Series #56
Final 1

1.
All of the following equity securities trade **EXCEPT:**

a. Common Stock
b. Preferred Stock
c. Treasury Stock
d. Common Stock Warrants

2.
XYZ Company has issued 10%, $100 par non-cumulative preferred stock. Two years ago, XYZ omitted its preferred dividend. Last year, it paid a preferred dividend of $5 per share. This year, XYZ wishes to pay a common dividend. In order to make the distribution to common shareholders, each preferred share must be paid a dividend of:

a. 0
b. $5
c. $10
d. $15

3.
Which of the following do not pay dividends?

I Preferred Stock
II ADRs
III Warrants
IV Real Estate Investment Trusts

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

4.
Equity options positions will be automatically exercised on the third Friday of the month if the contract is:

a. $.01 "in the money"
b. $.02 "in the money"
c. $.03 "in the money"
d. $.05 "in the money"

5.
A customer holds 1 ABC Oct 60 Call contract. The market price of ABC is currently 66. ABC declares a 20% stock dividend. On the ex date, the holder will have:

a. 1 contract with a multiplier of 100
b. 1 contract with a multiplier of 120
c. 1.2 contracts with a multiplier of 100
d. 1.2 contracts with a multiplier of 120

6.
Referring to the prior question, on the ex-date, the strike price:

a. is adjusted down to 50
b. is adjusted down to 55
c. remains at 60
d. is adjusted up to 72

7.
A customer enters an order to sell 100 shares of ABC at 40 stop limit when the market price of ABC is $40.88. The tape then shows the following:

.......ABC...PDQ.
39.88...40.25...40.00...40.13

The order will be elected at:

a. 39.88
b. 40.00
c. 40.13
d. 40.25

8.
Referring to the prior question, the first trade where the order can be executed is:

a. 39.88
b. 40.00
c. 40.13
d. 40.25

9.
Exercise settlement of a PHLX World Foreign Currency option is:

a. same day
b. next business day
c. 3 business days after trade date
d. 5 business days after trade date

10.
Which statements are true about the VIX option?

I High VIX levels are indicative of a volatile market
II High VIX levels are indicative of a stable market
III High VIX levels are generally bullish
IV High VIX levels are generally bearish

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

11.
Portfolio margining is:

I risk based
II strategy based
III calculated using Regulation T rules
IV calculated using probability-based loss percentages

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

12.
A NASDAQ market maker is quoting ABCD stock @ 10.00 - 10.25 (10 x 10). The quote represents the inside market. A customer enters an order to buy 200 shares at 10.00. Under SEC rules, the market maker:

a. must sell 200 shares at 10.00
b. must update its quote size to 10 x 12
c. must update its quote size to 12 x 10
d. is not required to take any action

13.
A member firm becomes aware of relevant information about a representative who was terminated 2 years ago. Which statement is **TRUE?**

a. The member firm is obligated to amend the individual's U-4 Form promptly
b. The member firm is obligated to amend the individual's U-5 Form within 30 days
c. The member firm must file a report with FINRA within 10 business days
d. No action needs to be taken because the individual has been out of the business for 2 years and all of that individual's licenses have lapsed

14.
The Trade Reporting Facility for NASDAQ reports trades of which of the following securities?

I NASDAQ Global Market stocks
II NASDAQ Capital Market stocks
III Third Market trades of exchange listed stocks
IV Trades of exchange listed stocks effected on the floor of the exchange

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

15.
Under ACT/TRF rules, round lot trades in Global Market stocks must be reported within:

a. 30 seconds of execution
b. 60 seconds of execution
c. 90 seconds of execution
d. 120 seconds of execution

16.
Which of the following is the equivalent of a short put position?

a. long stock / long call
b. long stock / short call
c. short stock / long call
d. short stock / short put

17.
Which of the following is the equivalent of a short stock position?

a. long stock / long call
b. long stock / short call
c. short call / long put
d. short call / short put

18.
A customer owns 100 shares of ABC stock and purchases 1 ABC Jan 50 Put @ $4 as a hedge. The market declines, and the customer wishes to exercise the put. ABC has declared a cash dividend that the customer wishes to receive. What is the first day that the customer can exercise the put and still receive the dividend?

a. One business day prior to "Ex" date
b. "Ex" Date
c. One business day after the "Ex" date
d. Record date

19.
In determining if there is a violation of position limits or exercise limits, the Options Clearing Corporation will aggregate long calls with:

I Long Puts
II Short Calls
III Short Puts

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

20.
Under SEC rules, issuers are prohibited from:

a. buying calls on their own stock
b. selling calls on their own stock
c. buying puts on their own stock
d. selling puts on their own stock

21.
All of the following orders can be accepted at the opening rotation **EXCEPT:**

a. market order
b. limit order
c. spread order
d. market if touched order

22.
Which of the following accounts would be aggregated to determine if a violation of options position limits existed?

a. All accounts that are the responsibility of a registered representative
b. All accounts over which a registered representative exercises discretion
c. All accounts of different customers holding the same series of options contract
d. All accounts of a registered investment adviser who does not have a power of attorney over the accounts

23.
Which of the following covers a short ABC Jan 50 Call position under O.C.C. rules?

I Long 1 ABC Dec 50 Call
II Long 1 ABC Feb 50 Call
III Long 1 ABC Jan 40 Call
IV Long 1 ABC Jan 60 Call

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

Use the following information to answer the next 2 questions:

On the same day, a customer buys 1 ABC Oct 80 Call @ $11 and sells 2 ABC Oct 85 Calls @ $5.

24.
The breakeven points are:

I 81
II 89
III 91
IV 96

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

25.
If ABC stock rises to 100, and all positions are exercised, the gain or loss is:

a. $100 loss
b. $1,000 loss
c. $1,100 loss
d. $1,600 loss

26.
Which of the following orders can be accepted during the opening rotation?

I Market
II Spread
III Limit
IV Straddle

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

27.
The Market Maker on the floor of the Chicago Board Options Exchange can trade with which of the following?

I Other Market Makers
II Floor Brokers
III Order Book Officials
IV Public Customers

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

28.
When is the first day that exercise is permitted for an equity option purchased in a cash settlement?

a. Trade date
b. Trade date + 1
c. Settlement date
d. Settlement date + 1

29.
The retention period for an options trade blotter is:

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

30.
Options order tickets must be written:

a. prior to order entry
b. prior to order execution
c. promptly after order execution
d. prior to order confirmation

31.
Which position exposes a customer to unlimited loss risk?

a. Long 1 ABC Jan 50 Call
   Long 1 ABC Jan 50 Put
b. Long 1 ABC Jan 50 Call
   Short 1 ABC Jan 40 Call
c. Short 1 ABC Jan 50 Put
   Short 100 shares of ABC @ $50
d. Short 1 ABC Jan 50 Put

32.
A customer buys 100 shares of ABC stock at $62 and sells 2 ABC Jan 65 Calls @ $4. The maximum potential loss is:

a. $5,400
b. $6,400
c. $6,600
d. unlimited

33.
Referring to the prior question, the breakeven points are:

I 54
II 58
III 73
IV 76

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

34.
Statements of account must be furnished to customers at least:

I monthly if transactions occur in the account
II monthly if no transactions occur in the account
III quarterly if transactions occur in the account
IV quarterly if no transactions occur in the account

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

35.
Under CBOE rules, all of the following procedures are required to prevent and detect insider trading by registered representatives **EXCEPT:**

a. All associated persons must be advised in writing of the prohibition against misuse of material, non-public information
b. Associated persons must sign attestations affirming their awareness of, and agreement to abide by, insider trading prohibitions
c. Brokerage accounts of associated persons must be reviewed periodically to detect possible misuse of material non-public information
d. Monthly reports of trading by associated persons must be filed with the Securities and Exchange Commission

36.
All of the following would cause options trading to be halted **EXCEPT:**

a. a trading halt on the primary exchange listing that issue
b. an SEC-directed trading halt on the primary exchange listing that issue
c. a trading halt on a regional exchange listing that issue
d. a delayed opening on the primary exchange listing that issue

37.
A market maker on the floor of the CBOE gives a firm quote without stating a size. This quote is good for:

a. 1 contract
b. 10 contracts
c. 100 contracts
d. the smallest order present on the floor at the moment

38.
A review of the daily trade blotter shows the following positions taken that day in a customer account:

Long 800 Shares of XXX @ $100
Long 8 XXX 120 Puts @ $25

Which statement is true?

a. This is an appropriate hedge for the account
b. This is an appropriate income strategy for the account
c. This is inappropriate hedge for the account
d. This is an inappropriate income strategy for the account

39.
Which orders can be accepted for the opening rotation?

I Market order
II Limit Order
III Straddle order
IV Spread order

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

40.
A trader is long an options contract that is nearing expiration which currently has no bid on the floor; and which is offered at $.05. Which closing transaction should be used?

a. Market order to sell
b. Limit order to sell at $.05
c. Cabinet trade
d. All or none order

41.
Which statements are true regarding cabinet trades?

- I Cabinet trades are effected by Market Makers
- II Cabinet trades are treated in the same manner as "off the floor" trades
- III Cabinet trades are effected at a premium of $.01 per share
- IV Cabinet trades may be placed for customer, firm, or Market Maker accounts

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

42.
Options trade confirmations include which of the following information?

- I Opening or Closing transaction
- II Exercise Price
- III Whether the trade was effected on an agency or principal basis
- IV Whether or not the trade was discretionary

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

43.
A member firm may assume a loss in a customer option account:

a. under no circumstances
b. if the loss resulted from the member's mistake
c. if approval of the Exchange is obtained in advance
d. either b or c above

44.
If it is now the beginning of January, The maximum maturity on the longest available January equity LEAP contract is:

a. 18 months
b. 24 months
c. 38 months
d. 40 months

45.
Under Regulation SHO, the list of "hard to borrow" threshold securities must be prepared by the exchange:

a. hourly
b. daily
c. weekly
d. bi-weekly

46.
Which of the following statements are true regarding passive market makers under Rule 103?

- I Passive bids can be no higher than the highest current independent bid
- II Passive bids reflecting customer limit orders may be higher than the highest current independent bid
- III Passive bids must be identified as such on NASDAQ
- IV Passive market makers are subject to daily volume restrictions

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

47.
If a registered person fails to complete the Regulatory Element of the Continuing Education requirement within the allotted time, that person:

a. may request an extension from FINRA
b. will have their license suspended, but can still be compensated by the member firm
c. will have their license suspended and cannot be compensated by the member firm
d. must be terminated within 30 days

48.
SEC Regulation FD covers:

a. notification to customers of a member firm's privacy policies and practices
b. selective disclosure of material non-public information by issuers
c. standardization of disclosure of financial and non-financial information by issuers
d. registration filings with the SEC by small business issuers

49.
A company holds a research analyst meeting and discusses information about the company that is likely to have an impact on the stock's price once the information is broadly released. A research analyst attending the meeting would be permitted to do all of the following **EXCEPT:**

a. Discuss the information with his immediate supervisor in the member firm's research department
b. Update the research file maintained by the member firm about that issuer
c. Release a revised opinion about the company to the member firm's customers
d. Revise the member firm's rating of the company and release it once the news is broadly disseminated by the issuer

50.
An individual that has been registered as a representative for 9 years:

a. is exempt from the Regulatory Element of the Continuing Education requirement
b. must complete the Regulatory Element of the Continuing Education requirement every 2 years
c. must complete the Regulatory Element of the Continuing Education requirement every 3 years
d. must complete the Regulatory Element of the Continuing Education requirement every 5 years

51.
An officer of a company would have to give a "disclosure notice" in which of the following situations?

a. At a meeting of the company's Board of Directors, where the officer is going to disclose the latest quarterly results
b. When taking outside analysts to a luncheon, where company results are going to be discussed
c. When talking to the issuer's outside counsel about company legal matters
d. When talking to company employees in training sessions that include discussions of company results

52.
Broker-Dealer reports of lost or stolen U.S. Government securities must be filed with:

a. Securities Investor Protection Corporation
b. FinCEN
c. Securities Information Center
d. Federal Deposit Insurance Corporation

53.
Money laundering regulations are established by all of the following **EXCEPT**:

a. SROs
b. SEC
c. FRB
d. Department of Treasury

54.
A cabinet transaction (accommodation liquidation) in an options series effected on the AMEX or CBOE:

I is permitted on any trading day
II is permitted only on the Third Friday of the expiration month
III must be reported within 90 seconds of execution
IV must be reported following the close of the business day

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

55.
A registered person of a member will be placed on "inactive status" and need not be re-registered by the member upon his or her return to active employment with the member if that individual:

I is called into active duty in the Armed Forces of the United States
II is called into religious missionary duty by a not-for profit charitable organization recognized by the Government of the United States
III volunteers for active duty in the Armed Forces of the United States
IV volunteers for religious missionary duty in a not-for profit charitable organization recognized by the Government of the United States

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

56.
A registered representative has received inside information about a listed company, but has not acted on that information. The representative should:

a. notify the SEC within 3 business days
b. inform the home office of this situation
c. notify FINRA within 3 business days
d. inform the issuing corporation of this situation

57.
Why would a customer choose portfolio margin instead of regular margin for his or her investment account?

a. Because the registered representative servicing the account can give recommendations to the customer that are only reserved for institutional customers
b. Because the margin requirement will be lower based on the fact that diversified and hedged positions in the account will lower overall risk
c. Because the account will be managed by a professional portfolio manager registered with the SEC under the Investment Advisers Act of 1940
d. Because the portfolio will be held in a separate investment account and will receive additional SIPC insurance coverage

58.
Annual testing of a member firm's AML program may be conducted by:

a. the designated anti-money laundering compliance person
b. a person who performs the functions being tested
c. a qualified outside party or member personnel
d. any of the above

59.
A registered person resigns from a broker-dealer in order to finish graduate school. Eighteen months 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 branch manager

60.
At 3:50 PM ET on expiration date, a customer wishes to close out a long position on an "out-the-money" options contract. To do this, the registered representative should:

a. enter a contrary exercise advice
b. enter a cabinet trade
c. enter a limit order
d. do nothing because the contract can no longer be traded

61.
Exercise settlement of index options is based on the:

a. premium at the moment of exercise versus the premium at the moment position was established
b. value of the underlying index at the moment of exercise versus the strike price of the index option
c. value of the underlying index at the end of the settlement day versus the strike price of the option
d. delivery of the underlying securities included in the index

62.
Under SEC Rule 15g-1, a member firm is exempt from the penny stock disclosure rules if its business from penny stock transactions accounts for less than:

a. 20% of revenue
b. 15% of revenue
c. 10% of revenue
d. 5% of revenue

63.
An institutional customer selects one firm to provide custody and financing of securities, while orders to buy or sell are placed with executing brokers. This is an example of a:

a. wrap account
b. give up (clearing) agreement
c. prime brokerage account
d. step out account

64.
A member firm receives a customer order to buy a Pink Sheet stock. Under FINRA rules, the member, in order to determine the prevailing market, must contact a minimum of:

a. 2 dealers
b. 3 dealers
c. 4 dealers
d. 5 dealers

65.
Under the Uniform Practice Code, the ex-date for stock dividends or stock splits which represent 25% or more of the value of the subject security is 1 business day:

a. before the Record Date
b. after the Record Date
c. before the Payable Date
d. after the Payable Date

66.
The last trade in ABCD stock occurred at $50 per share. An OTC Equity Trader effects multiple buy-sell trades in that stock for the firm's account at successive prices of $40, $45, $50, $55 and $60 per share. These transactions are:

a. wash trades
b. matched sales
c. boxed trades
d. pattern day trades

67.
A customer sells short and fails to deliver on settlement date. Mandatory close-out is required in which two of the following circumstances?

I The stock was on the threshold list as of trade date
II The stock was not on the threshold list as of trade date
III The stock remains on the threshold list for 5 settlement days
IV The stock remains on the threshold list for 13 settlement days

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

68.
Under SEC Rule 10b-18, an issuer purchasing its own securities in the market can pay no more than the:

I Highest current independent bid
II Lowest independent offer
III Last reported sale price

a. I only
b. I or III, whichever is higher
c. II or III, whichever is lower
d. III only

69.
A member firm, wishing to have a clearly erroneous trade nullified, must make the request to NASDAQ MarketWatch:

a. within 30 minutes of the transaction
b. within 1 hour of the transaction
c. no later than 4:00 PM ET on the day of the transaction
d. no later than 8:00 PM ET on the day of the transaction

70.
Under SEC rules, limit orders from which of the following must be protected by a market maker?

I Orders from customers of the market maker
II Orders from another member for customers of that member
III Orders from another member for that member's proprietary trading account

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

71.
A trader at a large market making firm routinely telephones his counterparts at smaller firms, inquiring as to why their orders are sent to other market makers, stating: "With our large institutional client base, directed orders will result in quick, profitable executions for both of us. Also, I'm sure I could get you into some of our syndicate deals if we begin to see order flow."

These phone calls are an example of:

a. Front running
b. Intimidation / Harassment
c. Collusion
d. Interpositioning

72.
A proprietary trading desk trades ahead of a customer limit order placed with the firm's market making desk. This action is:

a. permitted without restriction
b. permitted as long as a Chinese Wall is in place
c. permitted as long as the firm has a no-action letter from the SEC
d. prohibited

73.
Under Regulation M, if there is no independent market for a subject security, which statements are true?

I Stabilization is permitted
II Stabilization is not permitted
III Passive market making is permitted
IV Passive market making is not permitted

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

74.
A broker-dealer holds a limit order to buy 100 shares of ABCD stock at $20.00 for a customer. Which of the following trades are acceptable?

I The purchase of 100 shares of ABCD for the firm's trading account at $19.50 prior to executing the customer's order
II The purchase of 100 shares of ABCD for the firm's trading account at $20.50 prior to executing the customer's order
III The long sale of 100 shares of ABCD out of the firm's trading account to the customer at $20.00
IV The short sale of 100 shares of ABCD out of the firm's trading account to the customer at $20.00

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

75.
The SEC's Penny Stock Rule applies to which of the following?

I Capital Market stock trading at $4 per share
II OTC Bulletin Board stock trading at $4 per share
III Global Market stock trading at $4 per share
IV Pink Sheet stock trading at $4 per share

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

76.
An order ticket to sell securities that will be borrowed for delivery on settlement must be marked:

a. Sell-Long
b. Sell-Short
c. Sell Long-Exempt
d. Sell Short-Exempt

77.
NASDAQ MarketWatch has the authority to declare a clearly erroneous trade null and void on:

I its own motion
II the complaint of the buying dealer
III the complaint of the selling dealer

a. I only
b. II only
c. II or III
d. I, II, III

78.
The "Trade-Through" rule of Regulation NMS applies to all of the following **EXCEPT:**

a. NYSE issues
b. AMEX issues
c. NASDAQ issues
d. OTCBB issues

79.
A pegged order to buy is placed at the:

a. inside bid
b. inside ask
c. inside bid minus $.01
d. inside ask plus $.01

80.
OATS reports are submitted by:

a. the buy side of the transaction
b. the sell side of the transaction
c. both the buy and sell side of the transaction
d. the side of the transaction that is the Executing Member

81.
A customer places a market order with her broker-dealer to buy 1,000 shares of ABCD stock - a NASDAQ Global Market security. The NBBO at the time of order entry is: $10.50 - $11.00. The trade is sent to Market Venue "A," which is currently quoting the stock at: $10.25 - $11.25. The order is filled by Market Venue "A" at $11.25.

Which statement is true?

a. Market Venue "A" has not violated any rules
b. Market Venue "A" has committed a violation called "selling away"
c. Market Venue "A" has committed a violation called "trade shredding"
d. Market Venue "A" committed a violation called a "trade through"

82.
An index arbitrage trading desk places sequential buy orders at the market opening for securities included in the index to raise their price against the current index value. Which statement is true?

a. These transactions can only be effected on an upbid
b. This is an illegal practice known as Marking to Market
c. This is an illegal practice known as Marking the Open
d. This is an illegal practice known as Painting the Tape

83.
A member firm buys stock from a market maker and instructs the market maker to deliver the securities to another member for clearance and settlement purposes. This is an example of a:

a. wrap account
b. give up (clearing) agreement
c. prime brokerage account
d. step out account

84.
All of the following orders would be included in an SEC Rule 605 report **EXCEPT:**

a. limit orders
b. marketable limit orders
c. immediate or cancel limit orders
d. fill or kill limit orders

85.
All of the following transactions are **EXEMPT** from the trade through rule (Rule 611) **EXCEPT:**

a. benchmark trades (VWAPs)
b. intermarket sweep orders (ISOs)
c. stopped stock transactions
d. minimum quantity transactions

86.
Which of the following customers is considered to be "long" 100 shares of ABCD stock?

I A customer who has a long position of 200 ABCD shares and has shorted 100 shares of ABCD "against the box"
II A customer who owns 1 ABCD call contract
III A customer that owns two ABCD convertible bonds, convertible into 50 shares each, who has given irrevocable instructions to convert
IV A customer who owns 100 ABCD warrants and has exercised those warrants

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

87.
A firm's market making desk, aware that the firm is about to publish a bullish research report on ABCD stock, purposefully increases its long position in order to satisfy anticipated retail demand. This action is:

a. permitted without restriction
b. permitted as long as the research report is released within 48 hours of the first trade made to increase the firm's position
c. permitted as long as NASDAQ is notified, in writing, of the impending research report
d. prohibited

88.
The rate of change of an option premium as compared to the rate of change of the price of asset underlying the option is called:

a. alpha
b. beta
c. delta
d. gamma

89.
A registered representative buying call options on a stock with the advance knowledge of a large buy order being placed by an institution. This is a prohibited practice known as:

a. Free Riding
b. Front Running
c. Interpositioning
d. Backing Away

90.
To take a second job, an employee of a member firm:

a. must get permission from his or her employer
b. must get permission from the SRO
c. must amend his U-4 filing
d. is under no notification requirements

91.
Records of speaking engagements of registered personnel must be maintained by member firms for:

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

92.
All of the following are violations of the FINRA Conduct Rules **EXCEPT:**

a. guaranteeing a customer account against loss
b. selling a customer an exempt security with a written agreement to buy back that security at a fixed price
c. making blanket recommendations of low price speculative stocks to customers
d. selling dividends to customers by inducing customers to buy stocks just prior to the ex-date

93.
Which of the following individuals are permitted to be included in arbitration panels?

I Persons affiliated with member firms
II Disinterested persons with no industry affiliation
III Attorneys that are members of the bar

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

94.
Under the provisions of Regulation SHO, a short sale of an NMS security can only be effected on an upbid if its price declines by

a. 1%
b. 2%
c. 5%
d. 10%

95.
If a person is convicted of insider trading:

I the amount of any profit achieved or loss avoided must be paid
II three times the amount of any profit achieved or loss avoided must be paid
III payments are made to the Department of Treasury
IV payments are made to the Securities and Exchange Commission

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

96.
A registered representative with a wealthy clientele has many clients that are officers of publicly held companies. The registered representative receives an order from the executive vice-president of ADAP Corp. to sell 4% of the outstanding shares. Prior to placing this order, the registered representative may, in his or her personal account,:

a. buy ADAP put options
b. buy ADAP common stock
c. sell ADAP call options
d. sell short ADAP stock

97.
ABC stock has just closed at $70.50 on the NYSE. A customer has an open order on the Specialist's/DMM's book to sell short 100 shares of ABC at $70 Stop. ABC stock goes ex-dividend $.55. The order on the Specialist's/DMM's book the next morning will be:

a. Sell short 100 ABC at $69.45 Stop
b. Sell short 100 ABC at $70.00 Stop
c. Sell short 100 ABC at $70.50 Stop
d. Sell short 100 ABC at $80.05 Stop

98.
All of the following statements are true about American Depositary Receipts **EXCEPT:**

a. ADRs facilitate domestic trading of foreign securities
b. ADR holders receive dividends
c. ADR holders have voting and pre-emptive rights
d. ADRs are issued by domestic banks

99.
A customer places an order to buy 100 shares of ABC stock at $50 per share when the market price of the stock is at $60. The member firm fills the order at $58. By the time when the error is discovered the next day, the stock is trading at $48. Which statement is true?

a. The customer must be offered the $48 price per share
b. The customer must be offered the $50 price per share
c. The customer must be offered the $58 price per share
d. The customer must be offered the $60 price per share

100.

An order is reported to a customer as executed, but, in fact, was not executed. which statement is **TRUE?**

a. The firm must honor the trade
b. The firm must honor the trade only at the customer's insistence
c. The firm must correct the erroneous trade report sent to the customer
d. The firm must report the error to the SRO

Series #56 - Final 1 Explanations

1. The best answer is **c.** Treasury stock does not trade. It represents shares of the company that have been repurchased by the issuer. Such shares are held in "Treasury". Treasury stock does not vote, nor does it receive dividends. Issuers repurchase shares for Treasury typically to reduce the number of common shares outstanding. This increases reported Earnings per Share, and thus increases the common stock's market price. Common stock, preferred stock, warrants and rights all trade in the market.

2. The best answer is **c.** Since the preferred stock is **non**cumulative, to make a dividend distribution to common shareholders, the company need only make this year's preferred dividend distribution. The stated dividend rate on the preferred is 10% based on $100 par, so $10 of preferred dividends must be paid per share. If this preferred were cumulative, then all omitted dividends must be paid before a distribution can be made to common.

3. The best answer is **b.** Preferred stock pays a fixed dividend rate; American Depositary Receipt holders receive dividends; and Real Estate Investment Trusts make dividend distributions to shareholders. Holders of warrants and rights do not receive dividends on these instruments.

4. The best answer is **a**. Equity options positions that are "in the money" by $.01 or more as of the market close on the Friday prior to expiration are automatically exercised by the Options Clearing Corporation.

5. The best answer is **a.** When a company declares a stock dividend or a fractional stock split, the option contract is not adjusted. If there is an exercise, then the "deliverable" is adjusted. So, 1 ABC Jan 60 Call where there is a 20% stock dividend remains 1 ABC Jan 60 Call. If there is an exercise, then the deliverable is adjusted to 100 x 1.2 = 120 shares at $60/1.2 = $50 per share.

6. The best answer is **c.** When a company declares a stock dividend or a fractional stock split, the option contract is not adjusted. If there is an exercise, then the "deliverable" is adjusted. So, 1 ABC Jan 60 Call where there is a 20% stock dividend remains 1 ABC Jan 60 Call. If there is an exercise, then the deliverable is adjusted to 100 x 1.2 = 120 shares at $60/1.2 = $50 per share.

7. The best answer is **a.** Sell stop orders are placed **lower** than the current market price of the stock and are triggered when the market hits or goes through the stop price. Just prior to entering the order, the last trade in ABC stock was at 40.88. The stop price is set at 40.00. If the market trades at 40.00 or lower, the stop is activated. The next trade that takes place in ABC stock is at 39.88. The market has fallen right through the stop price, so this trade activates the order.

8. The best answer is **d.** This sell order was placed at 40 Stop Limit. Once it is activated, it becomes an order to sell at the limit price of 40 or higher. The next trade after 39.88 (which elected the order) is at 40.25. This meets the limit price to sell at 40 or higher, so execution can take place at this price.

9. The best answer is **b**. Exercise settlement of PHLX traded World Foreign Currency options is the same as for index options. On exercise (which can only happen at expiration, since the contracts are European style), the writer must pay the holder the "in the money" amount the next business day in U.S. dollars.

10. The best answer is __b.__ The VIX is a measure of market volatility - the higher the index value, the more volatile the market's price movements. Very volatile price movements are indicative of increased investor fear and are bearish.

11. The best answer is __b.__ Portfolio margin is a "risk" based margin method that gives substantially lower margin requirements for lower risk positions. It recognizes that if positions are hedged, such as a stock position hedged by the purchase of a put, then the loss potential of the combined position is much lower. Portfolio margin produces a much lower margin requirement for such a hedged position (the margin is basically equal to the maximum loss) than the separately calculated margins for each position that Regulation T would require. Regulation T is a so-called "strategy based" margin method, that applies a fixed margin percentage to each strategy separately. It does not account for the fact that one position may offset the risk of another position, which is what portfolio margin recognizes. Also note that portfolio margin can only be used by institutional or wealthy sophisticated individual customers.

12. The best answer is __c.__ Whenever a market maker receives a customer limit order that improves either its displayed price and/or size, it must display that order under SEC rules. In this case, the customer is placing an order to buy 200 shares at 10.00. Since the market maker's quote is 10.00 - 10.25 (10 x 10), the market maker is bidding the stock at 10.00 for 1,000 shares. Since the customer wants to buy 200 shares at the same price of 10.00, there are now willing buyers for 1,200 shares at 10.00. Thus, the quote must be updated to 10.00 - 10.25 (12 x 10).

13. The best answer is __b.__ If any information becomes known about a terminated representative after the U-5 filing is completed, FINRA applies an "open-ended" updating requirement. The U-5 must be amended with the new information within 30 days of discovery - it makes no difference how long the representative is out of the business.

14. The best answer is __a.__ The Trade Reporting Facility for NASDAQ (NASDAQ TRF) reports trades of all NASDAQ issues. Trades of NYSE listed issues are reported through the NYSE TRF. This reports trades of NYSE-listed issues effected OTC (both Third Market and Fourth Market trades). Reports of trades of OTCBB and Pink Sheet issues are made to the ORF (OTC Reporting Facility).

15. The best answer is __a.__ Under ACT rules, transactions in NASDAQ, OTCBB and Pink Sheet securities executed between 8:00 AM and 8:00 PM ET (the hours that ACT is open) must be reported within 30 seconds of execution (effective 11/1/10). The TRF for NASDAQ (Trade Reporting Facility) disseminates the trade report immediately for NASDAQ trades. The ORF (OTC Reporting Facility) reports the trade for OTCBB and Pink Sheet issues, also immediately.

16. The best answer is __b.__ A short put position has the characteristics of giving a fixed gain (the premium) if the market rises and the put expires out the money; and increasing loss as the market drops (where the writer is obligated to buy stock for less than it is worth). As an example, assume a customer sells 1 ABC Jan 50 Put at $5. If the market rises, the put expires and the customer has a $5 gain. If the market falls to "0," the put will be exercised, and the customer must pay $50 for stock that is worthless. The net loss is $45, since he received $5 per share in premiums for writing the put.

If the customer were to buy 100 shares of ABC stock at $50 and sell 1 ABC Jan 50 Call @ $5, these characteristics are matched. In a rising market, the call would be exercised. The stock that was purchased at $50 would be delivered at $50, for no gain or loss. However, a $5 premium is earned. In a falling market, the call expires and the customer loses on the long stock position. The maximum loss is $50 per share of stock, net of $5 premium received, or $45 per share. Thus, the synthetic equivalent of a short put position is long stock / short call (which is the same as being a covered call writer).

17. The best answer is **c.** If a customer has a short stock position, he has unlimited upside loss potential, and increasing gain as the market drops. Assume that a customer shorts 100 shares of ABC at $50, His maximum loss is unlimited; his maximum potential gain is $50 per share. If the customer sells 1 ABC Jan 50 Call @ $5, he matches the unlimited upside loss characteristic. However, his gain is limited to 5 points. If the customer also buys 1 ABC Jan 50 Put @ $5, the premium paid of $5 offsets the premium received of $5. In a falling market, the customer would gain from the long put position, while the call would expire "out the money." Thus, the synthetic equivalent of a short stock position is short call / long put.

18. The best answer is **b.** If a customer exercises a stock option contract, settlement occurs "regular way" 3 business days after trade date. To receive a dividend, a customer must be on the record books on Record Date. The "ex" date is set by the exchange, based from the record date. This is the first date that any purchaser of the stock in a regular way trade will settle **after** the Record date, and, thus will not receive the dividend. Thus, to receive the dividend, the holder of a put must exercise **on or after** to the ex date, since exercise of a put results in a regular way sale of the stock. Exercise of the put prior to the ex date will result on settlement on or before the Record date, and the person who exercised would not be on record to receive the dividend.

19. The best answer is **c.** To determine if there is a violation of position or exercise limits, the Options Clearing Corporation aggregates contracts on the same issuer on the same side of the market. Thus, long calls are aggregated with short puts (both representing the "upside" of the market); while long puts are aggregated with short calls (both representing the "downside" of the market).

20. The best answer is **b**. Under SEC and CBOE rules, issuers are prohibited from selling calls against their own stock.

21. The best answer is **c**. At the opening rotation, each series of option is traded **alone** for a brief period, followed sequentially by the next option in the series, etc., until the rotation is completed. Since all contracts are not being traded at the same time, it would be impossible to fill a spread or straddle order (since these orders require 2 different contracts to create the position, and only 1 contract is being traded at a time in the rotation).

22. The best answer is **b**. To determine if a violation of position limits exists, all accounts where an individual or entity makes investment decisions for accounts are aggregated; as are accounts where an individual or entity materially influences the actions of the person making investment decisions. In choice **b,** the registered representative is making the investment decisions (discretionary accounts) so these accounts come under the aggregation rule. In the other accounts, investment decisions are being made individually by the holders of the accounts.

23. The best answer is **c.** Under O.C.C. rules, for a short call option position to be covered, a long option position must be taken with the same expiration or later (thus, if the short call option is exercised, the long call can still be exercised to get the stock for delivery. If

the long call expired earlier, then there would be no way to get the stock if the short call were exercised); and the strike price on the long option must be the same or lower than that on the short call. (Thus, if the writer is exercised, the stock can be purchased at the same price or lower - there is no loss to the writer of the call. If the strike price on the long call were higher, then there would be a loss on the exercise of the short call.)

24. The best answer is **a**. This is a ratio spread. The positions are:

Buy 1 ABC Oct 80 Call @ $11 = $11 Debit
Sell 2 ABC Oct 85 Calls @ $5 = $10 Credit

Net $1 Debit

If the market falls, below 80, both positions expire "Out the money" and the loss is the $1 debit. If the market rises above $80, then the maximum gain occurs at $85. At $85, the short calls expire "at the money." There is a $5 point profit on the long 80 call - $1 net debit, for a maximum profit of $4 = $400 - this amount is now locked-in if the market continues to rise. However, if the market rises above 85, the maximum $4 profit is now reduced by the loss on the 1 naked short call. If the market rises to $89, there is a loss of $4 on the naked short call that equals the $4 locked-in profit, so this is breakeven. Above this, the loss potential is unlimited on the naked short call.

25. The best answer is **c**. Continuing from the prior explanation, if the market rises to 100, there is a 15 point loss on the short naked call, offset by the $4 point locked-in gain, for a net loss of $1,100.

26. The best answer is **a**. At the opening rotation, each series of option is traded **alone** for a brief period, followed sequentially by the next option in the series, etc., until the rotation is completed. Since all contracts are not being traded at the same time, it would be impossible to fill a spread or straddle order (since these orders require 2 different contracts to create the position, and only 1 contract is being traded at a time in the rotation).

27. The best answer is **c**. Market makers on the CBOE floor do not deal with the public. They trade with other market makers, floor brokers, and order book officials.

28. The best answer is **a**. This is a hard question! If an option contract is purchased in a cash settlement, then the transaction settles that day, rather than the next business day. In this case, the Options Clearing Corporation permits exercise on the same day as trade date.

29. The best answer is **d**. Unlike the majority of records related to options that must be kept for 3 years, certain records must be kept for 6 years. These include daily transaction records (the "blotters") and customer account statements.

30. The best answer is **a**. All order tickets must be put into written form prior to order entry. If the order is later changed, it must either be canceled and a new order entered, or if there is a change after execution, the principal must approve (initial) the change.

31. The best answer is **c**. If a customer is short stock and short a put, the customer has unlimited risk potential on the short stock position in the rising market (the short put would expire out-the-money). Choice **a** is a long straddle, where the maximum loss is the premium paid; Choice **b** is a short call spread, where the maximum loss is the difference

in the strike prices, net of the credit received. Choice **d**, a short put, has a maximum loss equal to the strike price minus the premium collected. Only Choice **c** has unlimited loss potential.

32. The best answer is **d**. This is a ratio write, which basically consists of 1 covered short call and 1 naked short call. The customer has bought the stock at $62, and sells 2 ABC Jan 65 Calls @ $4, for a collected premium of 8 points. If the market stays below 65, then the calls expire out-the-money, and the customer has reduced the cost of the stock to $62 - $8 total premium collected = $54 per share. If the stock drops below this price, then the customer loses on the stock position, while the calls expire out-the-money. This is the first breakeven point.

If the market rises above 65, then both short calls are exercised. The customer delivers 100 shares that he owns (purchased at $62) at the 65 strike price, for a gain of 3 points in addition to the 8 points collected in premiums. The exercise of the 1 naked short call obligates the writer to sell another 100 shares at 65 that he or she does not own. These shares can be bought in 11 points higher, at 76, and the customer will still breakeven. Above this price, the writer keeps losing on the 1 short naked call - the risk potential on this position is unlimited.

33. The best answer is **b**. This is a ratio write, which basically consists of 1 covered short call and 1 naked short call. The customer has bought the stock at $62, and sells 2 ABC Jan 65 Calls @ $4, for a collected premium of 8 points. If the market stays below 65, then the calls expire out-the-money, and the customer has reduced the cost of the stock to $62 - $8 total premium collected = $54 per share. If the stock drops below this price, then the customer loses on the stock position, while the calls expire out-the-money. This is the first breakeven point.

If the market rises above 65, then both short calls are exercised. The customer delivers 100 shares that he owns (purchased at $62) at the 65 strike price, for a gain of 3 points in addition to the 8 points collected in premiums. The exercise of the 1 naked short call obligates the writer to sell another 100 shares at 65 that he or she does not own. These shares can be bought in 11 points higher, at 76, and the customer will still breakeven. Above this price, the writer keeps losing on the 1 short naked call - the risk potential on this position is unlimited.

34. The best answer is **c**. Customer account statements must be sent at least quarterly if no trades occur in the account; and monthly if trades occur in that month.

35. The best answer is **d**. Member firms are obligated, under CBOE rules, to maintain procedures to prevent and detect insider trading violations. An annual report must be made to the exchange detailing these procedures. These procedures must include a written statement, given to all registered persons, detailing the insider trading prohibitions, that must be signed by each associated person, attesting to the fact that he or she is aware of the rules, and has not violated the rules. Under the rules, member firms are required to periodically review the account activity of associated persons to detect any possible insider trading violations. There is no requirement to report trading activity of associated persons to the SEC.

36. The best answer is **c**. If trading is halted in a stock on its principal exchange or if trading is halted by the SEC, then the option stops trading. The stopping of trading of a stock on a regional exchange will not stop the trading of the option, since it can still be priced by the trading taking place on its principal exchange.

37. The best answer is **b.** If no size is stated, a quote from a market maker on the CBOE is good for 10 contracts.

38. The best answer is **c.** This customer is hedging by purchasing a put that is 20 points "in the money." He is virtually insuring that the put will be exercised, forcing the customer to sell the stock (at $120). This is not the intent of a long stock / long put strategy. The intent is only to protect if the market should drop below the current price ($100); but to still give the customer the upside gain potential on the security.

39. The best answer is **c**. At the opening rotation, each option series trades alone for a brief time period to fill any orders for that series in an "orderly" fashion. When all of the series have been "rotated through," trading starts in all series. A spread or straddle order requires that 2 series be traded at the same time to create the position - this is an impossibility if only one series is trading at the time. Any order for a single series (buy, sell, buy limit, sell limit) can be filled at the opening (or closing) rotation.

40. The best answer is **c.** A "cabinet" trade is a closing trade for a worthless contract at a premium of $.01 per share ($1 aggregate premium per contract). These are handled by Board Brokers as an "accommodation" to give customers a closing trade confirmation. Since there is no bid on the floor for this option, the only way to effect a closing sale is through such a "cabinet trade."

41. The best answer is **c.** A "cabinet" trade is a closing trade for a worthless contract at a premium of $.01 per share ($1 aggregate premium per contract). These are handled by Board Brokers as an "accommodation" to give customers a closing trade confirmation. Cabinet trades can be placed with the Order Book Official by customers, member firms, and Market Makers. These are treated like an "off floor" trade because there is no reporting in real time of the trade to the tape. These transactions are reported at the end of the day.

42. The best answer is **c.** It is not noted on the trade confirmation that a trade was "discretionary" - however this is noted on the order ticket for the trade. The confirmation will include; opening or closing transaction; exercise price per share (but **not** aggregate exercise price of the contract); and whether the trade was effected on an agency or principal basis (among many other disclosed items).

43. The best answer is **d**. Exchange rules prohibit a member from assuming a customer loss, **unless** the loss resulted from the member's mistake; or the Exchange specifically allows such action to be taken by the member (not likely!).

44. The best answer is **b.** Equity LEAPS expire each January on the same date as the regular options expiration (remember that contracts expire on the Saturday following the 3rd Friday of the month). They are issued after the May expiration and expire in the January 30 months later. If it is now the beginning of January '11, the January '11 options are still trading, as are the January '12s and January '13s. After the May '11 expiration, January '14s will be issued. Thus, at the beginning of January '11, the longest available equity LEAP is the January '13. This contract has 24 months left to its life.

45. The best answer is **b.** Under Regulation SHO, the list of "threshold" securities must be prepared by each exchange and NASDAQ daily. NASDAQ posts the list just before midnight prior to each trading day. These are the securities that are "difficult to borrow."

46. The best answer is **d.** All of the statements are true regarding Rule 103 restrictions on passive market makers. Rule 103: Syndicate members who are market makers in that security may either seek an excused withdrawal from making a market in that security - that is, get permission of FINRA to stop making a market during this period; or may elect to operate as a "passive" market maker. A passive market maker may bid for that security at no higher than the highest current independent bid. Thus, the firm cannot push the price up in the market. If it elects to operate as a passive market maker, any bids are identified as "PSMM" - as in passive market maker. Note that under Rule 103, unsolicited customer orders to buy may be accepted at any price. In addition, passive market makers are limited as to the amount of "net purchases" of that security (orders from all sources) that can be made on any day during the restricted period. The limit is 30% of that market maker's average daily trading volume over the preceding month. Once this limit is reached for the day, it must obtain an excused withdrawal from making a market from FINRA.

47. The best answer is **c.** If a registered individual fails to complete the Regulatory Element of the Continuing Education requirement within the 120-day window that he or she is given, this person's registration is suspended and the member firm is prohibited from paying that individual. This is a very good incentive for each person to complete his or her Regulatory Element CE.

48. The best answer is **b.** Regulation FD (Fair Disclosure), passed in 2000, is basically an elaboration of the insider trading rules. It prohibits issuers from making selective disclosure of non-public information to research analysts, mutual fund managers, and other industry professionals, unless at the same time, the information is broadly disseminated to the public.

49. The best answer is **c.** Under Regulation F/D (Fair Disclosure), if an issuer makes "selective disclosure" of material non-public information, then the recipients are deemed to be insiders until the information is broadly released. Thus, the analyst could not use the information to issue a revised opinion to the firm's customers until the issuer released that information. However, the analyst can discuss the new information with his or her supervisors and can update the firm's records about that issuer in light of the new information.

50. The best answer is **c.** Any registered individual must complete the Regulatory Element of the Continuing Education requirement on the 2nd anniversary of registration and every 3 years thereafter.

51. The best answer is **b.** Regulation FD (Fair Disclosure) requires that when an individual that is associated with a company is going to divulge any information that might have a market impact to a group of individuals, simultaneous disclosure must also be made to the general public (that is what is meant by a disclosure notice). The Board of Directors already has a fiduciary responsibility to the company, as does the company's attorney and the company's employees, so they do not come under the rule. However, research analysts do not have such a fiduciary responsibility to the issuer, and if any disclosures are going to be made to them, simultaneous disclosure to the public is also required.

52. The best answer is **c.** Reports of any lost security (it makes no difference if it is a U.S. Government issue) must be made to the SIC - Securities Information Center - and to the transfer agent. If the security is believed to be stolen, the FBI must be notified as well.

53. The best answer is **b.** Money laundering regulations are established by the Federal Reserve and the Department of Treasury - and apply to banks, trusts, savings and loans, check cashing services, money wiring services, broker-dealers, etc. - that is, anyone routinely handling money transactions. In addition, each SRO (self-regulatory organization), such as the CBOE or FINRA requires member firms to put AML programs in place. The SEC has no money laundering regulations.

54. The best answer is **b.** Cabinet transactions, also called accommodation liquidations, permit a customer to close a worthless option contract at an aggregate premium of $1.00 per contract ($.01 per share). Orders for these transactions are kept in a "cabinet" on the AMEX or CBOE floor and are executed by the Specialist or Board Broker daily. Such trades are not reported within 90 seconds of execution - rather, they are reported at the end of each business day.

55. The best answer is **d.** If a customer fails to return the signed Options Agreement within 15 calendar days of approval of account opening, the customer is prohibited from opening new options positions in the account. However, closing trades are permitted. There is no requirement to "freeze" the account under Regulation T - this only occurs if the customer does not pay for transactions "promptly," in which case the account is frozen for 90 days and during this time window the customer must pay in advance for purchases.

56. The best answer is **b.** This question is subjective, but that is the nature of many of these "exam-type" questions. Nothing illegal has happened since the representative did not trade on the information. However, the representative should report the situation to the home office - specifically the compliance department. Compliance will investigate and decide what action (e.g., reporting the information to the exchange) should be taken.

57. The best answer is **b.** Portfolio margin is "risk-based" so that a diversified or hedged portfolio (which will have lower risk) will get a much lower margin than regular strategy based margin.

58. The best answer is **c.** Member firms that deal with the public must test their Anti-Money Laundering programs annually. (Note that a firm that does not execute transactions for customers, e.g., the firm conducts only proprietary trading or deals only with other broker-dealers, is required to test every 2 years.) The testing must be performed by an independent person. This independent testing may not be conducted by the designated anti-money laundering compliance person; by a person who performs the functions tested; or by any person who reports to these individuals. It can be performed by a qualified outside party or by a member firm employee who does not fall into the prohibited categories.

59. The best answer is **a.** If a registered person terminates association with a broker-dealer firm, and reassociates within 2 years of termination, that person is subject to the Regulatory Element of CE on a cycle based on initial registration.

60. The best answer is **b.** The customer wants to "close out" the position, meaning enter a closing trade. The contract stops trading at 4:00 PM ET, so a closing trade can be entered. Because the contract is "out the money," it can be closed in a cabinet trade for an aggregate $1 premium for the contract as an accommodation. 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. Filing a CEA (Contrary Exercise Advice) is not appropriate, since the customer does not want to exercise the contract.

61. The best answer is **c.** If an index option is exercised, exercise settlement is based on the closing index value that day versus the strike price of the option. This creates a bit of a "problem" because if the contract is exercised during the trading day, the closing index value is not yet known. A much better way to capture a profit on the contract is to close it at the current market premium. However, exercise is permitted as part of the basic contract!

62. The best answer is **d.** The "penny stock rule" is intended to apply to member firms that specialize in recommending speculative penny stocks to unsuspecting investors. These customers must sign a detailed suitability determination prior to confirmation of purchase, and where the customer signs is a big bold disclaimer that the customer is likely to lose everything! Thus, they are not likely to sign unless they really, really, think they are doing the right thing. The rule is not intended to apply to member firms that are not "in the business" of pushing penny stocks - defined as firms that derive less than 5% of their revenue from penny stock transactions.

63. The best answer is **c.** A prime brokerage account is one where a customer, generally an institution, selects one broker (the prime broker) to provide custody and financing of securities purchased, and other brokers (executing brokers) to buy and sell on behalf of the customer. Unlike a prime brokerage account which involves a customer, a give-up clearing arrangement is between two members. For example, member firm A agrees to settle and clear all trades entered by member firm B.

64. The best answer is **b.** In order to determine the prevailing market when buying or selling a non-NASDAQ security on behalf of a customer, member firms must contact a minimum of 3 dealers (if there are that many dealers making a market). However, if there are 2 or more market makers displaying priced quotations - meaning that there is an inside market in the issue, the 3 contact rule does not apply. Thus, the rule applies only to OTCBB or Pink Sheet issues where an inside market does not exist.

65. The best answer is **d.** The Uniform Practice Code sets ex-dates for corporate distributions. On the ex-date, the stock's price is reduced for the value of the distribution. The most commonly known ex-date is that for cash dividends - set at 2 business days prior to record date for regular way trades. Anyone who buys prior to this date will settle on the record date or before and thus will get the dividend. Anyone who buys on ex-date or after will settle after the record date and will not get the dividend - hence the reduction.

The ex-date for stock dividends and stock splits is totally different. It is set at 1 business day after the payable date (which is typically about 2 weeks after the record date). What happens is that anyone who buys, settling during the window of time encompassing the day after the record date through the payable date, will not be on record to get the stock split, yet on the day after the payable date, the price is reduced for the distribution that they were not on record to receive! These buyers claim the extra shares that they are owed with a "due bill." Anyone who settles after the payable date (the ex-date) will pay the reduced price, and a due bill is no longer required.

66. The best answer is **a.** Effecting a series of buy-sell transactions (these are wash trades, since they "wash" each other out) without any change of ownership is a "time-honored" manipulation known as "painting the tape" - it gives the appearance of active trading in a security when this is not the case. Note that Choice d is incorrect because only retail customers can be defined as "pattern day traders."

67. The best answer is **b.** Customer short sales not resulting in delivery must be bought-in after 10 business days from settlement, if the security was on the exchange's or the NASDAQ's threshold list as of trade date under Regulation SHO and remains on that list for "13 settlement days" - which is the same as 10 business days from settlement (T + 3 = Settlement + 10 = 13 settlement days). These are securities that are "hard to borrow" and the SEC does not want large outstanding short positions that are uncovered to build in these securities. A threshold security is one with a large outstanding short position - defined as one with a clearing short position at the National Securities Clearing Corporation of 10,000 shares or more; and the position represents 1/2% or more of the total shares outstanding.

68. The best answer is **b.** 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. It cannot buy the stock at the market open or within 1/2 hour of market close; and can pay no more than the highest current independent bid or the last sale price, whichever is higher. Thus, the issuer cannot push the price of its securities up in the market.

69. The best answer is **a.** Under FINRA rules, a member firm must contact NASDAQ MarketWatch within 30 minutes of an execution that it believes to be erroneous. NASDAQ will give a written determination and can nullify the trade, adjust the terms of the trade or do nothing. Either side can appeal the written determination within 30 minutes of receipt to MORC - the Market Operations Review Committee. All decisions made upon appeal are binding and final.

70. The best answer is **b.** The limit order protection rule applies to customer limit orders - not to member firm proprietary limit orders. Also note that customer limit orders must be protected whether they come from that market maker's own retail base of customers or from the customer base of another member.

71. The best answer is **b.** Routine telephone calls of this nature are a form of intimidation and harassment, which is a prohibited practice.

72. The best answer is **b.** This one is interesting. A member firm cannot "trade ahead" of, or front-run, a customer limit order. However, if the firm has a Chinese Wall in place between its proprietary trading desk and its market making desk, then each should have no knowledge of what the other is doing. In that case, there is no violation because the proprietary trading desk does not know about the customer limit order received by the firm's market making desk. On the other hand, if there were no Chinese Wall in place, this would be a clear violation.

73. The best answer is **d.** Regulation M consists of Rules 101 - 105, and covers trading by market participants during the "20-day cooling off period" in securities where a registered secondary offering is taking place; as well as stabilization in the after market. Rule 103 states that if a market maker in a security that is subject to a secondary offering joins an underwriting group for an "add-on" offering of that issuer's securities, then the market maker must either stop making a market or act as a passive market maker. Rule 104 covers stabilization of the security in the aftermarket. Both of

these rules require that to either act as a passive market maker or to place a stabilizing bid, an independent market must exist. That means that there must be one other market maker posting quotes who is not involved in the distribution of securities.

74. The best answer is **d.** If a dealer holds a customer order, he cannot execute an order for the firm account that competes with that order - unless the customer order is executed first. The customer has placed an order to buy 100 shares of ABC stock at $20. It is OK for the firm to buy the stock for its own account at $20.50 prior to executing the customer order, since the customer's limit price has not been met. However, the firm cannot buy for its own account at $19.50 until the customer order has been executed, since $19.50 is within the customer's limit. It is perfectly acceptable for the firm to sell the customer the stock at $20 out of its inventory account. It makes no difference whether the firm sells this stock long to the customer or if it sells the stock short to the customer. In trading accounts, firms routinely maintain both long and short positions.

75. The best answer is **b.** A "penny stock" is defined as one that is not exchange or NASDAQ listed, trading for less than $5 per share. Translated, a penny stock is a Pink Sheet or OTCBB issue, trading at less than $5 per share. Exchange listed or NASDAQ issues are not defined as "penny stocks" regardless of price. These securities are subject to the "penny stock rule," which is intended to apply to member firms that specialize in recommending speculative penny stocks to unsuspecting investors. These customers must sign a detailed suitability determination prior to confirmation of purchase, and where the customer signs is a big bold disclaimer that the customer is likely to lose everything! Thus, they are not likely to sign unless they really, really, think they are doing the right thing.

76. The best answer is **b.** If the shares to be sold are going to be borrowed for delivery on settlement, this is a "short" sale. Short-exempt is now used for short sales of stocks that are subject to the "circuit breaker" provisions of Rule 201 of Regulation SHO. If a stock falls by 10% from its previous close, short sales for the remainder of that day and the entire next day must be done at a price higher than the national best bid. Such an order to short a stock that is subject to the circuit breaker is now marked "short exempt."

77. The best answer is **d.** NASDAQ MarketWatch has the authority to declare an inter-dealer trade null and void; or can adjust the terms of the trade, given that the trade is clearly erroneous. It can do so on its own motion or at the request of either the buyer or the seller.

78. The best answer is **d.** Rule 611 of Regulation NMS (National Market System) prohibits an exchange from "trading through" the better priced quote of another exchange. Thus, all exchanges must be linked so that the trade execution will always occur at the NBBO. If another market is posting a better priced quote, the exchange that receives the order must fill the order at the better price, or must route the order to that market for a fill. Regulation NMS applies to NYSE, AMEX, and NASDAQ listed issues. These are all markets that can electronically update and access quotes for trade execution within 1 second of order receipt. The rule does not apply to OTCBB or Pink Sheet issues, where trades are still done manually.

79. The best answer is **a.** Peg orders dynamically track the inside market - their price movements are "pegged" to the movements of the NBBO. A "primary peg" order is tied to the same side of the NBBO - National Best Bid and Offer (inside market). Thus, a primary peg order to buy is tied to the inside bid. A primary peg order to sell is tied to the inside ask.

80. The best answer is **c.** Unlike trade reports, where generally the executing party reports the trade, OATS (Order Audit Trail System) reports are made by both the buyer and the seller.

81. The best answer is **d.** This customer placed a market order to buy the stock. The best offer at that moment is $11.00, yet the order was filled by Market Venue "A" at its offer of $11.25. This is a violation known as a "trade through" because Market Venue "A" is required by Regulation NMS to either match the best price of the other market ($11.00) or route the order to the other "better-priced" market for execution within 1 second. "Selling away" is the violation that occurs if a representative sells a customer a security that is being offered by another firm (the security is not being offered by the representative's firm). The representative is "selling away" from his or her firm. "Trade shredding" is the illegal practice of breaking up a large single trade into a bunch of smaller trades in order to increase "payment for order flow" received when that firm routes the orders to a "preferenced" executing broker with whom the firm has a "payment for order flow" agreement.

82. The best answer is **c**. Marking the Open is trading at the open, or falsely reporting trades at the open, just to affect the stock's opening price. FINRA has disciplined program traders for "marking the open" violations. These firms attempt to arbitrage the difference between an index option's value (which can be based on market open, depending on the index option) against the actual prices of the securities that are included in the index. The illegal practice was placing sequential orders at the open for the securities in the index to either move their price up (or down), so that the index arbitrage position would show a profit.

83. The best answer is **b.** In this situation, a member firm is "giving up" the name of its clearing broker to the market maker from which it is buying securities. In essence, the member firm has hired another firm to settle and clear all transactions on its behalf. This is a "give-up" clearing agreement. A prime brokerage account is one where a customer, generally an institution, selects one broker (the prime broker) to provide custody and financing of securities purchased, and other brokers (executing brokers) to buy and sell on behalf of the customer. Unlike a prime brokerage account which involves a customer, a give-up clearing arrangement is between two members.

84. The best answer is **d.** 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.

Only market and limit order executions (including marketable limit orders and IOC - Immediate or Cancel - limit orders) are included in the reports (an IOC order is one that is filled in part or in full in one attempt, with any unfilled portion canceled). Fill or kill orders (fill it all in one attempt or the entire order is canceled) are no longer accepted by any exchange. Special handling orders such as market-not held and average price orders are also excluded. Reports are only compiled for each stock exchange and NASDAQ (but not for the options exchanges, which differs from the options exchanges' inclusion in Rule 606). Also note that OTCBB and Pink Sheet security executions are excluded from these reports.

85. The best answer is **d.** Rule 611 requires that marketable orders in NMS securities (NYSE, AMEX and NASDAQ) be executed within 1 second of execution at the best price or be routed to the better-priced market for execution. Exempted from the rule are "Benchmark" orders, which are VWAP orders. These are filled after the market close at the volume weighted average price, so the rule does not apply. The rule also does not apply to ISOs - Intermarket Sweep Orders. ISOs place the responsibility to get the best price on the firm placing the order - such orders are sent to multiple markets to sweep their books. The rule does not apply to "stopped orders" which guarantee a minimum price to sell or maximum price to buy for a block trade (at least 10,000 shares or $200,000). There is no exemption from the rule for minimum quantity orders.

86. The best answer is **c.** A customer is considered to be long stock to the extent of his **net long** position. In the first choice, the customer is long 200 shares and short 100 shares (short 100 shares "against the box"), for a net long position of 100 shares. A customer is considered to be long if he owns options or warrants and **has exercised**. Choice II is not considered a long stock position since the call has not been exercised, while Choice IV is a long position because the warrants have been exercised. A customer is considered to be long stock if the customer owns a convertible security and gives irrevocable instructions to convert (Choice III).

87. The best answer is **d.** "Trading ahead of research" is prohibited. A member firm cannot alter its inventory position in anticipation of a research report that it is about to release. FINRA strongly suggests, but does not require, that member firms maintain a Chinese Wall between the firm's research department and trading desk.

88. The best answer is **c.** The rate of change in price of an option premium as compared to the change in price of the underlying asset is called "delta." Delta has a value anywhere between 0 and 1. A deep out the money option will have a delta of "0" - its price does not move as the underlying asset's price moves because, essentially, the option is worthless. An in the money option has a delta of "1" - for every $1 move in price of the underlying asset, the option premium also moves in lockstep by the same $1.

89. The best answer is **b.** A registered representative buying call options in advance of placing a large buy order for a customer is "front running" the trade, hoping to make a profit from a rise in the stock's price due to the influence of the large purchase. This is an illegal activity.

90. The best answer is **a.** To take a second job, each SRO requires that the individual obtain the written permission of his employer. No other approvals are needed.

91. The best answer is **c.** Generally speaking, all records related to advertising, including speaking engagements, must be maintained for 3 years.

92. The best answer is **b.** Choice **b** defines a repurchase agreement, which is permitted. Prohibited activities are guaranteeing a customer account against loss; making blanket recommendations of low price speculative stocks; and selling dividends to customers.

93. The best answer is **d.** Arbitration panels consist of individuals affiliated with member firms and representatives from the general public. Attorneys are also permitted on arbitration panels (a nice source of income for attorneys who are retired).

94. The best answer is **d.** Rule 201 of Regulation SHO requires that if an NMS stock (NYSE, AMEX or NASDAQ) falls by 10%, it can only be sold short on an "up bid" for the remainder of that trading day and the entire next trading day. The intent is to stop short sellers from relentlessly driving the price of a security down.

95. The best answer is **c.** Fines assessed for insider trading convictions are paid to the Department of Treasury. The fines are not paid to the SEC. If they were, then the SEC might be tempted to "go crazy" prosecuting insider trading cases to pump up its operating budget (raises for everyone!). The amount to be paid is 3 times (treble damages) the profit achieved or loss avoided.

96. The best answer is **b.** Front running a customer order that is likely to have a market impact is a prohibited practice. This officer is selling 4% of the outstanding shares, which is likely to depress the price of the stock. Prior to placing the order, the representative cannot personally take a position in that stock to profit from the likely market decline - thus, the representative cannot sell that stock short, cannot buy put options on the stock, and cannot sell call options on the stock. There is no reason why the representative cannot buy that stock for his or her personal account - since this is profitable if the stock rises, and will result in a loss if the stock falls.

97. The best answer is **a.** Orders placed below the market are adjusted on the specialists book for distributions on ex-date. The orders below the market are OBLOSS - Open Buy Limits Open Sell Stops. This is an open sell stop order. The dividend amount of $.55 is subtracted from the $70 order price, for an adjusted order price of $70 - $.55 = $69.45.

98. The best answer is **c.** ADR holders receive dividends but do not have voting or pre-emptive rights. The bank holding the shares passes through dividends to the receipt holders; the bank votes the shares and sells off any preemptive rights, distributing the monies to shareholders. ADRs are the means by which foreign securities are traded in the U.S.

99. The best answer is **a.** This is an error in execution, and the firm is obligated to execute the order properly. The customer placed an order to buy at $50 per share, meaning $50 or lower. Since the stock is trading at $48 when the error is discovered, the customer must be offered this price.

100. The best answer is **c.** If a trade is reported to a customer in error, the firm must correct the trade report. It has no obligation to give the customer the trade because it never occurred.

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