



Series #56
Final 2

1.

All of the following may trade for their own account on the floor of an options exchange **EXCEPT** a:

- a. market maker
- b. competitive option trader
- c. registered option trader
- d. floor broker (board broker)

2.

The OCC does all of the following **EXCEPT**:

- a. maintain an orderly trading market in options
- b. issue options contracts
- c. assign options exercise notices
- d. guarantee viability of options contracts

3.

Which statements are true regarding PHLX World Foreign Currency option contracts?

- I Contracts are available in American style
 - II Contracts are available in European style
 - III Exercise settlement is in units of the foreign currency
 - IV Exercise settlement is in U.S. dollars
- a. I and III
 - b. I and IV
 - c. II and III
 - d. II and IV

4.

A market maker is quoting ABCD at 31.00 - 31.20 (12 x 5). The inside market is 31.10 - 31.20. The market maker receives a customer order to sell 200 ABCD at 31.18. Under SEC rules, the market maker must:

- a. execute the order
- b. update its quote to .00 - .18 (12 x 2)
- c. update its quote to .00 - .18 (2 x 12)
- d. move its quote away from the inside market

5.

Under SRO rules, order tickets must be time stamped:

- a. at time of execution
- b. within 15 seconds of execution
- c. within 20 seconds of execution
- d. at, or prior to, market close on trade date

6.

Under SEC rules, a registered broker-dealer that engages in the purchase or sale of trading units of \$200,000 or more is known as a:

- a. Third Market Maker
- b. Qualified Block Positioner
- c. Registered Reporting Member
- d. Primary Market Maker

7.

Unless specified by a customer, a market-not held order must be entered as a:

- a. Day order
- b. GTC order
- c. VWAP order
- d. SIZE order

8.

Under Regulation M, the maximum restricted period for trading a subject security by a syndicate member that is **NOT** a market maker is:

- a. 1 day
- b. 5 days
- c. 10 days
- d. 20 days

9.

A "T.2" modifier next to a stock symbol where trading is halted on NASDAQ indicates:

- a. news is about to be announced
- b. news has been announced
- c. market makers are about to resume making quotes
- d. market makers are about to resume trading

10.

Currently, the market price of ABC stock is at \$50 and the market price of DEF stock is at \$27. In which choice can both of the following orders from customers be immediately executed?

- a. Buy 200 shares of ABC at the market; Sell 200 shares of ABC at \$55
- b. Sell short 200 shares of ABC at \$55; Sell 200 shares of ABC @ \$45
- c. Buy 200 shares of DEF at \$30; Sell short 200 shares of ABC at \$45
- d. Buy 200 shares of DEF at \$30 Stop; Sell short 200 shares of DEF @ \$45 Stop

11.

A Chinese Wall must be maintained by a broker-dealer between investment banking and which of the following departments?

- I Research
- II Trading
- III Retail Sales
- IV Mergers and Acquisitions

- a. I and II only
- b. III and IV only
- c. I, II and III
- d. I, II, III, IV

12.

Which of the following are true about OATS?

- I Order information must be reported to OATS within 30 seconds
- II Order information must be reported to OATS daily
- III Only the sell side reports to OATS
- IV Both the buy and sell side report to OATS

- a. I and III
- b. I and IV
- c. II and III
- d. II and IV

13.

A customer buys 1 Swiss Franc Mar 88 Call and sells 1 Swiss Franc Mar 90 Call. This position is a:

- a. bull call spread
- b. bear call spread
- c. horizontal call spread
- d. diagonal call spread



14.

If the holder of an OEX option contract decides to exercise, the holder:

- a. must pay the strike price of the contract
- b. will receive the current premium on the contract
- c. will receive the in-the-money amount on the contract
- d. will receive the in-the-money amount less the premium paid for the contract

15.

Which statements are true regarding European style foreign currency options?

- I The contracts can be exercised at any time
- II The contracts can only be exercised at expiration
- III The contracts can be traded at any time
- IV The contracts can only be traded at expiration

- a. I and III
- b. I and IV
- c. II and III
- d. II and IV

16.

On the floor of the Chicago Board Options Exchange, duties similar to those performed by the NYSE Specialist are handled by the:

- a. Floor Broker
- b. Designated Primary Market Maker
- c. Order Book Official
- d. Floor Official

17.

The latest time to trade an index option (other than during a closing rotation) is:

- a. 4:00 PM EST (3:02 PM CT)
- b. 4:15 PM EST (3:15 PM CT)
- c. 5:30 PM EST (4:30 PM CT)
- d. 11:59 PM EST (10:59 PM CT)

18.

On the same day in a margin account when the market price of ABC stock is at \$50, a customer takes the following positions:

Buy 1 ABC Jan 40 Call @ \$12

Sell 2 ABC Jan 50 Calls @ \$5

Buy 1 ABC Jan 60 Call @ \$1

The maximum potential loss is:

- a. \$300
- b. \$700
- c. \$9,700
- d. Unlimited

19.

A customer is long the Swiss Franc at a cost of \$.90 per SF. The customer wishes to place a collar on the position using PHLX SF World Currency options. To create the collar, the customer would:

- I Buy 1 PHLX 89 SF Call
- II Buy 1 PHLX 89 SF Put
- III Sell 1 PHLX 91 SF Call
- IV Sell 1 PHLX 91 SF Put

- a. I and III
- b. I and IV
- c. II and III
- d. II and IV

20.

FLEX options allow customers to choose:

- a. when the contract will be exercised
- b. the contra-party to the contract
- c. the terms of the contract
- d. when payment must be made for the contract

21.

A customer who is an officer of ABC Corporation confides in his registered representative that this quarter's earnings report will be worse than expected. As a result of this, the registered representative buys puts on ABC stock for his personal account. Which statement is true?

- a. No violation of "insider trading" prohibitions has taken place
- b. Only the registered representative is potentially liable for "insider trading" violations
- c. Only the corporate officer is potentially liable for "insider trading" violations
- d. Both the registered representative and the corporate officer are potentially liable for "insider trading" violations

22.

Quoted options premiums reflect which of the following?

- I Intrinsic value
- II Time Value
- III Commission
- IV Mark-up

- a. II only
- b. II and III only
- c. I and II only
- d. I, II, III, IV

23.

Listed stock options for a given expiration month stop trading on the Chicago Board Options Exchange at:

- a. 4:00 PM Eastern Standard Time on the third Friday of that month
- b. 11:59 PM Eastern Standard Time on the third Friday of that month
- c. 4:00 PM Eastern Standard Time on the Saturday following the third Friday of that month
- d. 11:59 PM Eastern Standard Time on the Saturday following the third Friday of that month

24.

Cabinet transactions may be accepted for:

- I Opening transactions for public customers
- II Closing transactions for public customers
- III Opening transactions for member accounts
- IV Closing transactions for member accounts

- a. I and II only
- b. III and IV only
- c. II and IV only
- d. I, II, III, IV

25.

"A market or limit order which is to be executed in whole or in part as soon as such order is represented in the trading crowd. Any portion not so executed is to be treated as canceled". This is the description of a(n):

- a. Fill or Kill order
- b. All or None order
- c. Immediate or Cancel order
- d. One Cancels the Other order



26.

Once the CBOE closing bell is rung on the Friday prior to expiration:

- I All trading ceases in options contracts listed on the Exchange
- II Closing rotations are employed once a closing price in the primary market is established
- III Cabinet trades that remain open must be matched and reported

- a. I only
- b. II only
- c. I and II
- d. I, II, III

27.

Approved copies of options communications must be retained by member firms for:

- a. 1 year
- b. 3 years
- c. 5 years
- d. 6 years

28.

A customer who is long 1 ABC Jan 50 Call exercises on Monday, January 15th. The Options Clearing Corporation notifies a member firm that is short that contract that it has been exercised on Tuesday, January 16th. The member firm selects and notifies a customer who is short that contract that he has been exercised on Wednesday January 17th. The customer who is exercised must deliver the stock no later than:

- a. Thursday, January 18th
- b. Friday, January 19th
- c. Monday, January 22nd
- d. Tuesday, January 23rd

29.

The OCC does all of the following EXCEPT:

- a. standardize listed options contracts
- b. guarantee the performance of the writer of listed options contracts
- c. adjust listed options contracts for cash dividends
- d. issue listed options contracts when a report of an opening transaction is received

30.

On the same day in a margin account, a customer sells 1 ABC Jan 65 Call and sells 1 ABC Jan 55 Put when the market price of ABC is at \$60. The customer has created a:

- a. Long Straddle
- b. Long Strangle
- c. Short Straddle
- d. Short Strangle

31.

The prohibited practice known as supporting would likely be employed by a customer with a:

- I Short Call Position
- II Short Put Position
- III Short Straddle Position

- a. I only
- b. II only
- c. I and III
- d. II and III

32.

The prohibited practice known as capping would likely be employed by a customer with a:

- I Short Call Position
- II Short Put Position
- III Short Straddle Position

- a. I only
- b. II only
- c. I and III
- d. II and III

33.

If the writer of an equity call option is exercised, the writer:

- a. must deliver the stock in 1 business day
- b. must deliver the stock in 3 business days
- c. can effect an offsetting closing trade the same day
- d. can effect an offsetting closing trade in 3 business days

35.

Which of the following would violate O.C.C. position limits, assuming a 75,000 contract limit?

- I Long 40,000 ABC Call Contracts / Long 40,000 shares of ABC stock
- II Long 40,000 ABC Call Contracts / Short 40,000 ABC Put Contracts
- III Long 40,000 ABC Put Contracts / Short 40,000 shares of ABC stock
- IV Long 40,000 ABC Put Contracts / Short 40,000 ABC Call Contracts

- a. I and III only
- b. II and IV only
- c. II, III, IV
- d. I, II, III, IV

34.

An order ticket is marked "Buy 100 ABC Jan 50 Calls @ \$5 IOC." The floor trader is able to buy 40 call contracts at the customer's limit. Which statement is true?

- a. The unfilled order balance of 60 contracts is canceled
- b. The trader can attempt a later execution to filled the remaining balance
- c. The unfilled portion of the order must be given to the Market Maker for execution
- d. The unfilled portion of the order must be given to the Board Broker for execution

36.

All of the following statements about the insider trading rules are true

EXCEPT:

- a. violators are liable for treble damages
- b. violators can be imprisoned
- c. reporters of violations can receive an informer bounty
- d. violators are subject to civil penalties only



37.

Under Regulation M, passive market making is permitted if:

- a. there are no independent market makers in that stock
- b. there are independent market makers in that stock
- c. there are independent market makers and any passive bid entered is higher than the independent bid
- d. the syndicate manager allows

38.

A customer shorts stock which is on NASDAQ's "threshold" (restricted) list. The following day, the stock is removed from the list. If there is a failure to deliver on settlement, which statement is true?

- a. Mandatory buy-in is required after 10 business days from settlement
- b. Mandatory buy-in is required after 45 days have elapsed from trade date
- c. Mandatory buy-in is required only at the specific direction of NASDAQ
- d. Mandatory buy-in is not required

39.

Which of the following is defined as a "public" arbitrator? An individual who:

- a. within the past 3 years was associated with a securities broker-dealer
- b. is retired from the securities business
- c. is an accountant who has devoted 20% or more of his or her professional work in the last two years to securities firms
- d. is an author who has written magazine articles about the securities business for industry trade publications

40.

Under the provisions of the USA PATRIOT Act of 2001, when opening a new account for a non-resident alien, which of the following must be obtained from the customer?

- a. Social security number
- b. Passport number
- c. Driver's license number
- d. Major credit card number

41.

Which statement is true about inspection of customer account records by the Office of Supervisory Jurisdiction?

- a. Customer account records must be inspected at least annually by the Office of Supervisory Jurisdiction
- b. Customer account records must be inspected at least quarterly by the Office of Supervisory Jurisdiction
- c. Customer account records must be inspected periodically by the Office of Supervisory Jurisdiction
- d. No inspection of customer account records is required by the Office of Supervisory Jurisdiction

42.

All of the following associated persons are required to be fingerprinted **EXCEPT**:

- a. registered representative who solely solicits customer orders
- b. registered representative who solely transfers securities
- c. registered representative who solely processes customer transactions
- d. registered representative who solely handles customer securities and funds

43.

Stabilizing bids may be entered:

- I Above the Public Offering Price
- II Below the Public Offering Price
- III Below the Public Offering Price but above the current independent market
- IV At the Public Offering Price

- a. I and IV only
- b. II and III only
- c. II and IV only
- d. II, III, IV

44.

An individual who was previously employed as a registered representative at a broker-dealer seeks employment at another member firm. The new employer member requests a copy of that individual's U-5 form. The applicant must provide the copy of the U-5 to the prospective employer within:

- a. 1 business day of request
- b. 2 business days of request
- c. 3 business days of request
- d. 5 business days of request

45.

Responsibilities of the Office of Supervisory Jurisdiction include:

- I Annual review of each registered representative's reputation
- II Annual review of customer account records
- III Review and endorsement of each customer order
- IV Review and endorsement of correspondence sent to customers if the firm has not implemented a correspondence compliance program

- a. I and II only
- b. III and IV only
- c. II, III, IV
- d. I, II, III, IV

46.

All of the following would fall under the definition of an "insider"

EXCEPT:

- a. Lawyer working on a proposed corporate acquisition
- b. Accountant preparing financial statements of a company that is the subject of a merger
- c. Financial printer typesetting the documents for a tender offer that will be announced soon
- d. Investment advisor recommending the stock of a company that is the target of a tender offer



47.

Under industry regulations, which disclosures are required to be made by a member firm upon request?

- I A customer requests that a member firm provide a copy of its latest balance sheet
- II A customer requests that a member firm provide a copy of FINRA rules
- III Another member firm requests that the member firm provide its latest financial statement
- IV The Securities and Exchange Commission requests that a member provide information on a new issue offering managed by that firm

- a. I and II only
- b. III and IV only
- c. I, II, III
- d. I, II, III, IV

48.

A registered individual leaves the industry, and is concerned that he might not reassociate with another member firm within 2 years. The individual approaches a friend at another member firm to hold his license during his absence. This action is:

- a. permitted without restriction
- b. permitted with the permission of the principal
- c. permitted with the permission of the self-regulatory organization
- d. prohibited

49.

An amended U-4 filing is required if a registered individual:

- I is convicted of a felony
- II discovers a deficiency in the existing filing
- III changes employers or residence address
- IV changes marital status

- a. I and II only
- b. III and IV only
- c. I, II, III
- d. I, II, III, IV

50.

A customer who bought stock at \$42 per share has seen the position appreciate to \$79 per share. The customer would like to protect the gain at minimal cost. The customer should buy a:

- a. 75 call and sell an 80 put
- b. 75 put and sell an 80 call
- c. 40 call and sell an 80 put
- d. 40 put and sell an 80 call

51.

An investor that is bearish on stock price movements would:

- I Buy VIX Calls
- II Buy VIX Puts
- III Sell VIX Calls
- IV Sell VIX Puts

- a. I and III
- b. I and IV
- c. II and III
- d. II and IV

52.

A registered representative has been called to active duty in the Persian Gulf. At the time of receiving notice to report for active duty, the representative had previously received notice to complete his Regulatory Element Continuing Education requirement. The representative has 30 days left to complete his CE obligation. The representative leaves for active duty without completing the CE requirement and returns to civilian life 30 months later. Which statement is true regarding the representative's registration status upon his return?

- a. The representative's registration will be suspended because the Regulatory Element CE requirement was not satisfied within the required time frame
- b. The representative's registration remains active and the Regulatory Element CE requirement is waived due to the military service
- c. The representative's registration will lapse because he has not been associated with a member firm for more than 2 years
- d. The representative's registration would have been placed in special inactive status with FINRA and resumes upon return to his securities firm employer

53.

When can a member firm share in the gains and losses of a customer account?

- a. Under no circumstances
- b. If the member shares in direct proportion to the capital contributed
- c. If the customer is an immediate family member
- d. If the SRO gives advance approval

54.

A registered person resigns from a broker-dealer in order to finish graduate school. 3 years later, this individual reassociates with another broker-dealer firm. This person must participate in the Regulatory Element of CE (Continuing Education) on a cycle based on:

- a. the date of initial registration
- b. the date of reassociation
- c. a date determined by FINRA
- d. a date determined by a general principal

55.

Who issues an escrow receipt?

- a. Bank
- b. Brokerage firm
- c. American Depository Trust
- d. Options Clearing Corporation

56.

A customer takes the following positions:

Short 100 ABC Shares @ \$50
Short 2 ABC Jan 50 Puts

This is a:

- a. Married put
- b. Ratio write
- c. Short straddle
- d. Synthetic short call

57.

What is the maximum number of securities in a narrow-based ETF?

- a. 1
- b. 5
- c. 9
- d. 11



58.

A market maker has 2 limit orders to buy 500 shares of ABCD at 10.00. A market order to sell 400 shares is executed by the firm at 10.00, at which point the firm fills one of the two orders for 400 shares. Which statement is true?

- a. This is permitted without restriction
- b. This is permitted as long as the firm consistently applies a methodology for dealing with multiple limit orders
- c. This is prohibited as any limit order must be filled in its entirety
- d. This is prohibited as FINRA rules require equal allocation between multiple limit orders

59.

Under SEC Rule 10b-18, all of the following statements regarding an issuer purchasing its own securities are true **EXCEPT**:

- a. purchases cannot affect the opening or closing of the security
- b. daily purchases cannot exceed 25% of the daily trading volume
- c. purchases outside the normal flow are permitted
- d. purchases on any single day can be made through no more than 2 market makers

60.

A market maker in ABCD is quoting 10.00 - 10.50 (15 x 10), which is the inside market. A customer enters an order to buy 100 shares at 10.00. Under SEC rules, the market maker:

- a. must update its quote size to 16 x 10
- b. must update its quote size to 15 x 11
- c. must execute the order immediately
- d. is not required to update its quotation

61.

Under SRO rules, which **TWO** of the following are examples of locked or crossed markets?

- I Bid quotation is greater than the asked quotation
- II Bid quotation is lower than the asked quotation
- III Asked quotation is greater than the bid quotation
- IV Asked quotation is lower than the bid quotation

- a. I and III
- b. I and IV
- c. II and III
- d. II and IV

62.

An order ticket to sell 100 ABCD shares long is executed. Under normal circumstances, the securities must be delivered on:

- a. T
- b. T + 1
- c. T + 3
- d. T + 5

63.

An OATS report includes all of the following **EXCEPT**:

- a. where the order was routed for execution
- b. aggregated orders
- c. date and time of receipt of each order
- d. name of contra party

64.

A market maker is quoting ABCD at 17.25 - 17.50 (10 x 10), which represents the inside market. The bid reflects a customer limit order. To avoid its Manning obligation, the market maker could buy, as principal, as long as it offers incoming sell orders a price at least:

- a. 1 cent above the bid
- b. 5 cents above the bid
- c. 10 cents above the bid
- d. 25 cents above the bid

65.

Interpositioning is permitted if:

- a. the member's trading desk is inadequately staffed due to heavy volume
- b. the member charges a lower than normal commission
- c. the member receives order flow in return
- d. the member receives a superior execution

66.

An officer of a publicly held company provides material non-public information to a neighbor, who immediately buys puts on the subject company. Which statement is true?

- a. The officer violated the insider trading rules
- b. The neighbor violated the insider trading rules
- c. Both the officer and the neighbor violated the insider trading rules
- d. Neither the officer nor the neighbor violated the insider trading rules

67.

Under SEC rules, trade tickets are:

- a. only required for customer orders; not for proprietary orders
- b. only required for proprietary orders; not for customer orders
- c. required for both customer orders and proprietary orders
- d. not required if the details of the trade are promptly reported for matching and settlement

68.

"Marking the Close" is best described as a:

- a. series of trades at or near the close
- b. series of trades at or near the close intended to down-tick the security
- c. series of trades at or near the close intended to up-tick the security
- d. series of trades at or near the close intended to either up-tick or down-tick the security



69.

Under SEC Rule 605 of Regulation NMS, market centers, in their monthly reports on order execution, must disclose all of the following information **EXCEPT**:

- a. quoted spreads
- b. speed of executions
- c. rates of price improvement
- d. fill rates

70.

The Trade Reporting Facility for NASDAQ:

- I requires reports of trades of NASDAQ listed issues within 30 seconds during ACT operating hours
- II immediately disseminates reported last sale information to the NASDAQ ticker
- III provides on-line access to real-time trade reporting information

- a. I only
- b. I and II only
- c. II and III only
- d. I, II, III

71.

NASDAQ market makers must maintain business hours from:

- a. 7:00 AM - 8:00 PM ET
- b. 8:00 AM - 8:00 PM ET
- c. 9:30 AM - 4:00 PM ET
- d. 9:30 AM - 8:00 PM ET

72.

An order entry firm has a "payment for order flow agreement" with a large NASDAQ market maker that pays the entry firm for each round lot 100 share order submitted to the market maker for execution. The order entry firm has a 1,000 share customer order that it submits as 10-100 share orders to the market maker to increase the payment for order flow received. Which statement is true?

- a. This practice is permitted since NASDAQ quotes are only firm for 100 shares
- b. This practice is known as decrementation and is prohibited
- c. This practice is known as trade shredding and is prohibited
- d. This practice is known as wash trading and is prohibited

73.

Under FINRA rules, all of the following information must be recorded on an order ticket **EXCEPT**:

- a. payment for order flow
- b. time of execution
- c. if a sale, whether long or short
- d. whether the trade was solicited or unsolicited

74.

A trader at a large market making firm calls a counterpart at another firm and strongly suggests that the firm raise its offer by 5 cents in order to allow his firm to reduce inventory. In return, the trader promises order flow. This action is

- a. permitted
- b. permitted if the agreement is documented in writing
- c. permitted with the approval of the general principal
- d. prohibited

75.

A customer enters a limit order to buy 800 shares of ABCD at 21.50, which includes an agreed upon mark-up of 25 cents. The last sale was reported at 21.43. Under SEC rules, the order must be protected at:

- a. 21.25
- b. 21.43
- c. 21.50
- d. the next trade of 800 shares or more

76.

The TRF for NASDAQ:

- a. displays quotes for NASDAQ issues
- b. reports completed trades of NASDAQ issues
- c. displays quotes for Third Market makers in exchange listed issues
- d. reports completed trades of OTCBB and Pink Sheet issues

77.

Trading in a NASDAQ stock has been halted pending an important news announcement. A customer wishes to place a limit order to sell short the shares during this trading halt.

Which statement is true?

- a. The customer order cannot be accepted until trading resumes
- b. The customer order cannot be accepted because it is a short sale
- c. The customer order can be accepted by the member firm but the customer should be notified that trading is currently halted
- d. The customer order can be accepted by the member firm and executed through an unlinked ECN

78.

Under Regulation M, Rule 105, covering add-on offerings of securities, any short sales effected by persons within how many days of the effective date are prohibited from being closed by the purchase of the same security from the underwriter?

- a. 1
- b. 2
- c. 3
- d. 5

79.

The Manning Rule requires that:

- a. customer limit orders for OTC securities be protected
- b. customer limit orders for OTC securities be displayed
- c. execution of customer limit orders for OTC securities orders be reported to the Network C Tape
- d. customer limit orders for OTC securities be segregated from proprietary orders for the firm's trading account

80.

Which of the following orders for ABCD stock can be accepted into Single Book when ABCD is trading at \$10.50?

- I Buy 100 shares of ABCD @ \$10.00
- II Sell 100 shares of ABCD @ \$10.00 Short
- III Buy 100 shares of ABCD @ \$11.00
- IV Sell 100 shares of ABCD @ \$11.00 Short

- a. I and III
- b. I and IV
- c. II and III
- d. II and IV



81.

Which of the following is a manipulative practice?

- a. Placing successive orders to buy the same stock at \$50, \$55, \$60, \$65 and \$70
- b. Placing successive orders to buy a stock and then sell that stock repetitively on the same day
- c. Placing orders to buy stock for the firm's proprietary trading account while holding customer orders to buy that security
- d. Placing orders to short a stock for the firm's proprietary trading account while holding a customer order to buy that security

82.

A trader receives a block order for a NASDAQ security and breaks up the trade into smaller orders to maximize payment for order flow. This action is permitted:

- a. with the permission of the client
- b. if the order is placed as a market-not held
- c. without restriction
- d. under no circumstances

83.

Trading in a stock is suspended. Which statement is true regarding the trading of listed options on that stock?

- a. Only opening transactions are permitted
- b. Only closing transactions are permitted
- c. Both opening and closing transactions are permitted until the contracts expire
- d. Trading will be halted in options contracts on the suspended stock

85.

A tender offer is announced for ABC stock. Which of the following is permitted to tender ABC shares?

- I A customer who is long 100 shares of ABC stock
 - II A customer who is short 100 shares of ABC stock
 - III A customer who is "short against the box" 100 shares of ABC stock
 - IV A customer who is long ABC call options
- a. I only
 - b. I and IV
 - c. II and III
 - d. I, II, III, IV

86.

Which of the following statements are true regarding the Conduct Rule on sharing in customer accounts? Sharing in an account:

- I is prohibited in all circumstances
 - II is not permitted unless the member firm gives prior written approval to the account
 - III is only allowed in direct proportion to the capital contributed by the person associated with the member
 - IV of the "immediate family" of the person associated with the member is permitted and need not meet the "proportionate test"
- a. I only
 - b. II and III only
 - c. III and IV only
 - d. II, III, IV

87.

Members must make which of the following available to regular bona-fide customers and other members upon request?

- I Copy of the firm's latest statement of financial condition
- II Copy of the firm's latest income statement
- III Copy of the firm's latest SRO audit results

- a. I only
- b. II only
- c. I and II
- d. II and III

88.

A member is permitted to give an amount in excess of the gift limitation amount annually to an employee of another firm:

- a. if the principal approves of the amount in writing
- b. if there is a written employment contract spelling out the work to be performed and the compensation to be paid that has been previously approved by the principal
- c. if the individual agrees to provide a 1099 Form to the recipient of the payment
- d. under no circumstances

89.

If, in the course of settlements, securities are suspected to be stolen, a report must be filed with the Securities Information Center within:

- a. one business day of discovery
- b. two business days of discovery
- c. three business days of discovery
- d. four business days of discovery

90.

Under Rule 17a-3, all of the following are records required to be kept by broker-dealers **EXCEPT**:

- a. records of all activity in customer accounts
- b. records of all dealer quotations made in the course of trading
- c. records of original entry for cash receipts and disbursements
- d. record of original entry for all purchases and sales, whether for a customer or the dealer's account

91.

Under Rule 17f-2, which of the following employees of a broker-dealer must be fingerprinted?

- I Registered representatives
- II Registered principals
- III Unregistered employees that process securities
- IV Unregistered employees that process monies

- a. I and II only
- b. III and IV only
- c. I and IV only
- d. I, II, III, IV



92.

A trading halt has occurred and will last the rest of the day. A customer sends an urgent message to her broker to sell the security on **ANY** exchange. The broker should:

- a. hold the trade until the market reopens the next day
- b. send the trade to the Canadian exchange for execution
- c. execute the trade in the upstairs market
- d. execute the trade in the firm's proprietary trading account

93.

A "threshold list" security is one that:

- a. has a history of settlement failures over 5 settlement days
- b. must be bought in 5 business days past settlement if there is a fail to deliver
- c. is subject to higher position limits because it is actively traded
- d. is subject to computerized oversight in the StockWatch program

94.

A registered representative has been called to active military duty and his registration has been placed in "inactive status" by the member firm. Once the registered individual returns to civilian life, special inactive status ceases if the individual does not return to work at the member firm within:

- a. 30 days
- b. 60 days
- c. 90 days
- d. 120 days

95.

Which of the following is **NOT** a reason why the CBOE would halt trading in an options series?

- a. There is a pending news material news announcement about the company
- b. The CBOE trading system is experiencing technical problems
- c. The underlying stock has halted trading in its primary market
- d. The open interest in the contract has exceeded pre-set levels

96.

Which of the following open orders on the Specialist's (DMM's) book as of the close of trading would be adjusted if the "ex" date were tomorrow?

- I Buy 100 ABC @ 50 Day
- II Buy 100 ABC @ 60 Stop GTC
- III Buy 100 ABC @ 50 GTC
- IV Sell 100 ABC @ 60 GTC

- a. III only
- b. I and III
- c. II and IV
- d. I, II, III

97.

Which is **NOT** considered to be a good delivery for an 800-share purchase of stock?

- a. One 800-share certificate
- b. Eight 100-share certificates
- c. Ten 80-share certificates
- d. Thirty two 25-share certificates

98.

Which orders, if executed, do **NOT** guarantee a specific price or better?

- I Buy Limits
- II Buy Stops
- III Sell Limits
- IV Sell Stops

- a. I and II
- b. III and IV
- c. I and III
- d. II and IV

99.

Which statements are true regarding ex-dates?

- I The ex-date for cash distributions is set at 2 business days prior to record date
- II The ex-date for cash distributions is set at the day after the payable date
- III The ex-date for non-cash distributions is set at 2 business days prior to record date
- IV The ex-date for non-cash distributions is set at the day after the payable date

- a. I and III
- b. I and IV
- c. II and III
- d. II and IV

100.

Which statements are true?

- I Regular way trades of listed stocks settle on the business day after trade date
- II Regular way trades of listed stocks settle 3 business days after trade date
- III Regular way trades of listed stock options settle on the business day after trade date
- IV Regular way trades of listed stock options settle 3 business days after trade date

- a. I and III
- b. I and IV
- c. II and III
- d. II and IV



Series #56 - Final 2 Explanations

1. The best answer is **d**. On the Options Exchanges, floor brokers, also known as board brokers, handle trades as agent only. They accept orders from the public for execution but do not trade for their own account. Market makers on the exchange floor make markets in option contracts and are buying and selling for their own account. Registered options traders and competitive options traders are individuals that trade on the floor for themselves to add liquidity to the market. They can take positions and carry them.
2. The best answer is **a**. The Options Clearing Corporation is the issuer and guarantor of listed options contracts. The OCC keeps the record of all long and short positions and changes that occur in these positions due to trading or exercise. When the OCC receives an exercise notice, it picks a writer to be assigned the contract on a random basis. Trading of the contracts occurs on exchanges - there is no trading at the OCC!
3. The best answer is **d**. PHLX-traded World Foreign Currency options are only available European style and can only be exercised at expiration, not before. However, they can be traded anytime. Exercise settlement results in the writer delivering the holder the "in the money" amount in cash - in U.S. dollars only. There is no delivery of the foreign currency.
4. The best answer is **b**. If a market maker receives an order which improves its quoted price or size, it must reflect this improvement in its quote. This customer has placed an order to sell 200 shares at 31.18, which is better than the market maker's current offer of 31.20. Thus, the quote must be updated to: 31.00 - 31.18 (12 x 2).
5. The best answer is **a**. Order tickets must be stamped at time of order entry, at time of order execution, and at time of order cancellation, if canceled.
6. The best answer is **b**. Under SEC rules, a Qualified Block Positioner is defined as any broker-dealer who is registered with the SEC under Section 15 of the Act that engages in the purchase or sale of blocks of stock of \$200,000 or more. A Qualified Block Positioner must meet higher capital standards than Qualified Third Market Makers. Such firms can execute block transactions without being subject to Regulation SHO. In executing block transactions, the firm must exercise reasonable diligence so that the block could not be sold to or purchased from others at better terms; and that the shares comprising the block are sold as rapidly as possible under the circumstances.
7. The best answer is **a**. Market-Not Held orders give the representative discretion over price and time of execution. For retail customers, these must be "Day" orders and must be filled that day, unless the customer specifies otherwise.
8. The best answer is **b**. During the cooling off period for "add-on" offerings, Regulation M places restrictions on syndicate members that are not market makers from trading that issuer's securities. The idea is that the syndicate members will not attempt to bid up the price of the issuer's outstanding shares, in order to be able to raise the POP of the additional issue. The rule states that:

If the security is actively traded (average daily trading volume of \$1,000,000 or more and public float of at least \$150,000,000), there are **no** restrictions placed on market

makers trading the issue prior to the distribution. The idea here is that this issue is too big for the price to be manipulated. This is called a "Tier 1" issue.

If the security has an average daily trading volume of \$100,000 and a public float of at least \$25,000,000, the restricted period is the business day prior to the effective date. This is called a "Tier 2" issue.

Any other security not meeting these minimums is a "Tier 3" issue and is subject to a restricted period of 5 business days prior to the effective date.

9. The best answer is b. "T.1" next to a NASDAQ stock symbol indicates that the trading is halted pending a news announcement. "T.2" indicates that the news announcement has been made. "T.3" indicates that market makers can begin quoting the stock, and 5 minutes later, may begin making a market in that stock.

10. The best answer is c.

In Choice A, the market order to buy ABC stock can be immediately executed, but the order to sell ABC at \$55 (a sell limit) cannot be executed because ABC is currently at \$50 and a sell limit order at \$55 means sell at \$55 or higher.

In Choice B, the order to sell short ABC at \$55 (sell limit, with the sale of borrowed shares) cannot be executed because ABC is currently at \$50, and the order to sell at \$55 means that the customer wants to sell for \$55 or higher. The order to sell ABC at \$45 is a sell limit order - the customer wants to sell at \$45 or higher. Since the stock is currently at \$50, this order can be executed immediately at \$50.

In Choice C, the order to buy DEF @ \$30 is a buy limit order - the customer does not want to pay more than \$30. Since the stock is currently at \$27, this order can be executed immediately at \$27. The order to sell at \$45 is a sell limit order - meaning sell at \$45 or higher. Since the stock is currently at \$50, this order can be filled immediately at \$50.

In Choice D, the customer has placed an order to buy DEF at \$30 stop. The order is used to establish a long position in a rising market and is placed above the current market price of \$27. If the market rises to \$30, the order is triggered and becomes a market order to buy. Thus, this order cannot be filled right now since the market is now at \$27. The order to sell short ABC at \$45 stop establishes a short position in a falling market and is placed below the current market price of \$50. If the market falls to \$45, the order is triggered and becomes a market order to sell. Thus, the order cannot be filled right now because the market is at \$50.

11. The best answer is c. Chinese Walls to stop information flow must be maintained between:

Investment Banking and Trading;
Investment Banking and Research; and
Investment Banking and Sales (Retail and Institutional).

The intent is to stop the flow of information on upcoming underwritings, mergers or takeover deals being done by the underwriting department to others that might trade on the information for a profit before the public knows about the upcoming deal. Regarding the Chinese Wall required between investment banking and research, the



intent is to make sure that research is truly independent and not influenced by the investment bankers at that firm that might demand a "favorable" research report on an issuer so that they can curry favor with that issuer to get future underwriting business. The M & A department and the underwriting department are usually one and the same at investment banking firms. There are no barriers required between these two groups.

12. The best answer is d. OATS stands for Order Audit Trail System - the system for automated order entry. Both the buy and sell side enter their orders into OATS. OATS reports are made at the end of each day, and are matched, retroactively, to the actual trade reports that were made throughout that day. Any unmatched transactions are then "kicked-out" of the system for timely resolution. Also note that the CBOE has a similar system called "COATS."

13. The best answer is a. The customer's position is:

Buy 1 SF Mar 88 Call
Sell 1 SF Mar 90 Call

This is a price or "vertical" spread. It is not a horizontal spread (different expirations) or a diagonal spread (both strike price and expiration being different). Price spreads can either be bullish or bearish. In this example, the customer is buying the lower strike price call, so this must have the higher premium. Thus, the long call is more expensive than the short call and this is a "debit" call spread. When a customer buys (pays the debt) for a call spread, it is essentially the same as buying a call with limited upside gain potential. This is a bull position - a bull call spread.

14. The best answer is c. Index options settle in cash if they are exercised. The writer of the option must pay the holder the in-the-money amount the next business day.

15. The best answer is c. Both European style and American style option contracts can be traded at any time until expiration. The distinction between the contract types relates solely to exercise provisions. American style contracts can be exercised at any time up until expiration. European style contracts can only be exercised at the expiration date. In the U.S., all option contracts are American style except for foreign currency options, which are available in both forms.

16. The best answer is b. The Specialist (now called the DMM - Designated Market Maker) on the NYSE floor performs 2 functions. He acts as market maker in a specific security, buying and selling for his own account. He also keeps the "book" of limit and stop orders that are away from the market for other brokers, and executes these orders for a commission. On the CBOE, the DPM (Designated Primary Market Maker) performs both functions. In addition, to add liquidity to the market, the CBOE also has other Market Makers in listed options that compete with each other and the DPM, but they do not maintain a book of orders. The CBOE also has OBOs - Order Book Officials - in listed options that maintain the book of public orders, but who do not make markets.

17. The best answer is b. Unlike equity options, which stop trading at 4:00 PM EST; index options stop trading at 4:15 PM EST.

18. The best answer is a. This customer has created a butterfly spread with a net debit of \$300.

Buy 1 ABC Jan 40 Call @ \$12
Sell 2 ABC Jan 50 Calls @ \$5
Buy 1 ABC Jan 60 Call @ \$1

The customer must pay \$12 for the Jan 40 Call and must pay \$1 for the Jan 60 Call; since \$5 per contract was received from selling each of the Jan 50 Calls, a credit of \$10 is received; so the net debit is 3 points ($\$13 - \$10 = \$3$). If the market stays below 40, all of the contracts expire "out the money" and the \$300 debit is lost.

If the market rises from 40 to 50, there is a 10 point gain on the Jan 40 Call; while the other contracts expire. The net gain is 10 points - 3 point debit = 7 points or \$700. This is the maximum potential gain.

If the market rises above 50, the customer will begin to lose on the Short Jan 50 Call. Above \$50, there is a maximum 10 point gain on the long call spread (Long Jan 40 Call; Short Jan 50 Call); and a maximum 10 point loss on the short call spread (Short Jan 50 Call; Long Jan 60 Call). The net of these is "0." Thus, the maximum loss in a rising market is limited to the \$3 debit paid.

19. The best answer is c. A "collar" is the purchase of a put at a strike price below that of the underlying instrument (putting a floor on the instrument's price); and the sale of a call at a strike price above that of the underlying instrument (creating a ceiling price, above which the instrument will be called away). By putting a collar on the price, the customer is essentially guaranteeing a minimum and maximum price for the underlying instrument. The net cost of such a collar should be close to "0" since both contracts are "out the money" and the premium received from the sale of the call offsets the premium paid to buy the put.

20. The best answer is c. FLEX options available on the CBOE and PHLX allow the customer to customize the terms of the contract. The contra-party to such a contract would be the Specialist on the PHLX or Designated Primary Market Maker (DPMM) on the CBOE. In contrast, regular options are standardized trading instruments.

21. The best answer is d. The registered representative is clearly liable for "insider trading" violations, since he effected trades based upon material, non-public information. In addition, the officer is liable (the "tipper") as well under the provisions of the Insider Trading Act of 1988, since he should not have been relating this information in this manner.

22. The best answer is c. Premium quotes (which are the quotes of market makers) reflect the total of intrinsic value and time value components. Commissions and mark-ups are not included in these quotes. However, they would be added to the quote as the charge to a public customer for effecting a trade at the stated quote.

23. The best answer is a. Listed stock options for a given expiration month stop trading at 4:00 PM Eastern Standard Time on the third Friday of that month. (Also note that index options, in contrast, trade until 4:15 PM Eastern Standard Time.)



24. The best answer is c. Cabinet trades ("accommodation liquidations") are used to provide a record to individuals who have worthless options positions that are soon to expire "out the money." In a closing transaction, the Order Book Official will accept limit orders from holders and writers of "out the money" contracts to close the positions at a total premium of \$1 per contract (\$.01 per share). The OBO will match the orders as an accommodation, and report the executed trades to the firm that placed the order. The OBO may accept these trades from anyone, not just the public (which is the case with all other orders placed with OBOs). Thus, market makers and member firms may place cabinet trades with OBOs for their own accounts.

25. The best answer is c. "A market or limit order which is to be executed in whole or in part as soon as such order is represented in the trading crowd. Any portion not so executed is to be treated as canceled" is the description of an immediate or cancel order.

26. The best answer is c. Once the closing bell is rung on the Friday prior to expiration, trading **stops**, including cabinet trades. The only remaining activity is a closing rotation performed for 10 minutes or so, in each series that is expiring. This allows for an orderly closing of any "in the money" contracts, based upon the reported closing price on the principal Exchange for that stock, that still remain open.

27. The best answer is b. Copies of options communications must be retained for 3 years.

28. The best answer is a. Exercise settlement is 3 business days from exercise date. The fact that the writer was notified of the exercise 2 days after this date is of no relevance. If exercise occurs on Monday, January 15th, the stock must be delivered on Thursday, January 18th - that is, 3 business days after exercise date.

29. The best answer is c. The OCC does not adjust listed equity options for normal cash dividends. It only adjusts contracts for 2:1 or 4:1 stock splits and for extraordinarily large cash dividends. For fractional stock splits, stock dividends and reverse stock splits, it does not adjust the contract - rather it adjusts the "deliverable" if there is an exercise. The OCC standardizes listed option contracts, issues listed options contracts and guarantees performance of contract writers upon exercise.

30. The best answer is d. A strangle is a variation on a straddle. In a long strangle, a customer buys an "out the money" call and an "out the money" put on the same stock, hoping for a sharp market movement either up or down. The premium outlay is lower than for a long straddle; but a sharper market move is needed for the position to be profitable. In a short strangle, a customer sells an "out the money" call and an "out the money" put on the same stock, hoping that the market stays relatively stable (flat). The premium received is lower than for a short straddle; but a sharper market move, either up or down, is needed for either position to move "in the money" at the expense of the writer. Since the market price of the stock is at \$60, the short 65 call is 5 points "out the money" and the short 55 put is also 5 points "out the money," creating a short strangle.

31. The best answer is d. Supporting is a prohibited manipulative practice to attempt to "support" a stock's price, that is, keep the stock's price from falling. This would be used by unscrupulous investors who stand to lose in a falling market. Naked short puts show ever increasing loss as the market falls, as do short straddles, (which are composed of both a naked short call and a naked short put). Naked short call positions show a gain in a falling market.

32. The best answer is c. Capping is a prohibited manipulative practice to attempt to “cap” a stock’s price, that is, keep the stock’s price from rising. This would be used by unscrupulous investors who stand to lose in a rising market. Naked short calls show ever increasing loss as the market rises, as do short straddles, (which are composed of both a naked short call and a naked short put). Naked short put positions show a gain in a falling market.

33. The best answer is b. Exercise settlement of equity options results in a regular way delivery of the stock, 3 business days after exercise date.

34. The best answer is a. An “Immediate or Cancel” (IOC) order is an order to be filled in its entirety or in part in one attempt; any unfilled portion is canceled.

35. The best answer is b. Position limits only apply to options contracts on each “side” of the market - they do not apply to stock positions on each side. Thus, 40,000 Long Calls (40,000 contracts on the upside) and 40,000 Short Puts (40,000 contracts on the upside) exceed the maximum 75,000 contract limit on 1 side. Similarly, 40,000 Long Puts (40,000 contracts on the downside) and 40,000 Short Calls (40,000 contracts on the downside) exceed the 75,000 contract limit on 1 side.

36. The best answer is d. Insider trading violations are punishable by civil penalties, treble damages and imprisonment. Anyone who gives information to prosecutors that leads to an insider trading conviction can claim an informer bounty of 10% of the amount recovered.

37. The best answer is b. By definition, to be a “passive market maker” under Regulation M, a firm cannot bid any higher for a security than the highest current independent bid. Thus, in order to be a passive market maker, there must be at least one other independent market maker in that issue.

38. The best answer is d. If a customer sells short a security and fails to deliver on settlement, Regulation SHO requires that the position be bought-in after 10 business days from settlement (called “13 settlement days” in the rule, since the rule counts from trade date. $T + 3 = S + 10 = T + 13$) if the security is on the exchange’s list of “threshold” securities as of trade date and remains on the list during that entire time window. If the security is removed from the list after trade date, then the time window does not restart counting unless the security is added to the threshold list again (the list is updated daily). Basically, a “threshold” security is one that has a large outstanding short position - the SEC does not want large outstanding short positions that cannot be covered to build over time.

39. The best answer is d. FINRA defines a “Non-Public Arbitrator” as any person (or that person’s immediate family member), who:

— within the past 3 years was associated with a securities broker-dealer (including government and municipal dealers) or with a commodities firm;

is retired from engaging in any of the business activities in the previous definition;

is an attorney, accountant, or other professional who has devoted 20% or more of his or her professional work in the last 2 years to clients in the first definition;

is an employee of a bank or other financial institution and effects transactions in securities (including governments and municipals) or commodities (including

futures and options) or monitors compliance of employees engaged in these activities.

Arbitration panels generally consist of 3 individuals (if the amount in dispute is \$100,000 or more), with 1 being a non-public arbitrator; and 2 being public arbitrators for disputes with customers; and 3 non-public arbitrators for "intra-industry" disputes.

40. The best answer is b. When opening a customer account for a non-resident alien, the customer's foreign passport number must be obtained. In addition, the customer must have a U.S. tax identification number.

41. The best answer is c. The Office of Supervisory Jurisdiction must inspect customer account records periodically to detect and prevent irregularities or abuses. In addition, the member firm must inspect each OSJ at least annually, to ascertain that these procedures are, in fact, being carried out.

42. The best answer is c. Rule 17f-2 requires that all officers and employees of broker-dealers be fingerprinted **EXCEPT** for the following:

Persons not engaged in the sale of securities; and

Persons who do not regularly have access to the keeping, handling, or processing of monies, securities, or the records of original entry.

Thus, a registered representative who solely processes customer transactions (e.g., preparing confirmations) need not be fingerprinted.

43. The best answer is c. Under the SEC's rules relating to stabilization, stabilizing bids may only be entered at or below the Public Offering Price, if no current independent bid exists for that issue. If a current independent bid exists, then a stabilizing bid can only be placed at or below this quote. For most new issues, there is no current independent bid because the NASDAQ screen is "blacked out" until the syndicate manager closes the syndicate books and notifies NASDAQ operations that the security is free to trade. When the screen is "turned on," it opens showing the stabilizing bid placed by the manager. At that point, any other independent market makers may enter quotes.

44. The best answer is b. If a person who has left a member firm associates with another member; and the new member requests a copy of that individual's U-5 form from the new employee; the new employee must provide a copy of the U-5 to the new employer within either 2 business days of the request if the U-5 has been obtained from the ex-employer; or 2 business days of receipt from the ex-employer.

45. The best answer is b. FINRA supervisory requirements for the Office of Supervisory Jurisdiction (OSJ) include an annual compliance review with each registered representative and registered principal to review recent regulations, firm policies, etc. There is no requirement for a review of the registered representative's reputation. Customer account records must be inspected by the OSJ periodically - an annual inspection is not sufficient. The OSJ principal must review and endorse each customer order. Each piece of correspondence to customers must also be reviewed and endorsed if the firm has not implemented a correspondence compliance program that trains representatives as to what is permitted in such communications and that audits these for compliance. If such a program is adopted, then the principal need only review correspondence - there is no need for a principal signature on each piece.

46. The best answer is d. An "insider" is someone who has material non-public information. In this question, the lawyer, accountant, and financial printer all have non-public information. The investment advisor recommending the stock does not appear to have non-public information, and thus is the best choice as a "non-insider."

47. The best answer is d. FINRA rules require that a member firm give its latest financial statement (balance sheet) to either a customer or another member upon request. FINRA rules also require that a customer be furnished with a copy of the FINRA Manual upon request. For purposes of this rule, a customer is defined as a person who has cash or securities in custody of the member firm. Of course, any SEC requests for information from a broker-dealer must be complied with by that firm.

48. The best answer is d. If a person disassociates from a member firm, that person's registration is terminated within 30 days with the filing of the U-5 form. If that person does not reassociate with another member firm within 2 years, all licenses lapse. FINRA prohibits the "parking" of licenses with a "friendly" member firm during any period when a person is working outside the industry to avoid this consequence.

49. The best answer is c. On the U-4 filing, disclosure is given of the prior 10 years' employment; and the prior 5 years' residences. If these change, an amendment must be filed. If a person is convicted of a felony, this must be disclosed on the U-4. Obviously, if a deficiency is found in an existing U-4 filing, this must be remedied with an amendment. Finally, marital status is not asked on the U-4 Form, so a change would not require an amendment.

50. The best answer is b. To protect an appreciated stock position at minimal cost, the customer should "collar" the stock position - this is the purchase of a put just below the current market price of the stock and the sale of a call just above the current market price of the stock. Both the put and the call are "out the money," so the market premiums will be low - giving the customer a "collar" at minimal cost. The current market price of the stock is at \$79 per share. If the customer buys a 75 put, the customer has the right to sell the stock at \$75 per share in a falling market. This put is 4 points "out the money," so it won't cost too much. However, the customer will lose 4 points if the stock falls below \$75 (stock is worth \$79 and can be sold at \$75 by exercising the put in a falling market). To reduce the cost even further, the customer can sell an 80 call (1 point out the money when the stock is at \$79). The premium collected reduces the customer's cost of protection - however the price of this is that the customer will not have any gain if the stock rises above \$80 - since the call will be exercised. Thus, "collaring" the position only makes sense if the customer believes that there is a good risk that the stock might drop, and that there is not much chance that the stock's price will rise, during the life of the collar.

51. The best answer is b. The VIX option is negatively correlated to stock price movements. If stock prices are falling, then the VIX would be expected to rise. The profitable VIX options positions would be long VIX calls and short VIX puts.

52. The best answer is d. If a registered individual is called up for active duty, his or her registration is placed in special "inactive" status, and basically is frozen in time until that person returns to civilian life. Upon return to work, the clock starts ticking again on the CE requirement, which must be completed within 30 days of that person's return to work (since it had 30 days to go when the individual was called for military service).

53. The best answer is **b.** The wording of the SRO rule on sharing in a customer account applies to both member firms and associated persons. The rule states that a member firm and an associated person can only share in a customer account if:

- 1) the associated person obtains written permission from the member firm; and
- 2) the member firm or person associated with the member firm obtains prior written permission from the customer; and
- 3) the member or person associated with the member firm only shares in direct proportion to capital contributed by the member or person associated with the member firm (the proportionality test is waived for sharing in accounts of immediate family members).

Thus, Choices a and d are clearly incorrect. Choice c is incorrect because sharing is not restricted only to accounts of immediate family members. Choice b is the best one offered, since it covers the requirement for sharing in direct proportion to capital contributed. Notice that the question does not address the requirement to get written customer approval.

54. The best answer is **b.** If a registered person terminates association with a broker-dealer firm, and reassociates after 2 years of termination, that person is subject to the Regulatory Element of CE on a cycle based on the date of reassociation (i.e., the most recent registration date).

55. The best answer is **a.** The OCC accepts an “escrow receipt” for stock to cover short call positions or an escrow receipt for cash to cover short put positions. An escrow receipt is a receipt from a bank showing that the stock is being held on deposit by the bank and that the bank will deliver the shares if there is an exercise of the short call; or that it will deliver the cash if there is an exercise of a short put.

56. The best answer is **b.** Ratio writes are ratio income strategies used in flat markets. This customer is selling 2 puts against a short stock position (a 2:1 ratio write) to earn double income in a flat market (since both short puts would expire). If the market rises, the puts expire and the customer is left with a short stock position that has unlimited upside risk. If the market falls, both short puts are exercised, obligating the customer to buy 200 shares of stock at the strike price. One short put is covered by the short stock position; the other short put is naked and the customer can lose all the way to “0” on that position.

57. The best answer is **c.** The technical definition of a narrow-based index is one with 9 or fewer stocks; where no one stock is more than 30% of the value of the index; and no more than 60% of the index value is attributable to the 5 largest stocks in the index.

58. The best answer is **b.** All firms that accept limit orders must have a methodology in place to deal with multiple limit orders at the same price. This firm can allocate the market order to sell against either of the customer limit orders to buy. Since the market order to sell 400 shares is less than either customer limit order to buy of 500 shares, the balance of the one partially filled order (100 shares) must be protected; as must the other unfilled 500 share order to buy at 10.00.

59. The best answer is d. Under SEC Rule 10b-18, if an issuer wishes to buy its stock in the open market, it cannot do so in a manner that will influence the stock's price. All transactions on a given day must be executed through only 1 market maker (not 2). It cannot buy the stock at the market open or within 1/2 hour of the close; and can pay no more than the highest current independent bid or the last sale price, whichever is higher. Its daily purchases cannot exceed 25% of daily trading volume in the issue, however purchases outside the normal order flow are permitted - such as block purchases (block order handling procedures have safeguards in them so that the order will not unduly influence the market price of the issue).

60. The best answer is d. If a customer limit order is at the inside market and is of "de minimis" size (10% or less of display size), the order does not have to be displayed. The market maker's bid at 10.00 is for 1500 shares. This customer order is for 100 shares, so it is for less than 10% of the display size and need not be displayed. Note, however, that it must still be protected, whether it is displayed or not.

61. The best answer is b. A locked market is one where the inside bid and ask are the same. A crossed market is one where the inside bid is higher than the inside ask. A normal market is one where the inside ask is higher than the inside bid.

62. The best answer is c. If there are no other instructions on an order ticket, it is assumed that settlement will be "regular way" - which is 3 business days after trade date for equity securities.

63. The best answer is b. OATS stands for the Order Audit Trail System, and is FINRA's electronic record of all orders entered for NASDAQ, OTCBB and Pink Sheet issues. This data is used for matching the order data to the actual trade that results through the ACT system. Reports into OATS are made on an order-by-order basis - they cannot be aggregated. In contrast, trade reports through ACT can be aggregated. The OATS information must include, among other things, date and time of order receipt; the contra-party; order identifier; terms of the order; time in force; where the order was routed for execution; and execution price. OATS data is entered at the end of each day, and is matched to the ACT reports that were made throughout that trading day.

64. The best answer is a. The market maker's displayed bid is at 17.25 - representing a customer limit order. If it were to buy at 17.25 or lower as principal, it would trigger a Manning obligation to buy for the customer. If it buys, as principal at 17.26 or higher (1 cent above the bid), then the firm has not "traded ahead" of the customer and there is no Manning obligation to fill the customer limit order to buy.

65. The best answer is d. Interpositioning (putting a middleman firm between a customer and the best market) is a prohibited practice unless it can be demonstrated that the use of the middleman firm will result in a better execution for the customer.

66. The best answer is c. The insider trading rules place liability on both the "tipper" and the "tippee," if the inside information was used to trade. Thus, the officer of the company that gave the tip; in addition to the neighbor who traded on it; are liable. Note that the actual stock of the issuer does not have to be traded for a violation to occur. Trading of equivalent or derivative securities based on inside information is a violation as well.



67. The best answer is c. The SEC requires that a copy of **each** order memoranda (trade ticket) be made and retained for 3 years, with all the details of the order information. It makes no difference if the order is for a customer account or for the firm's proprietary trading account. This can be kept either as a paper or electronic record.

68. The best answer is d. "Marking the close" refers to trading, at or near the close, to influence the closing price of the security, either up or down. This is a prohibited manipulative practice.

69. The best answer is a. SEC Rule 605 of Regulation NMS requires that market centers prepare, and make available to the public, monthly standardized reports summarizing their order executions. Included in the report is data on:

Effective spreads;

How market orders of various sizes were executed relative to the public quote;

Speed of execution;

Fill rates; and

Price improvement or disimprovement.

Quoted spreads are often much wider than effective spreads, since most trading occurs within the quoted spread. Thus, effective spreads are included in the report - not quoted spreads.

70. The best answer is d. The NASDAQ TRF (Trade Reporting Facility) is operated on the ACT platform. It requires that trades that occur in NASDAQ issues be reported within 30 seconds of execution during ACT operating hours (8:00 AM - 8:00 PM). Trade reports received by the TRF are immediately disseminated to the NASDAQ ticker and the news media through NASDAQ's "TDDS" - Trade Data Dissemination Service. Members have on-line access to real-time trade reporting information through the TRF's "Time and Sales" feature.

71. The best answer is c. NASDAQ market makers must be open for business during regular Market trading hours - 9:30 AM - 4:00 PM ET. They may elect to be open for the Premarket hours session as well as Aftermarket hours session - but are not obligated to do so.

72. The best answer is c. "Trade Shredding" is the practice of splitting large orders into multiple smaller orders for execution for the primary purpose of maximizing "payments for order flow." This is a prohibited practice. These payments could come in the form of credits, commissions, rebates of fees or any other payment of value.

73. The best answer is a. Payment for order flow information, if such a payment was made, is required on customer confirmations. It is not required on order tickets. Order tickets must have the time of execution stamped on the ticket. If the order is a sale, the ticket must be marked long or short. Finally, the ticket must be marked "solicited" or "unsolicited," showing how the order was received.

74. The best answer is d. This is a form of intimidation, which is prohibited.

75. The best answer is a. Limit orders are protected at a net price, excluding any mark-ups or mark-downs. Since the order to buy was placed at 21.50, including an agreed upon mark-up of 25 cents, the order must be protected at 21.25.

76. The best answer is b. The Trade Reporting Facility for NASDAQ runs on the ACT platform and reports completed trades of NASDAQ issues. The NYSE TRF reports completed trades of exchange listed issues effected OTC in the "Third Market." Note that it does not show quotes. Quotes for NASDAQ issues show in Single Book. Quotes for exchange listed issues show in CQS - the Consolidated Quotations Service. Finally, the ORF (Over The Counter Reporting Facility) reports completed trades of OTCBB and Pink Sheet issues.

77. The best answer is c. There is nothing prohibiting a member firm from accepting an order for a security that is subject to a trading halt. The order will be executable when trading resumes. However, the customer should be notified that there is a trading halt and that the order cannot be filled currently. If there is a trading halt, that means that there is no trading in that security anywhere, including ECNs.

78. The best answer is d. Rule 105 of Regulation M governs short-selling in connection with a public offering of securities during the cooling off period. Regulation M only applies to add-on offerings, not to IPOs. The rule establishes a 5-day restricted period prior to the effective date, where anyone who sells that security short is prohibited from purchasing that security from the underwriters to cover the short position. The intent is to stop a nasty market manipulation where short-sellers would "pounce" on the stock of a company that was about to issue shares in an add-on offering, relentlessly selling that company's stock short. This would drive down the price, and this would force the underwriters to lower the POP of the issue. The short sellers could then make a tidy profit by purchasing that stock from the underwriters at the lower POP, and using those shares to cover the short positions. With Rule 105, these covering purchases would have to be made in the market and not from the underwriter.

79. The best answer is a. The "Manning Rule" is the limit order protection rule. It prohibits NASDAQ and OTCBB market makers from "front running" customer limit orders.

80. The best answer is b. The market price is currently \$10.50 per share.

Orders that are lower than the current market (Buy Limits) will be placed in Single Book and filled if the market drops. Thus, the order to Buy 100 shares of ABCD @ \$10 will go onto the book of orders. An order to Buy 100 shares of ABCD @ \$11 will be immediately filled at \$10.50 since this is an order to buy at \$11 or better (buying lower is better).

Orders that are higher than the current market (Sell Limits) will be placed in Single Book and filled if the market rises. Thus, the order to Sell 100 shares of ABCD @ \$11 will go onto the book of orders. It makes no difference if the order is a long or short sale. An order to Sell 100 shares of ABCD @ \$10 will be immediately filled at \$10.50 since this is an order to sell at \$10.50 or higher (selling higher is better). Again, it makes no difference if the order is a long or short sale.

81. The best answer is a. Choice a is the manipulative practice of "painting the tape" - placing a sequence of trades at successively higher or lower prices to make it appear that the price of the security is moving either rapidly up or down. The idea (which is illegal, of course) is to attract other investors to continue "trading the trend" either



pushing the price ever higher or ever lower. Choice b is "pattern day trading" and is perfectly legal. Choice c is "front running" of a customer order - which is illegal since the firm must act in the best interests of the customer. This is an unethical practice, but it is not manipulation. Choice d is a perfectly legal trade - there is no prohibition on a member firm selling (either long or short) a stock while holding a customer order to buy that stock.

82. The best answer is **d**. Each SRO prohibits the breaking up of large trades into smaller units for purposes of increasing payments for order flow. This is the prohibited practice of "trade shredding." There are no exceptions to the prohibition.

83. The best answer is **d**. If trading in a stock is suspended, say on the New York Stock Exchange, the exchange where the option trades will also stop trading in the option contracts. This must occur because there is no longer any way to price the option contracts if there is no current market for the underlying stock. Any holders of outstanding options can still exercise their contracts during a trading halt, since this is performed through the Options Clearing Corporation and does not occur on the exchange floor.

85. The best answer is **a**. A customer is considered to be long a security to the extent of his **net** long position. In a tender offer, a customer can tender shares only to the extent of his net long position. In Choice I, the customer is net long 100 shares, so that stock can be tendered. In Choice II, the customer is short the stock and cannot tender (known as the short tender rule). In Choice III, the customer has a net "0" position (long 100 shares; short 100 shares) in the stock and therefore cannot tender. Furthermore, a customer who owns call options or warrants is **not** considered to be long unless these are exercised. Similarly, the holder of convertible securities is not long the stock unless irrevocable instructions to convert are issued by the customer.

86. The best answer is **d**. Sharing in a customer account is prohibited under each SRO's rules **unless** the member firm gives prior written approval to the account; and sharing in the customer account occurs in direct proportion to the capital contributed by the person associated with the member. Sharing in an account of the "immediate family" of the person associated with the member is permitted and need not meet the "proportionate test." This account also needs approval of a principal.

87. The best answer is **a**. Under SRO rules, bona-fide customers must be provided with the latest copy of the firm's balance sheet upon request. Members must also provide this information to other member firms. A bona-fide customer is defined as one who has cash or securities in the possession of the broker-dealer.

88. The best answer is **b**. A member can only compensate another person associated with a member in an annual amount in excess of \$100, if there is a written employment contract spelling out the work to be performed, and the compensation to be paid is previously approved by the principal. Otherwise, the SRO gift limitation is \$100 per person per year for gifts related to one's activities in the securities business.

89. The best answer is **a**. If securities are suspected to be stolen, the Securities Information Center must be notified within 1 day of discovery. In addition, the transfer agent must be notified and the local authorities must be contacted promptly.

90. The best answer is b. There is no requirement to keep a record of all quotes given in the course of trading. Required records include all activity in customer accounts; cash receipts and disbursements blotter; and a purchases and sales blotter, among others.
91. The best answer is d. Rule 17f-2 requires that all personnel of a broker-dealer must be fingerprinted **EXCEPT** those that are partners, directors, officers, or employees that are not engaged in the sale of securities; or do not have access to the keeping, handling or processing of securities; or do not have access to the keeping, handling or processing of monies; and do not have direct supervisory responsibility over these persons.
92. The best answer is a. If trading is halted, the trade cannot be executed and it cannot be sent to another country for execution. The trade will be executed the next day when the markets reopen.
93. The best answer is a. The threshold list is defined under Regulation SHO. It is a list of "hard to borrow" securities that have fails to deliver for 5 consecutive days of 10,000 shares or more; or that have fails to deliver that represent 1/2% or more of outstanding shares. If a security on the threshold list is sold short and there is a fail to deliver on settlement, Regulation SHO mandates "buy-in" in 13 settlement days.
94. The best answer is c. FINRA permits registered representatives that are called up for military duty to be placed on "inactive status," during which time they are not required to complete the Continuing Education requirements. Once the registered representative returns to civilian life, this status ceases upon return to work at the broker-dealer. If the individual does not return to work within 90 days of return to civilian life, this special status ceases and a U-5 must be filed by the firm terminating that individual's registration.
95. The best answer is d. An options trading halt will occur if trading of the stock is halted in its primary market; if the exchange is experiencing technical problems; or if there is a material pending news announcement about the issuer (which would also cause the stock's primary market to halt trading). A high open interest level (the number of options contracts created that have yet to be closed by trading or exercise), has nothing to do with a trading halt.
96. The best answer is a. Only orders that are placed **lower** than the current market are adjusted on ex-date by the Specialist (DMM - Designated Market Maker). These are Open Buy Limit and Open Sell Stop orders (OBLOSS). Choice I is a Buy Limit order placed for the day. If it is not executed this day, it is canceled and does not remain open on the books of the Specialist/DMM. Choice II is an Open Buy Stop order. This is placed above the current market and is not adjusted. Choice III is an Open Buy Limit order and would be adjusted. Choice IV is an Open Sell Limit order, which is placed above the market and would not be adjusted.
97. The best answer is c. To be a good delivery, stock certificates must be delivered in multiples of 100 on one certificate or in certificates of less than 100, where the certificates can be added exactly to 100 share units. Choice c does not meet this requirement. Individual 80 share certificates cannot be added into 100 share units. 25 share certificates are good (Four 25 share certificates = 100), as are eight-100 share certificates or one-800 share certificate.

98. The best answer is d. If a "Stop" order is elected, it becomes a market order to be filled at the first opportunity. Thus, the actual price at which the order is executed is not known. On the other hand, a "Limit" order specifies that the execution must comply with the limit price specified or better. Thus, limit orders are filled at that price or better.

99. The best answer is b. The ex-date for cash distributions is set at 2 business days prior to record date. Anyone who buys a stock in a regular way trade (3 business day settlement) will now settle after the record date, and will not be entitled to the cash dividend. On this date, as of the market opening, the stock's price is reduced for the dividend, since any buyers will not receive the distribution.

The ex-date for non-cash distributions such as rights, stock dividends or stock splits is totally different. It is set at the day after the payable date, which is typically a few weeks after the record date. This means that anyone who buys and settles after the record date will not be on the shareholder list to get the distribution. Since the price is not adjusted until the day after the payable date (about 2 weeks later), anyone who buys where the trade settles after the record date, but before the ex-date (day after payable date) will pay the higher unadjusted price, but will not be on the record books to receive the stock dividend or split. When the price is adjusted on the ex-date, each share held by this person will be reduced in price. If this person did not get the extra shares, he or she would be very unhappy. To claim the extra shares, these securities trade with a "due bill" for the extra shares, for trades that settle after record date until the ex-date. Also note that this is difficult, so if you find this confusing, consider yourself to be normal!

100. The best answer is c. Regular way trades of listed stocks settle 3 business days after trade date. In contrast, regular way trades of listed stock options settle 1 business day after trade date.

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