 - Municipal statement prepared by the issuer
 - Not subject to MSRB rules
 - Municipal securities principal does not have to approve an OS
- CONVERSION RATE FOR CONVERTIBLE BONDS
 - Par divided/convertible price gives conversion ratio
 - Multiple conversion ratio by current stock price to get total value
- SMALL BUSINESS ADMINISTRATION (SBA)
 - Not involved in housing market
 - Federal agency involved in providing financial assistance to small businesses

- If brokerage firms decide to charge a customer for services the charges must be reasonably fair and not discriminate between customers
- COMMERCIAL BANK QUALIFIED MUNICIPAL BONDS
 - Issued by small municipalities
 - Municipality may issue up to a max of 10mm annually
 - Commercial banks that purchase this security can deduct 80% of the interest cost paid to depositors on the funds used to purchase the bonds
- ADJUSTED DIVIDEND PER SHARE FOR SPLITS
 - Multiple inverse of split by original dividend (2 for 1 split, .12 dividend) $\frac{1}{2} * .12 = .06$ new dividend
- MUNICIPAL BOND CONFIRMATIONS MUST DISCLOSE
 - Whether bonds are subject to alternative minimum tax (AMT)
 - Whether bonds are issue as an original discount
 - Whether bonds are subject to federal income tax
 - *They do not need to disclose whether or not the bonds are subject to state income tax*
- TO DETERMINE DIVIDEND BEING PAID PER SHARE
 - Divide dividend amount by common shares outstanding
- MOODY'S COMMERCIAL PAPER RATINGS
 - P-1 – Highest Rating/quality
 - P-2, P-3 – Intermediate ratings
 - NP (Not Prime) – speculative
- Narrow based index options protect against movement of stocks in the same industry
- Broad based index options protect against diversified portfolio of stocks

- 1035 EXCHANGE
 - Tax-free exchange of an existing annuity contract for a new one, new annuity may have different/additional restrictions
 - BONDS PURCHASED AT A PREMIUM AND CALLABLE AT PAR
 - Will always have a lower yield to call than to maturity because premium is amortized over holding period
 - BONDS PURCHASED AT A DISCOUNT AND CALLABLE AT PAR
 - Will always have a lower yield to maturity than yield to call
 - Options are created by Options Clearing Corporation (OCC) not issuers of securities
 - APPROPRIATE REGULATORY AGENCIES
 - Broker dealers
 - SEC/FINRA
 - Federal Banks
 - Comptroller of the currency
 - State banks that are Federal Reserve Bank (FRB) members
 - FRB
 - Member banks of Federal Deposit Insurance Corporation (FDIC)
 - FDIC
 - WILSHIRE ASSOCIATES EQUITY INDEX
 - Shows market value in dollars of roughly 7,000 NYSE and Nasdaq stocks
 - NYSE INDEX
 - Includes all NYSE traded stocks, greater than 1,900 stocks
 - RR cannot do anything with IPO's until
 - The firm offering the securities has filed a registration statement with the SEC (violation of SEC Act of 1933)

- WITHDRAWAL FROM ANNUITIES BEFORE AGE OF 59.5
 - Results in 10% penalty charge
- Prices of transactions when dividends are announced must be adjusted to keep transaction cost the same
- Uniform Transfers to Minors Account (UTMA)
- DEBT PER CAPITA
 - Used when analyzing general obligation bonds, not revenue bonds
- REGULAR WAY SETTLEMENT FOR STOCK TRANSACTIONS
 - Take 3 business days and are settled at the buyer's premises
- VARIABLE RATE DEMAND OBLIGATIONS (VRDO)
 - Debt security that bears interest at variable rates, adjusted at specified intervals
 - Can be redeemed at holder's options if rate changes
 - Long term security with short term trading features
 - Have put features allowing holders to redeem security at par
- AUCTION RATE SECURITIES (ARS)
 - Debt security sold through dutch auction
 - Sold at an interest rate that will clear the market at the lowest yield possible
 - Long term security with short term trading features
 - Do not have put features allowing holders to redeem security at par
 - If auction fails investors may not have immediate access to funds
- STAGFLATION
 - Prolonged period of high inflation rate and high unemployment rate
- EXCHANGE TRADED NOTES (ETNS)
 - Do not usually pay annual coupons or dividends

- Type of unsecured debt security
- Linked to performance of commodities, currencies, indexes
- Impacted by issuer's financial condition
- SHELF REGISTRATION UNDER RULE 415
 - Allows a corporation to issue bonds and sell them quickly if interest rates suddenly drop
- REVERSE CONVERTIBLE SECURITIES
- IRA WITHDRAWALS
 - Penalty if withdrawn prior to age 59.5
 - Withdrawal must begin by age 70.5
- KEYNESIAN ECONOMIC THEORY
 - States that government intervention in the economy is necessary
- OVERLAPPING DEBT
 - Involves only general obligation borrowing (not revenue bonds)
- DAILY BOND BUYER'S 30-DAY VISIBLE SUPPLY
- UNIVERSAL LIFE INSURANCE
- VARIABLE LIFE INSURANCE
- EQUITY IN LONG MARGIN ACCOUNT
 - MARKET VALUE – DEBIT BALANCE
 - SMA is not used in equation
- 5% MARKUP POLICY
- NOT-HELD ORDER
- INTERBANK MARKET
- PUT/CALL RATIO
 - Reversal indicator
- CALCULATING COST BASIS WHEN WASH SALE IS ACTIVATED

- CORPORATE RETIREMENT PLANS
- REQUIRED EQUITY FOR SHORT SALES WHEN PRICE IS LESS THAN \$5
- Z-TRANCHE IN CMO
- DELIVERY VERSUS PAYMENT (DVP) ORDER
- DIVIDED ACCOUNT (WESTERN ACCOUNT)

Q&A Notes Exam 3

- STOCK SPLITS
 - Must have shareholder approval
- Shareholder approval is not needed for anything having to do with dividends
- MUNICIPAL UNDERWRITING
 - Negotiated offering
 - Competitive bidding process
- SECURITIES SOLD AT DISCOUNTS
 - Bankers acceptances (BA's)
 - Treasury bills
 - Commercial paper
- MUNICIPALITY OFFICIAL STATEMENT INCLUDES
 - Project feasibility
 - Financial statements and audits
- MUNICIPALITY NOTICE OF SALE INCLUDES
 - Amount of good faith deposit
 - Expenses to be borne by purchase/issuer
- SALES CHARGE OF A MUTUAL FUND
 - Difference between bid and offer / offer
- Gains or losses on short sales are treated as short-term capital gains/losses

- DIVIDEND REGULAR WAY SETTLEMENT
 - 2 business days prior to declared dividend date
- INCOME BONDS
 - Interest does not need to be paid if corporation does not have sufficient income
- REGULAR WAY SETTLEMENT FOR STOCK TRANSACTIONS
 - 3 business days counting day of transaction
- OPTIONS TRADING ACCOUNT OPENING
 - When a customer refuses to provide financial information the brokerage firm must record the customer's refusal on its records and use whatever information that is obtainable to determine whether or not the account should be accepted
- SUBORDINATED DEBENTURE HOLDERS
 - Paid after everybody except preferred and common stockholders
- DIRECT PARTICIPATION PROGRAM IN REAL ESTATE
 - Real Estate Limited Partnership (RELP)
 - Do not pay cash dividends
- PROSPECTUS
 - Required under SEC Act of 1933 for investors purchasing securities in the primary market (public offering)
- SYNDICATES – EASTERN AND WESTERN ACCOUNTS
- HYPOTHECATION AGREEMENT
 - Needed to open a margin account and gives broker right to pledge customer securities to a bank as collateral for a loan
- BOND POWER/STOCK POWER
 - Alternate method of transferring securities from one party to another

- IRA CONTRIBUTION TAX DEDUCTION
 - Must be made by april 15th of subsequent year to be used on previous full yr's tax return
- SIPC BROKERAGE PROTECTION
 - 500K for each different account within the firm
- ADVERTISING MUST BE APPROVED PRIOR TO FIRST USE BY MUNICIPAL SECURITIES PRINCIPALS
 - Abstract of official statement
 - Research report
- CORRESPONDENCE
 - Any written or electronic communication distributed or made available to 25 or less retail investors
- RETAIL COMMUNICATION
 - Written/electronic material made available to more than 25 retail investors
 -
- SOCIAL MEDIA SITES
 - Fall under the guidelines of a public appearance
 - Most firms do not permit RR's to use social media because they are not able to monitor the sites
- ISSUER'S BOND COUNSEL
- A.M. BEST
 - Assigns credit ratings to insurance companies

- DOW JONES COMPOSITE AVERAGE
 - Measurement of 65 stocks
 - 30 industrial
 - 20 transportation
- 15 utility
- FEDERAL FUNDS
 - Leading money-market indicator
 - Excess reserves loaned by commercial banks to other commercial banks
- PLACEMENT RATIO
- GENERAL OBLIGATION BONDS
 - Do not have flow of funds provisions IE school district bonds
- GNMA (government national mortgage association)
 - Guaranteed by US govt
- FNMA (federal national mortgage association)
 - Not backed by US govt
- SELLING SECURITIES RULE 144
- RECAPTURE
 - Amount added back to income for tax purposes that was allowed as a deduction in a prior period
- PRICING OF MUNICIPAL BONDS
 - Term bonds – quoted using dollar pricing
 - Serial bonds – quoted using ytm basis
- SALE REQUIREMENT UNDER NEW ISSUE RULE

- PUBLIC SECURITIES ASSOCIATION (PSA) MODEL
 - Used when pricing CMOs
 - Created standard model for estimating prepayment rate for mortgage backed securities
- FINRA RULE 2330
 - Variable annuities
- SEC ACT OF 1934 & SHORT-SWING INSIDER PROFITS
- U.S. government debt is exempt from state taxes
- SRO MINIMUM MAINTENANCE REQUIREMENT FOR STOCK SOLD SHORT AT \$5 OR ABOVE IS:
 - The greater of \$5 or 30% of price
- 20 YEAR PERIOD CERTAIN ANNUITY

Q&A Notes Exam 4

- ELECTRONIC COMMUNICATION NETWORKS (ECNS)
 - Client's order may have a limited ability to be executed if the system cannot match buyer and sellers
- DISCRETIONARY ACCOUNT
 - Registered representative may not purchase direct participation program (DPP) in a discretionary account without prior written approval by the customer
- RR's are not required to certify that a customer is an institutional investor
- ACCREDITED INVESTOR
 - At least 1mm net worth or 200k of annual income
 - Defined under Regulation D

- INSTITUTIONAL INVESTOR
 - Financial institution or account with at least 50mm of invested assets
 - Defined by FINRA
- DIRECT PARTICIPATION PROGRAM (DPP) INVESTING
 - Customer must verify he meets suitability standards
 - Can be accomplished by
 - Furnishing past tax returns and/or statement of net worth
- DELIVERY OF MUNICIPAL BONDS REJECTED
 - If they do not meet delivery requirements such as:
 - Missing/mutilated coupons
 - Lack of legal opinion
- ROTH IRA
 - No required minimum distribution (RMD)
 - Contributions are not tax deductible
- TRADITIONAL IRA
 - If customer does not take distribution penalty is 50% of RMD amount
 - Contributions are tax-deductible
- SHORT MARGIN ACCOUNT CREDIT BALANCE
 - Determined by adding short sale proceeds and the Reg T deposit (50% of purchase)
- HOLD ORDER
 - Placed by customer wanting to hold an auction rate security if the rate is set at or above a specified level
- A husband or wife may give a lifetime tax-free gift of an unlimited amount to a spouse
- SINKING FUND
 - Used by issuer to set aside funds that will be used to redeem bonds prior to maturity

- In dark pools, quotes are not displayed
- NOTICE OF SALE
 - Published by issuer
 - Announces issuer's intention to sell an issue
 - Invites firms to compete for the issue
 - All information pertaining to bidding process is contained in notice of sale
- TRANSFER AGENT RESPONSIBLE FOR
 - Issuing new certificates
 - Cancelling old certificates
 - Keeping record of shareholders and number of shares each owns
 - Handling problems in cases of missing/mutilated securities
 - IS NOT responsible for making sure outstanding shares do not exceed authorized shares
- TREASURY BILLS, SERIES EE BONDS ARE ZERO COUPON BONDS
- TAX ANTICIPATION NOTES (TANS)
 - Interest bearing securities
 - Trade with accrued interest
- NEGOTIABLE CDS
 - Traded in secondary market
 - Min denominations of 100k
 - Commonly traded in 1mm denominations
 - Issued by commercial banks and secured only by bank's credit
 - No time limit
- BOND AMORTIZATION AND COST BASIS

TRADING HALTS

- REVERSE CONVERTIBLE SECURITIES
 - Security seeking above market coupon rate
 - Short-term notes issued by banks/broker dealers that usually pay a coupon rate above market
 - Shares of an underlying asset are usually included
 - Issuer has option of selling security to investor if price falls below specified value, known as the knock-in level
- MUNICIPAL DEALER MSRB QUOTE RULES
 - Quotes must be bona fide – firm at time given
 - Nominal or subject quotes are permitted if they are identified as such
- REGISTRATION PERIOD
 - Once registration statement is filed with SEC
 - RR may send preliminary prospectus
 - RR may not send research reports, or accept payments/orders
- CORPORATE DIVIDEND EXCLUSION
 - Corporations may exclude 70% of eligible dividends received from taxation
 - Corporations owning 20% or more of another corporation's outstanding common/preferred shares, the exclusion increases to 80%
- THIRD MARKET TRANSACTIONS
 - Transactions in listed securities between FINRA members in the OTC market
- AGENT, PRINCIPAL
- SYNDICATE MEMBERS RECEIVE 0.25 a share for risk
- 11-BOND INDEX
- 20-BOND INDEX
- PAID-IN CAPITAL

- BALANCE SHEET EQUATION
 - $\text{Total Assets} = \text{Total Liabilities} + \text{Stockholders' Equity}$
- VARIABLE ANNUITY CONTRACT HOLDER DIES
 - Proceeds in excess of cost are taxable to beneficiary as ordinary income
- DISPUTE BETWEEN RR AND EMPLOYER
 - Must go to arbitration
- EXERCISE LIMIT
 - Number of contracts an individual may exercise during a five business day period for each underlying stock on each side of the market
- Research reports must be approved by supervisory analysts and contain the proper disclosures
- DIVIDEND TAX RATE
 - On stock held by individuals for more than 60 days during 120 period beginning 60 days before ex-dividend date are taxed as LT capital gains
 - Less than 60 day period – taxed as ordinary income
- 1035 EXCHANGE CONSIDERED APPROPRIATE
 - Individual must benefit from the new contract
 - Representative must sign-off on its suitability
 - Exchanged made within 36 months of a previous exchange are generally considered inappropriate
- Under industry rules, mutual funds or annuities may not be recommended as short-term investments or trading vehicles
- When an equity option is exercised, delivery of the underlying stock and payment for the stock is expected within 3 business days (regular-way settlement)
- Banker's Acceptances (Bas) help facilitate foreign trade

- For bond issues
 - Total takedown + underwriting fees is what is taken out of the total amount the issuer receives
- Mutual fund reduces sales charges
 - Are allowed for mutual funds in the same fund family based upon the accounts of other family members and what they are holding
 - Accounts can be held at multiple broker dealers and can be joint accounts, minors' accounts, and certain retirement accounts
- IPO RESTRICTIONS
 - Immediate family members
 - Member firms and any associated people
 - Portfolio managers, institutional money managers
- After IRA's and 401K's, variable annuities can be used for retirement vehicles
- Margin accounts are marked to the market once a day
- If a partner opens a cash account for a partnership then dies, the assets of the account are frozen until proper legal documents are obtained to release the assets
- For a company to only sell shares of a new issue in one state, it must conduct at least 80% of business in that state
- Required Minimum Distributions (RMD) in IRA's must be done
 - By the year following the calendar year in which the individual turns 70 ½
- Gift of no more than \$100 does not apply to personal gifts such as
 - Birth of child
 - Wedding gift

Gifts must not be related to business between recipient and broker dealer

- MORTALITY EXPENSES
 - Charged against variable annuity accounts
 - Provide death benefits found in annuities
 - Cover cost of providing annuitant with payments for life
- Bonds are still in good deliverable form if CUSIP numbers are not legible
- Repurchase agreements are not traded in the secondary market
- UGMA accounts are not considered joint accounts

Q&A Notes – Exam 5

- Sale of securities by Fed result in withdrawal of reserves from banking system which decreases the money supply
- Delivery of certificates must be made in multiples of 100, up to 100 shares
- Accumulation unites are converted to annuity unites when the individual chooses to being receiving payments
- Open-end and closed-end investment companies differ in their capitalization abilities
 - Open end companies may only issue common stock
 - Closed-end companies may issue common/preferred stock and bonds
- The AIR of an annuity does not impact it's value during the accumulation period
 - Air is important only during annuity payout period
- Federal Farm Credit System composed of
 - Banks for Cooperatives
 - Federal Intermediate Credit Banks
 - Federal Land Banks

- Placement Ratio
 - Amount of bonds sold by new issue syndicates as a percentage of new issues brought to market during the week
- Eurodollar bonds are issued outside the U.S. and are exempt from SEC registration
- American depository receipts (ADRs) must register with SEC
- Customer discretionary accounts do not need approval by the customer to execute orders
 - Principal/supervisors are required to approve the orders in writing
- Decreasing interest rates makes call protection most valuable to bond purchasers
- GTC orders entered below market are automatically reduced when stock sells ex-dividend
- If client of broker-dealer moves to another state, account can only be kept if broker-dealer registers in the client's new state of residency
- TRACE – Trade Reporting and Compliance Engine reports
 - Created to provide greater transparency in the corporate bond market
- Transactions in municipal securities must be reported
 - To the Real-Time Transaction Reporting System (RTRS)
- BOND AMORTIZATION WHEN SELLING BEFORE MATURITY
- DPP investments require investors to disclose annual income and net worth
- Margin requirements by FRB may be increased by broker-dealers in the form of in house rules
- To be entitled to receive dividends, an investor must purchase shares business day before ex-date
- OTC equity securities are not marginable
- Premature withdrawals from an IRA account are subject to 10% penalty
- Amount of foreign tax on dividends may be used as a deduction or tax credit
- Most advantageous tax benefit of natural resource programs is depletion
 - Accounts for use of natural resource
- 5% policy applies to securities found on NASDAQ

- RR are not permitted to have customer's mail forwarded to them if they go on vacation
- Municipal Finance Professionals (MFPs) are allowed to make political contributions of up to \$250 per person to candidates for whom they are permitted to vote
- Keogh Plan
 - Allows maximum annual contribution of 100% of compensation or \$52,000, whichever is less
 - Amount deductible is lesser of 20% of compensation or 52,000
 - Self-employed individual may make deductible contribution of 20% of self-employed income, up to max 52K
- 20 Bond Index Ratings
 - Average on S&P of AA
 - Moody's Aa2
- 11 Bond Index
 - GO bonds
 - Average rating on S&P AA+
 - Moody's Aa1
- INSIDER TRADING – TIPPER
 - Individual who is liable under federal securities law for trading based on insider information or communicating such information to others who use the information to profit
- AD VALOREM TAX
 - Tax based on value of real estate or personal property
 - Bonds backed by ad valorem taxes are a type of GO bond

- SPECIAL TAX BOND
 - Backed by taxes on cigarettes, liquor, gasoline
 - Voter approval not required
- CERTIFICATE OF PARTICIPATION (COP)
 - Revenue bond backed by lease payments
 - Do not require voter approval
- BOND BUYER MUNICIPAL BOND INDEX
 - Based on prices of 40 recently issued, LT general obligation revenue bonds
 - Index calculated by taking price estimates and adjusting them to a 6% coupon
- THREE OTHER BOND INDICES
 - Average yield on 25 revenue bonds with 30yr maturities
 - Avg yield on 20 municipal GO bonds with 20yr maturities
 - Avg yield on 11 municipal GO bonds with 20yr maturities
- Payments of a variable annuity are based on performance of subaccount products in separate account
- IF A CLIENT IS CONSIDERING EXCHANGING ONE VARIABLE ANNUITY FOR ANOTHER
 - Client must be asked if he has engaged in an exchange within the previous 36 months
 - Customer must be informed and understand the ramifications of making the exchange
- Direct Participation Program (DPP) subscription agreement
 - States the suitability standards for the program
 - Specify who must sign the agreement
 - Specifies whom the check must be payable to
 - Makes inquiries of the purchaser to make sure he or she understands the ramifications of the investment and can meet financial requirements of it

- OFFERING DOCUMENTS OF DPP
 - Contain provisions for liquidating a limited partnership
 - Tax implications
- WHEN SHORTING STOCK LESS THAN \$5 PER SHARE
 - Maintenance requirement is greater of \$2.50 per share or 100% of market value
- 30 DAY VISIBLE SUPPLY
 - Refers to face amount of new municipal bonds that will be sold in the next 30 days through competitive and negotiated sales of GO and revenue bonds
 - Indication of expected supply in the new issue market
 - Published each day in Bond Buyer
- MONEY-MARKET FUNDS
 - No load, open-end investment companies
 - Portfolio consists of short-term, fixed income securities such as treasury bills, commercial paper and bankers' acceptances
 - Dividends on money market fund shares are usually computed daily and credited monthly
- Securities of the state of Hawaii are not exempt from state and local taxes unless investor is a resident of Hawaii, they are exempt from federal taxes
- Securities issued by federal government are exempt from state and local taxes
- Interest received from Federal Home Loan Bank is taxable at federal level but exempt from state and local
- Securities issued by Puerto Rico are triple-tax exempt, through a special act of congress
- Exempt from federal, state and local

- FED FUNDS RATE
 - Charged by one bank with excess reserves to another bank needing overnight loans to meet reserve requirements
 - Not under the Fed's direct control
- IN ORDER TO CHARGE MAX 8.5% SALES CHARGE
 - Mutual funds must offer breakpoints and rights of accumulation
- THROUGH A NEW ISSUE, SHAREHOLDER TENDERS (SUBMITS) RIGHTS TO ANY OF THE TRANSFER AGENTS
- IF AN INVESTOR HAS SECURITIES THAT PAID DIVIDENDS AND/OR INTEREST THAT WERE SUBJECT TO FOREIGN TAX
 - Broker-dealer will send the investor a form that will report the
 - Gross amount of dividends or interest
 - Amount of tax withheld by foreign government
- INVESTOR WANTS TAX-DEFERRED GROWTH WITH MODERATE DEGREE OF RISK APPETITE
 - Variable annuities are the most suitable choice
- CONSOLIDATE QUOTATION SYSTEM (QCS)
 - Provides subscribers with bid/ask quotations for securities listed on national exchanges, including quotes from OTC market makers in those securities (third market)
- MSCI EAFE INDEX
 - Morgan Stanley Capital International Europe, Australasia and Far East
 - Follows equity performance of the developed markets but excludes the US and Canada
- MSRB rules require a copy of the official statement to be sent to each purchaser of a new issue
- US GOVERNMENT NOTES HAVE A NEXT BUSINESS DAY SETTLEMENT
 - Payment is due for the notes the next business day

- On a life insurance policy, there are no tax consequences to the beneficiary
 - The death benefit is included in the person's estate for tax purposes
- FIXED DOLLAR METHOD OF MUTUAL FUNDS
 - Allows investor to receive monthly fixed amount of dollars on withdrawals from mutual funds
- FINRA SUITABILITY RULES
 - Recommendations made by RR's must be suitable for at least some investors
 - RR must have reasonable basis to believe recommendation is suitable for a particular customer based on his investment profile
- ANY GAIN OR LOSS ON A SHORT POSITION IS TREATED AS SHORT-TERM
- S&P's MUNICIPAL BOND RATINGS
 - Best rating – SP-1
 - Worst rating – SP-3
- S&P'S BOND RATINGS
 - AAA is best for corporate bonds
- REVERSE CONVERTIBLE SECURITIES
 - Short-term notes issued by banks and broker-dealers that usually pay coupon rate above prevailing market rates
 - Investor may be required to purchase shares of an underlying asset at a fixed price
 - Knock-in level – is security falls below this, investor is required to purchase shares of underlying asset at fixed price
 - If stays above knock-in level, investor gets the better yield and full return of principal
- Mutual funds (OPEN-END INVESTMENT COMPANIES)
 - May automatically reinvest in additional shares if the fundholder chooses to do so

- MUTUAL FUND SETTLEMENTS
 - Same-day
- OPTIONS AND US TREASURY SECURITIES SETTLEMENTS
 - T+1
- CORPORATE AND MUNICIPAL SECURITIES SETTLEMENTS
 - T+3
- DECISIONS OF THE DISTRICT BUSINESS CONDUCT COMMITTEE REGARDING COMPLAINTS CAN BE APPEALED TO THE NATIONAL ADJUDICATORY COUNCIL
- 1 POINT = \$10 ON BONDS WITH 1,000 PAR VALUE

Q&A Notes – Exam 6

- CONVERSION RATIO
 - Par value of bond / conversion price
- PROCESS OF OPENING OPTIONS ACCOUNT
 - Customer needs to receive OCC risk disclosure document
 - Registered options principal must approve account
 - Orders may be entered
 - Customer has 15 days from the time the account is approved to sign the options agreement
- WILDCATting PROGRAM
 - Exploratory program, searches for oil in unproven areas
 - Riskiest type of oil and gas program and has the highest profit potential
- EQUIPMENT LEASING PROGRAMS & LOW INCOME HOUSING
 - Designed to generate income and have the potential for tax benefits

- ASSET ALLOCATION FUNDS
 - Hold diversified portfolios
 - Percentage of portfolios invested in each category is shifted by the fund manager from time to time
- WHEN ISSUING A RESEARCH REPORT FIRM MUST DISCLOSE
 - If it was the managing underwriter in a recent public offering
 - Whether or not it owns shares of the stock
 - Does not need to disclose number of shares
 - Partners of firm who hold options to purchase stock
 - Firm makes market trading in the stock
- TERM ISSUE OF BONDS
 - All bonds mature in one specific year
 - Issuer deposits money in a sinking fund to help retire some of the bonds prior to maturity
- SERIAL ISSUE
 - A portion of the bond issue is paid off each year
- EQUITY INDEXED ANNUITIES
 - Not considered securities
- 1035 EXCHANGE
 - Should not occur within 36 months of previous exchange

Exchange of one variable annuity for another

- RESTRICTION ON ISSUING RESEARCH REPORTS ON IPO'S
 - If firm is a manager/co-manager
 - Must maintain quiet period of 40 days following IPO
 - Must maintain quiet period for 10 days following secondary offering
 - If firm is syndicate member or selling group member
 - Must maintain quiet period of 25 days
- Options cannot be used as collateral in a margin account
 - Exception is LEAPS, which can be bought on margin and therefore have loan value
- MINIMUM MAINTENANCE REQUIREMENT
 - Equity must equal at least 25% of market value of securities in the account
- OFFICIAL STATEMENTS OF MUNICIPAL SECURITIES
 - Contains detailed financial information similar to prospectus
- FIXED ANNUITIES DO NOT HAVE INVESTMENT RISK
- VARIABLE ANNUITIES DO HAVE INVESTMENT RISK
- NASDAQ LEVEL I
 - Provides subscribers with highest bid and lowest offer for a security (inside market)
 - Does not show cumulative trading volume nor price of the transactions as they occur
- RENEWAL AND REPLACEMENT FUND
 - Holds money put aside for municipal revenue issues for the improvement of the facility
- LETTER OF INTENT
 - May be backdated up to 90 days
- Family of funds allows an investor to take advantage of breakpoints although investing in more than one fund
- RULE 144 – GREATER OF THE TWO
 - Customer able to sell 1% of outstanding shares or avg weekly volume over last 4 weeks

- PAC TRANCHE (PLANNED AMORTIZATION CLASS)
 - Type of CMO which has the least prepayment risk and is designed for more risk averse investors
 - Has top priority and receives principal payments up to a specified amount
- MARGIN MAINTENANCE REQUIREMENTS
- REQUIREMENT FOR HOLDING SECURITIES IN STREET NAME IS THEY MUST BE SEGREGATED
- BOND BUYER MUNICIPAL INDEX REPRESENTS AVG OF 40 LT MUNICIPAL BONDS ADJUSTED TO YIELD OF 6%
- MINIMUM MARGIN MAINTENANCE REQUIREMENT IS 30%
- MAXIMUM UNDERWRITING COMPENSATION FOR SELLING PARTNERSHIP UNITS
 - 10%
- DIVIDENDS ON PREFERRED STOCK ARE PAID IN AFTER-TAX DOLLARS
- DMM does not need permission of an exchange official to stop stock
- TOTAL TAKEDOWN IS LARGEST PORTION OF UNDERWRITING SPREAD IN A MUNICIPAL ISSUE
 - Total takedown = additional takedown + concession
- MEMBER FIRMS REQUIRE DUPLICATE ACCOUNT STATEMENTS
- EXERCISE OF A STOCK INDEX OPTIONS IS SETTLED BY CASH INSTEAD OF SECURITIES
- CORPORATE CASH ACCOUNTS REQUIRE CORPORATE RESOLUTION DOCUMENTS
 - Corporate resolution authorizes person to trade for corporate cash account
- AFTER AN IPO, PROSPECTUSES MUST BE DELIVERED ON ALL PURCHASES FOR 25 DAYS
- REPURCHASE AGREEMENT IS A COLLATERALIZED LOAN

- REPURCHASE AGREEMENT
 - Dealer sell securities to another dealer or investor and agrees to buy them back at a specific time and price
- REVERSE CONVERTIBLE SECURITIES
 - Short-term notes issued by banks and broker-dealers
- RELATED PORTFOLIO ORDER
 - Syndicate member must disclose to the syndicate an order for a unit investment trust or an accumulation account to be used for a unit investment trust
- AMOUNT OF DIVIDEND NOT RELEVANT IN CALCULATING P/E RATIO
- JOIN AND LAST SURVIVOR ANNUITY
 - Provides longest stream of income
 - Guarantees payments until last annuitant dies
- LIFE ANNUITY – 20yr period certain
 - Results in payments ending after 20 years even if survivor still alive
- UNIT REFUND LIFE ANNUITY
 - Refunds balance of what is left over after the annuitant dies
- STRAIGHT-LIFE ANNUITY
 - Payment ceases after annuitant dies
- Serial bonds mature in successive years
- Member banks are charged a discount rate when borrowing from Fed
- MARGIN MAINTENANCE REQUIREMENT WHEN LONG AND SHORT SAME NUMBER OF SHARES OF SECURITY
 - Equal to 5% of the long position
- MARGIN ACCOUNT – AMOUNT ABLE TO WITHDRAW AFTER SALE

- SPECIAL MEMORANDUM ACCOUNT – SMA
 - Functions like a line of credit
 - Excess margin from client's account is deposited
 - 50% of proceeds from sales are marked for SMA
- UNIT INVESTMENT TRUST
 - Does not charge management fee
 - Portfolio is fixed and there is no investment adviser
 - They are supervised but not managed
- ODD-LOT THEORY
 - States that small investor is usually wrong because he is uninformed
 - Odd-lot buying on balance is seen as bearish
 - Odd-lot selling on balance is seen as bullish
- CROSSOVER POINT
 - Point is reached in DPP when project's revenue exceeds expenses and net income is produced
- TAX SWAP
 - Sale and purchase of bonds or other securities to realize a capital loss which can offset a capital gain
- OPEN MARKET OPERATION
 - Used by Federal Reserve Board (FRB) to regulate amount of money and credit in banking system
 - Most flexible tool and can be fine-tuned easily by buying/selling more or less US govt securities in the open market

- MSRB rules for trade confirmations
 - Must be sent to customer at or before the completion of the transaction
 - Confirmation must include:
 - Whether customer purchase/sold par amount
 - Complete description of securities including
 - Coupon and maturity date
 - Call features must be shown as well as principal amount, accrued interest, and total amount of transaction
 - Broker-dealer must disclose if it acted as principal or agent
 - If acting as agent amount of commission must be disclosed
 - Rating and denominations are not included in confirmation
- FED FUNDS RATE
 - RISES – TIGHTENING OF CREDIT
 - FALLS – EASING OF CREDIT
- SUBORDINATED DEBENTURE HOLDERS
 - Paid after all other bondholders and general creditors but before common stockholders
- Stocks of defense companies are not considered a defensive investment, they are more influenced by changes in government spending
- DEFENSIVE STOCKS
 - Food, liquor and tobacco companies
- BUILD AMERICA BONDS (BAB)
 - Treasury reimburses 35% of interest payments
 - Bonds are suitable for taxable, fixed-income investors
 - Allow municipality to issue a bond with a higher interest rate but pay an equivalent tax-free rate

- GREEN SHOE CLAUSE
 - Allows syndicate to increase number of shares sold by 15% above the original number of shares in the offering
- CMO's may not be compared to any other type of investment
- FACE AMOUNT CERTIFICATE
 - Type of investment company
- MANAGEMENT COMPANY
 - Considered type of investment company
- BUSINESS CONTINUITY PLAN
 - Does not need to include home addresses of employees
- REGULATION T PAYMENT DATE IS 5 BUSINESS DAYS
- OPTIONS TRANSACTIONS SETTLE THE NEXT BUSINESS DAY
- RECLAMATION
 - Process of returning securities that were previously accepted on the settlement date
- Officials of the exchange on which the options trade would make the decision to halt options trading on a security that has been halted

Q&A Notes – Exam 7

- RULE 145
 - Applies to mergers, consolidations, reclassifications of securities or transfers of corporate assets
 - Requires company to provide written disclosures to shareholders about transactions

- REGULATION FD
 - Applies to issuers of securities
 - Requires material, nonpublic information disclosed to analysts or other investors be made public
 - If disclosure is intentional, information must be disclosed right away to public
 - If unintentional, disclosure must be made within 24 hours
- Payout on a variable annuity
 - Fixed number of annuity units multiplied by variable dollar amount
 - Fixed number is assigned once annuity is annuitized based on value of investment, assumed interest rate, age and gender and payout option chosen
 - Number of annuity units is multiplied by net asset value of separate account at each payout period to determine dollar amount annuitant will receive each pay period
- Broker-dealers must follow 5% Markup policy
- Banker's Acceptances are considered collateralized time drafts
 - They are used to facilitate foreign trade
 - Collateralized by a bank
- Max loss for debit spread is amount of debit
- Most important factor of a DPP (DIRECT PARTICIPATION PROGRAM) is whether or not it is a good investment
- Corporate guarantor is the place that backs revenue bonds
 - They use the facility that was built by the bond proceeds and become the sole party responsible for backing it
- MINIMUM MAINTENANCE REQUIREMENT FOR SHORT POSITION IS 30% OF MARKET VALUE

- DOW COMPOSITE
 - 30 industrial stocks
 - 20 transportation stocks
 - 15 utility stocks
- BROKER'S BROKER
 - Primary source for quote in the secondary market
 - Assists trader in finding the best price on a specific issue
- WHEN PRICING A BOND, ONLY CALL FEATURE THAT IS USED IS THE IN-WHOLE CALL
 - This is the only call feature that allows the issuer to call the entire issue used
- Options on outright US Dollar not available
- MINIMUM MAINTENANCE REQUIREMENT FOR SECURITIES UNDER \$5
 - Greater of the two:
 - 100% value of securities
 - \$2.50 per share
- PREFERRED SHAREHOLDERS DO NOT HAVE VOTING RIGHTS
- TRACE
 - Reporting system used for corporate bonds
- RTRS
 - Reporting system for municipal bonds
- TRF
 - Reporting system for stocks listed on NASDAQ
- DEFINED BENEFIT PLAN
- Options with more than 9 months to expiration can be purchased on margin
- When making a political contribution, MFP cannot exceed \$250 or underwriting ban is triggered

- PARITY BOND
 - Two or more revenue bonds have the same claim against revenue
- DOUBLE-BARRELED BOND
 - Backed by source of revenue and full faith and credit of an issuer that has taxing power
- General obligation bonds require voting approval
- Revenue bonds do not require voter approval
- Straight line depreciation is not a tax-preference item
- BROKER-DEALERS ACT AS PRINCIPALS WHEN BUYING FOR OR SELLING FROM INVENTORY
- INSIDERS MAY WRITE COVERED CALLS ON STOCK THEY OWN
- TRUSTEES OF PENSION FUNDS CAN WRITE COVERED CALLS
- WILSHIRE INDEX
 - Consists of more than 7,000 stocks that trade on NYSE and NASDAQ
- MORAL OBLIGATION BONDS
 - Municipal revenue bonds that are payable by the state if revenues from the project do not satisfy the debt service payments
- DOUBLE BARRELED BOND
 - GO bonds backed by full faith and credit of issuing municipality
- VELOCITY OF MONEY
 - Represents number of times dollar is spent over a given period
 - Measure of business activity in the marketplace
- 20-BOND INDEX
 - Avg YTM on a particular day of 20 specific GO bonds with 20yr maturities
- 11-BOND INDEX
 - Avg YTM on a particular day of 11 of the 20 specific GO bonds from the 20-Bond Index

- REVENUE BOND INDEX (REVDEX)
 - Avg YTM on a particular day of 25 specific revenue bonds with 30yr maturities
- CURRENT YIELD
 - Take yearly interest payment and divide by current market price of bond
- CD's are only insured up to 250K by FDIC
- According to Regulation T:
 - Securities must be paid for within 2 business days of the regular way settlement date
 - Regular way settlement is 3 business days
 - Payment is required within 5 business days from the trade date
- MINIMUM DENOMINATION FOR NEGOTIABLE CD'S
 - 100,000
- FEDERAL HOME LOAN BANK ISSUES 2 TYPES OF SECURITIES
 - Discount notes with maturities less than 1 yr
 - Consolidated bonds with maturities up to 30 yrs
- RECORDS OF CUSTOMER COMPLAINTS
 - Must be maintained according to SRO record-keeping rules
- CUSTOMER MUST WAIT 30 DAYS BEFORE BUYING THE SAME SECURITY TO ESTABLISH TAX LOSS ON TRADE
- SECTION 457 PLAN
 - Retirement plan used by many public sector workers (state and local, not federal)
- When a DMM stops stock, the price is guaranteed
- REPURCHASE AGREEMENTS (REPOS)
 - Short-term investments

- SERIAL BONDS
 - Have different maturity dates
 - Declining interest payments and principal amounts
- TERM BONDS
 - Stable interest payments, principal paid on maturity date
- Education Savings Accounts (ESAs)
 - Pay for private elementary, high school and postsecondary school expenses
- FEDERAL FUNDS RATE
 - Most volatile
 - Money-market rate
- WHEN CALCULATING EPS, DO NOT INCLUDE PREFERRED SHARES AND SUBTRACT PREFERRED DIVIDENDS
- MUNICIPAL BONDS ARE EXEMPT FROM
 - Regulation T
 - Trust Indenture Act of 1939
 - Registration Provisions of Securities Act of 1933
- MUNICIPAL BONDS ARE NOT EXEMPT FROM ANTIFRAUD PROVISIONS OF SECURITIES ACT OF 1933
- STRUCTURED SECURITIES MAY BE LINKED TO
 - Equity securities
 - Commodities
 - Interest rates
 - Can be structured to provide principal protection
- WHEN STOCK SELLS EX-DIVIDEND, ORDERS ARE REDUCED THAT WERE ENTERED **BELOW MARKET**

- PAYOUT ON VARIABLE ANNUITY
 - Based on fixed number of annuity units with fluctuating value per unit
- ACCUMULATION UNIT IN VARIABLE ANNUITY
 - Used to determine contract owner's interest in the separate account
- REGULATION T APPLIES TO CASH AND MARGIN ACCOUNTS