Series 56 Supplemental Questions

1.
The margin requirement to purchase a penny stock is:

a. 25%
b. 30%
c. 50%
d. 100%

2.
The CBOE will institute an individual stock trading pause due to extraordinary market volatility if an NMS stock included in the S & P 500 Index falls by:

a. 5% or more within five minutes
b. 10% or more within five minutes
c. 5% or more during the trading day
d. 10% or more during the trading day

3.
Which foreign currency option is NOT quoted in cents?

a. Japanese Yen
b. Euro
c. British Pound
d. Swiss Franc

4.
The CBOE can institute an individual stock trading pause due to extraordinary market volatility during the hours of:

a. 9:30 AM - 4:00 PM ET
b. 9:45 AM - 4:00 PM ET
c. 9:30 AM - 3:35 PM ET
d. 9:45 AM - 3:35 PM ET

5.
Treasury stock has:

a. voting rights
b. dividend rights
c. pre-emptive rights
d. no rights

6.
SingleBook shows the following quotes at the Inside Ask in time entry sequence:

MM I	**100 Displayed Size / 400 Undisplayed**
MM II	**200 Displayed Size / 300 Undisplayed**
MM III	**500 Displayed Size / 0 Undisplayed Size**

A market order to Buy 500 shares would be filled against:

a. MM III's displayed size of 500 shares
b. MM I's displayed size of 100 shares and undisplayed size of 400 shares
c. MM I's displayed size of 100 shares; MM II's displayed size of 200 shares and finally 200 shares against MM III's displayed size of 500 shares
d. MM I, MM II and MM III pro-rata for 133.33 shares each

7.
Who has ultimate responsibility for, and authority over, a member firm's written supervisory procedures?

a. OPRA
b. Proprietary Trader
c. Principal Officer
d. Customer

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8.
A broker-dealer receives 2 large institutional customer orders, one to buy $500,000 of ABCD stock and one to sell $500,000 of ABCD stock. The broker-dealer operates a dark pool and routes the orders there for execution, without sending the orders to a public market. The orders are electronically matched in the dark pool. This action is:

a. illegal
b. legal and no reporting of the resulting trade is required
c. legal as long as the resulting trade is reported to the TRF within the required time frame
d. legal as long as the resulting trade is reported to the TRF by the end of that trading day

9.
A stock is traded OTC during regular market hours. The trade must be reported within:

a. 15 seconds
b. 30 seconds
c. 60 seconds
d. 90 seconds

10.
A trading firm does not have sufficient capital to be self-clearing. It uses other firms to execute its trades and another firm to legally clear these trades. This is an example of a:

a. give up
b. step out
c. back away
d. trade through

11.
A trader on the CBOE floor has been asked by CNBC to give an "on the record" interview during the trading day. Which statement is **TRUE**?

a. The trader is prohibited from giving the interview
b. The trader can give the interview without restriction
c. The trader can only give the interview after the market close
d. The trader can only give the interview if he or she follows CBOE rules regarding public appearances

12.
Which of the following would be a Manning violation?

a. A customer order is received to buy 100 shares of ABC at $30; 40 seconds later, the member firm buys 100 shares of ABC for its proprietary account at $31
b. A member firm buys 100 shares of ABC for its proprietary account at $30; 40 seconds later, the member firm receives a market order from a customer to buy 100 shares of ABC, which is immediately filled at $29
c. A customer order is received to buy 100 shares of ABC at $30; the member firm immediately buys 100 shares of ABC at $29 in the market and fills the customer order at $30
d. A customer order is received to buy 100 shares of ABC at $30; the member firm immediately buys 100 shares of ABC at $31 in the market and does not fill the customer order

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13.
Which of the following is **NOT** an exemption from options position limits?

a. Delta Hedging
b. Firm Facilitation
c. Equity Hedge
d. Dividend Capture

14.
The typical par value for preferred stock is:

a. $10
b. $50
c. $100
d. $1,000

15.
What is the principal advantage of trading listed derivatives as compared to trading OTC derivatives?

a. No counter-party risk
b. Assurance of a secondary market
c. Multiple market makers
d. Contract standardization

16.
Under Regulation SHO, a stock will be put on the threshold list if it has a large clearing short position at NSCC for:

a. 1 business day
b. 5 business days
c. 10 business days
d. 15 business days

17.
Exercise settlement of PM Index options is based on the:

a. reported level of the index derived from the opening prices of the component securities on the day of exercise
b. reported level of the index derived from the last reported prices of the component securities at the close of market hours on the day of exercise
c. reported level of the index derived from the opening prices of the component securities on the business day after exercise
d. reported level of the index derived from the last reported prices of the component securities at the close of market hours on the business day after exercise

18.
All of the following statements are **TRUE** about a "Fast" market **EXCEPT**:

a. the price and size of disseminated quotes may be inaccurate
b. electronic orders may be denied access to the market
c. Order Book Officials at other posts may be assigned trading in the option classes or series
d. Trading Floor Officials may step in to facilitate trading

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19.
Which is an example of an exchange declaring a "self-help" exemption?

a. Exchange A's quote system is down so it declares "self-help" and routes its incoming executable orders to Exchange B to be filled
b. Exchange A routes its executable orders to the better-priced quotes of Exchange B, where the orders are filled and declared as "self- help" orders
c. Exchange A routes its executable orders to the better-priced quotes of Exchange B and gets no response, so Exchange A declares self-help against Exchange B and fills the orders
d. Exchange A routes its executable orders to the better-priced quotes of Exchange B; Exchange B does not wish to fill at its quote, so it declares "self-help" and re-routes the order back to Exchange A for a fill

20.
All of the following changes must be reported on Form U-4 by a registrant **EXCEPT**:

a. change of residence
b. change of marital status
c. change of name
d. change of employer

21.
Today is the Record Date for a cash dividend distribution declared by ABC Corporation. A customer that wishes to buy the stock and receive the cash dividend:

a. can no longer do so
b. can do so if the trade is performed "cash settlement"
c. can do so if the trade is performed "regular way settlement"
d. can do so if the trade is performed "seller's option settlement"

22.
A proprietary trader that is long a listed option contract wishes to exercise. The exercise notice is given to:

a. the clearing firm
b. the OCC
c. OPRA
d. the contra-party

23.
The threshold list is assembled daily by the:

a. Exchange
b. Member firm
c. OCC
d. OPRA

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24.
An NMS stock included in the Standard and Poor's 500 Index drops by 10% in its principal market over a 3 minute time window. Which statement is **TRUE**?

a. Trading in that stock and related options is unaffected
b. Trading in that stock and related options will be paused for 3 minutes
c. Trading in that stock and related options will be paused for 5 minutes
d. Trading in that stock and related options will be halted for the remainder of that day and the entire next day

25.
Under the provisions of Regulation SHO, prior to selling a stock short, which is required?

a. Ascertaining the location of the shares to be borrowed and documenting this
b. Determining if the last trade occurred on an up bid, allowing that security to be sold short
c. Checking to see if that security is included on the threshold list
d. Depositing the required margin as stipulated under Regulation T

26.
Required information to be recorded on order tickets is set by the:

a. exchange
b. SEC
c. member firm
d. clearing corporation

27.
OPRA has the authority to do all of the following **EXCEPT**:

a. publish consolidated options quotes
b. report options trades to a consolidated tape
c. aggregate options trading volumes
d. break clearly erroneous options trades

28.
A clearly erroneous trade in an option listed on the CBOE must be reported within:

a. 15 minutes
b. 30 minutes
c. 45 minutes
d. 60 minutes

29.
A clearly erroneous trade in an equity security listed on NASDAQ must be reported within:

a. 15 minutes
b. 30 minutes
c. 45 minutes
d. 60 minutes

30.
The legislation that covers the trading of securities in the secondary market is the:

a. Securities Act of 1933
b. Securities Exchange Act of 1934
c. Investment Company Act of 1940
d. Securities Investor Protection Act of 1970

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31.
Supervisors are obligated to review and endorse blotters:

a. daily
b. at the end of each week
c. at the end of each month
d. at the end of each calendar quarter

32.
A registered proprietary trader receives a notice from CRD to complete his Regulatory Element CE requirement during the next 120 days. If the CE is not completed within this time window, this individual:

a. can continue to trade and can be paid any profits on those trades by the clearing firm
b. cannot trade
c. can continue to trade but cannot be paid any profits on those trades by the clearing firm
d. will be expelled from association with the member firm

33.
A member firm has a displayed quote for ABCD of:

15.25 - 15.50
6 x 10

The member receives a customer order to sell 500 shares of ABCD at $15.40 AON. The member firm is:

a. required to update its quote to 15.40 - 15.50 (5 x 10)
b. required to update its quote to 15.25 - 15.40 (6 x 5)
c. required to update its quote to 15.50 - 15.40 (10 x 5)
d. not required to update its quote

34.
Which of the following is **NOT** a violation of Regulation FD?

a. A public company gets a large government contract and tells a research analyst about the news before it is released to the public. The research analyst publishes a report recommending the stock.
b. A research analyst writes a report about a public company stating that she believes that the company is a takeover target and that if this occurs, the price will double
c. The CEO of a public company gives earnings guidance to a research analyst in advance of the release of that company's quarterly earnings report. The research analyst publishes a report recommending the stock
d. At a meeting with 10 other research analysts, the divisional president of a company complains that his division is going to be spun-off in a corporate reorganization due to poor operating performance. Based on this, the analysts publish sell recommendations on the stock

35.
An associated person has been taken to arbitration to settle a customer dispute. The associated person loses and is ordered to pay the customer $75,000. Which statement is **TRUE**?

a. The associated person may appeal the decision to the District Hearing Panel
b. If the award is not paid within 30 days, that individual will be suspended
c. The associated person may bring the matter to a court of competent jurisdiction
d. A lien will be placed on the bank account of the associated person until the fine is paid

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36.
Cumulative voting is considered to be an advantage for the:

a. small investor
b. large investor
c. institutional investor
d. infrequent investor

37.
Which statement is **NOT TRUE** about Intermarket Sweep Orders (ISOs)?

a. ISO orders are mainly used by institutions
b. ISO orders are placed as limit orders
c. ISO orders are subject Rule 611 (trade through rule)
d. ISO orders are required to be noted as such on the order ticket(s)

38.
An individual buys a security for himself and then sells that security, with the intent of showing trading activity in the stock. This is an example of:

a. a wash trade
b. a straddle
c. painting the tape
d. insider trading

39.
Why would an investor trade OTC in the "upstairs market" as opposed to trading on the floor of an exchange?

a. Lower margin requirements
b. Price protection
c. Better handling of a large investment
d. Faster execution time

40.
Every day, a proprietary trader enters several orders to buy a specific stock 2 minutes before market close. This is an illegal practice known as:

a. trading ahead
b. trading away
c. marking the market
d. marking the close

41.
A market shows the following quotes:

	Bid	**Ask**
MM I	**15.25**	**15.75**
MM II	**15.50**	**15.90**
MM III	**15.75**	**15.80**

Which statement is **TRUE**?

a. This is a locked market
b. This is a crossed market
c. This is a controlled market
d. This is a dominated market

42.
A customer that is short a call on ABC stock is exercised. The customer is obligated to:

a. deliver cash
b. deliver stock
c. take delivery of cash
d. take delivery of stock

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43.
A customer is long 1 ABC Jan 110 Call. The company declares and pays a 10% stock dividend. As of the ex-date for the dividend, the customer will have:

a. 1 ABC Jan 100 Call
b. 1 ABC Jan 110 Call
c. 1 ABC Jan 121 Call
d. 1.1 ABC Jan 110 Calls

44.
A market shows the following quotes:

	Bid	**Ask**
MM I	**15.25**	**15.75**
MM II	**15.95**	**16.05**
MM III	**15.75**	**15.80**

Which statement is **TRUE**?

a. This is a locked market
b. This is a crossed market
c. This is a controlled market
d. This is a dominated market

45.
A customer is:

Long 1 ABC Jan 50 Call
Long 1 ABC Jan 50 Put

This position is a:

a. spread
b. straddle
c. strangle
d. collar

46.
Information barriers are required between specified departments in a broker-dealer as a defense against:

a. trading ahead
b. front running
c. marking the close
d. trading away

47.
Regular way settlement of stock trades takes place on:

a. T
b. T + 1
c. T + 2
d. T + 3

48.
Regular way settlement of options trades takes place on:

a. T
b. T + 1
c. T + 2
d. T + 3

49.
The transfer agent is responsible for all of the following **EXCEPT**:

a. Issuing and canceling certificates to reflect changes of ownership
b. Acting as the paying agent for the company
c. Replacing lost, stolen or destroyed certificates
d. Refunding transfer fees paid by the seller to the buyer of the shares

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50.
A clearing firm receives an options assignment from the OCC. It would not be allowed to assign the notice to a customer using:

a. FIFO selection
b. LIFO selection
c. random selection
d. a fair and reasonable selection method

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Series 56 Supplemental Explanations

1. The best answer is **D**. Penny stocks are not marginable. They must be purchased with a deposit equal to 100% of the purchase amount. The only marginable stocks are listed securities (NYSE, AMEX or NASDAQ).

2. The best answer is **B**. The CBOE has a specific rule to address the issues created by the "flash crash" of May 2010. If any single stock rises or falls by 10% or more within a 5 minute window of time in its primary market, the exchange will stop trading of that stock for 5 minutes; and the CBOE will stop trading of related options as well. When the stock reopens for trading, the CBOE will reopen that stock using an opening rotation before general trading will resume.

3. The best answer is **A**. As a general rule, foreign currency options are quoted in cents. However, the Japanese Yen option is quoted in 1/100ths of a cent (because there are about 100 Yen to a U.S. Dollar, while the other foreign currencies used as the basis for PHLX options have a ratio of between .5 to 1.5 to a U.S. dollar).

4. The best answer is **D**. The CBOE has a specific rule to address the issues created by the "flash crash" of May 2010. If any single stock rises or falls by 10% or more within a 5 minute window of time in its primary market, the exchange will stop trading of that stock for 5 minutes; and the CBOE will stop trading of related options as well. It will do this only between the hours of 9:45 AM - 3:35 PM ET. Note that the rule is not applied to market opening or market closing, where trading may normally be a bit volatile. It is only applied to extreme volatility that occurs intra-day.

5. The best answer is **D**. Treasury stock represents common shares of a company that were issued and then subsequently repurchased by the company. These shares are, in essence, retired. They have no dividend rights, voting rights, pre-emptive rights or rights to company assets in a dissolution. Thus, the best answer is that they have no rights. Companies repurchase shares for their Treasury to reduce the number of common shares outstanding. This increases reported Earnings Per Share and thus, tends to increase the stock's market price.

6. The best answer is **C**. When a market maker enters a "hidden" undisplayed quote, any orders that are received are first applied against all displayed quotes from all market makers at that price. Once all displayed quotes have been decremented to "0," then the "hidden" quotes become "live" and will now be displayed and orders are applied against these.

7. The best answer is **C**. A designated principal, who is an officer of the member firm, is the person responsible for creating and enforcing that firm's written supervisory procedures.

8. The best answer is **C**. So-called "dark pools" are permitted by the SEC and are operated by broker-dealers and exchanges. These allow market participants to bid and offer shares without showing these orders - thus, these orders represent "hidden liquidity." Dark pools are attractive to large institutional traders, since their large orders can "move the market" if they are displayed. Furthermore, if such a large order were sent to a public market where it would be displayed, it could move the market and the institution could get an inferior fill. The SEC recognizes this, and exempts institutional orders (typically $200,000 or more) from Regulation NMS quote display requirements. These institutional orders are also

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exempted from the trade-through rule of Regulation NMS - the idea being that the institution is "sophisticated" enough to protect itself from an inferior execution. However, when such a trade is executed, it must still be reported to the tape within the required time frame (30 seconds during regular market hours) as an OTC trade.

9. The best answer is **B**. Equity trades effected OTC are reported by the executing party within 30 seconds of execution. This applies to any trades that occur between 8:00 AM - 8:00 PM ET. (Note, in contrast, that the CBOE trade reporting rule for trades on the floor is that the sell side reports within 90 seconds).

10. The best answer is **A**. This question is not very clear, but it is getting at a "give-up" clearing agreement. A broker-dealer that does not have a large capital base can go into business by signing a clearing agreement with a clearing firm. For example, Pershing clears for about 1,000 smaller broker-dealers; National Financial clears for about 500 broker-dealers. The standard clearing agreement requires that all trades of that broker be cleared and settled through the clearing firm. A variation on that clearing agreement is a "give up" clearing agreement, where the introducing broker can use other executing broker-dealer to do its trades, and the names of these executing brokers are "given up" to the clearing firm - which agrees to clear and settle these trades. A "step out" is an "after the fact" reassignment of a trade to another broker for commission credit. Backing away is a prohibited trading practice where a trader gives a firm quote and fails to honor it. A "trade through" is a failure to execute a trade at the best price of all markets, so that execution "traded through" another market's better priced quote.

11. The best answer is **D**. An unscripted interview is defined under the communications rules as a "public appearance." Public appearances are permitted, but must comply with the member firm's policies and procedures. Furthermore, since these are communications that are not accompanied or preceded by delivery of the ODD (Options Disclosure Document), they cannot include specific recommendations and cannot show past or projected performance (only communications where the recipient has already received the ODD can make recommendations or show performance).

12. The best answer is **C**. The "Manning Rule" is the limit order protection rule. It states that member firms cannot "front run" customer limit orders. In Choice C, the customer limit order to buy was placed at $30. The member firm immediately buys the stock at $29 and then sells it to the customer at $30. This is a Manning violation - the member firm should have bought the stock directly at $29 for the customer. There is no Manning violation in Choice A because the member firm bought the stock for its own account at $31 and the customer does not want to pay more than $30. Choice B is not a Manning violation because the member firm bought the stock for its own account at $29 before it received the customer buy order at $30. Finally, Choice D is not a Manning violation because the customer does not want to pay more than $30 for the stock.

13. The best answer is **D**. Options positions limits are intended for speculative positions. Options positions that are hedged or covered by an offsetting security position (e.g., long stock / short call) are exempted; as are delta hedges (hedges designed to offset options price volatility). In addition, market makers are given an exemption so that they can provide sufficient depth to the market; and member firms may get an exemption for proprietary options accounts that are being used to fill customer orders (called a firm facilitation exemption). Note that there is no exemption for dividend capture positions.

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14. The best answer is **<u>C</u>**. The usual par value for preferred stock is $100. In contrast, the typical par value for bonds is $1,000. For both of these, the dividend or interest payments made are expressed as a percentage of par value.

15. The best answer is **<u>A</u>**. There are a number of advantages to trading listed derivatives as compared to trading OTC derivatives. The main advantage is that the OCC clears all listed option contract trades and guarantees performance on listed option contracts. Thus, there is no counter-party risk and each side of the contract is free to trade out its position because of this. This is not the case with OTC contracts, which are custom contracts negotiated between a specific buyer and seller. There is no "assurance" of a secondary market for listed options, making Choice B incorrect. There are usually multiple market makers for listed options, but this is not necessarily so, making Choice C incorrect. Finally, contract standardization makes listed options easier to trade, but is not an advantage, in and of itself, as compared to OTC options.

16. The best answer is **<u>B</u>**. Regulation SHO requires the exchanges to create a daily list of securities that are "Hard To Borrow." These are known as the "threshold" securities. A "threshold list security" is one which has a clearing short position at NSCC (National Securities Clearing Corporation division of DTCC) of 10,000 shares or more; and this clearing short position represents at least 1/2% of the total shares outstanding. To be on the list, the security must meet these tests for 5 business days. Basically, a threshold list 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.

17. The best answer is **<u>B</u>**. Most American Style options are "PM" settled if they are exercised. This means that whenever an exercise occurs during a trading day, the actual settlement value is determined based on the closing index value that day. In contrast, European style options, if exercised (which can only happen at expiration, not before) are "AM" settled. This means that they can be exercised at expiration and the actual settlement value is calculated using the opening prices the following business day.

18. The best answer is **<u>D</u>**. Floor Officials oversee options trading to insure that it is fair and orderly, but do not trade themselves. In a "Fast" market, as declared by 2 Floor Officials:

- the affected contracts can be assigned to OBOs at other trading posts to handle the increased trading volume;
- OBO clerks can be authorized to execute trades to handle the increased volume;
- trading rotations can be instituted;
- the firm quote requirement can be suspended (therefore, quotes may be inaccurate);
- RAES may be turned off (the automated options trading system); and
- any other necessary actions may be taken.

19. The best answer is **<u>C</u>**. Rule 611 of Regulation NMS (the "trade through rule") requires that if a market receives an executable order, it must fill it within 1 second at the best price available in all markets, otherwise it must route out the order to the better-priced market for a fill. If an order is routed out by Exchange A in this manner to Exchange B, it is expected that Exchange B will fill the order in 1 second. If Exchange B fails to respond to the receipt of the order, Rule 611 allows Exchange A to declare a "self-help" exemption from the rule. Because Exchange B is not responding to the order,

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Exchange A may retake possession of the order and fill it at its best price, declaring that it is using the "self-help" exemption because Exchange B is experiencing technical problems. It must also notify Exchange B that this is occurring.

20. The best answer is **B**. The U-4 Form is the uniform securities industry application used for registered representatives and principals. The form asks basic identifying information, employment history, residence history, and includes a detailed questionnaire seeking to determine if that individual will be subject to statutory disqualification (e.g., have you ever been arrested?). Any changes in the information must be reported as an amendment to the U-4 "promptly." Thus, a change of residence address or employer requires an amendment, as does a change of name. There is no amendment for a change of marital status, unless it changes your name.

21. The best answer is **B**. The Record Date is the day that the shareholder list is taken to be sent the dividend. To be on record, a buyer of the stock must settle by the close of business on the Record Date. Since a Regular Way stock trade settles in 3 business days, such a trade would settle after the Record Date and the buyer would not get the dividend. If the buyer settled the trade "for cash," then the trade settles that day and the buyer would be on the record list that evening. A seller's option settlement takes place any time after Regular Way, at the seller's option. Such a settlement would occur after the Record Date and would not allow the stock buyer to capture the cash dividend.

22. The best answer is **A**. The OCC only accepts exercise notices from member firms. A customer or proprietary trader that wishes to exercise does not notify the OCC directly - it won't respond! The customer or proprietary trader must notify the clearing member firm, who, in turn notifies the OCC, who in turn, will assign the exercise notice to a writer of that contract.

23. The best answer is **A**. Regulation SHO requires the exchanges to create a daily list of securities that are "Hard To Borrow." These are known as the "threshold" securities. A "threshold list security" is one which has a clearing short position at NSCC (National Securities Clearing Corporation division of DTCC) of 10,000 shares or more; and this clearing short position represents at least 1/2% of the total shares outstanding. To be on the list, the security must meet these tests for 5 business days. Basically, a threshold list 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.

24. The best answer is **C**. The CBOE has a specific rule to address the issues created by the "flash crash" of May 2010. If any single stock rises or falls by 10% or more within a 5 minute window of time in its primary market, the exchange will stop trading of that stock for 5 minutes; and the CBOE will stop trading of related options as well. The actual calculation of the percentage move that will trigger the pause is based upon the last reported traded trade as compared to any trade the occurred during the preceding 5 minutes, so, in reality, the pause will be triggered by a 10% drop that occurs within 5 minutes or less.

25. The best answer is **A**. Prior to selling a security short, Regulation SHO requires that the member firm determine the location of the securities to be borrowed and that they can be delivered by settlement. This must be documented. The intent is to stop "naked short selling" - the sale of shares that cannot be borrowed for delivery. The up bid requirement for a short sale is only applied to a stock that has dropped by 10% in price - then it can only be sold short on an up bid for the remainder of that day and the entire

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next day. The threshold list of hard to borrow securities is used to determine which securities will be subject to mandatory buy-in if a fail occurs. Margin deposits for short sales are required to be collected "promptly" but no later than settlement. There is no requirement to collect margin deposits in advance of the trade.

26. The best answer is **B**. This one is a little vague. Both the SEC and the SROs (CBOE, FINRA, etc.) set the requirements for what must be recorded on order tickets. However, the SEC sets forth its requirements under Rule 17a-3. Exchanges must meet these minimums and then can add additional information as needed.

27. The best answer is **D**. OPRA stands for Options Price Reporting Authority. Its members are all of the options markets. OPRA publishes consolidated bid and ask quotes for options, reports last sale information and reports trading volume. It has nothing to do with the process for resolving clearly erroneous trades.

28. The best answer is **A**. The CBOE rule for resolution of "clearly erroneous trades" requires that the trade be reported to a Trading Official within 15 minutes of execution. The Trading Official must review the circumstances of the trade and make a determination within 60 minutes. If either party disagrees with the determination, an appeal can be made to the Obvious Error Panel within 30 minutes. The Obvious Error Panel reviews the complaint and makes a final determination by the end of that trading day. Also note that the NASDAQ rule for reporting clearly erroneous trades is quite different.

29. The best answer is **B**. Should a member want to have an equity trade cleared through ACT (Automated Confirmation of Trade system) nullified or adjusted based on an obvious error in number of shares or price, the member must notify NASDAQ MarketWatch and provide the relevant details within 30 minutes of execution. The member filing the complaint must provide NASDAQ MarketWatch with the relevant details of the trade, including the name of the contra-broker and the executing NASDAQ system. In turn, NASDAQ will notify the contra-broker, giving it 30 minutes to provide details on its record of the trade. After review of all information, NASDAQ makes a written determination and communicates its decision to both parties - either nullifying the trade, adjusting the trade, or declining to act - that is, confirming 1 side's view of the trade. Note that these time frames are different than the CBOE's rules for reporting obvious errors that occur in options trades.

30. The best answer is **B**. The Securities Exchange Act of 1934 regulates the trading market - the secondary market. In contrast, the Securities Act of 1933 regulates the primary (new issue) market.

31. The best answer is **A**. Blotters are daily transaction records. These include the purchase and sales record (trade blotter); cash receipts and disbursements blotter; and the securities receive and deliver blotter. These must be reviewed at the end of each day by a principal, and this review must be documented with a signature.

32. The best answer is **B**. Regulatory Element CE (Continuing Education) must be completed on an individual's 2nd anniversary of registration and every 3 years thereafter. If that individual fails to complete Regulatory Element CE, his or her registration is suspended. He or she can no longer trade and cannot be paid based on any future work. Once the Regulatory Element CE has been completed, that individual may now trade and pay can resume.

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33. The best answer is **D**. The Limit Order Display Rule requires that if a member firm receives a customer limit order that is better priced than its quote, it must display that order in lieu of its inferior quote. In this case, it would mean that the customer order to sell 500 shares at $15.40 would replace the dealer's ask of $15.50 for 1000 shares. However, the rule does not apply to AON (All or None) customer limit orders, so no updating is required!

34. The best answer is **B**. Regulation FD stands for "fair disclosure." It applies the insider trading rules to company officials that disclose non-public information (they are "tippers") to selected groups of individuals (they were targeting research analysts in the rule who could use the information to recommend trades in advance of the public release of the information). The research analysts become "tippees" if they recommend trades based on this non-public information. In Choices A, C and D, the non-public information was received from the company directly, so Regulation FD applies. In Choice B, the analyst is actually basing the recommendation on independent research.

35. The best answer is **B**. Arbitration awards are binding and non-appealable. If the award is not paid within 30 days, the person or member firm ordered to pay the money will be suspended.

36. The best answer is **A**. Cumulative voting is considered to be an advantage for the small investor, because that investor can accumulate all of his or her votes in a Board of Directors' election and apply them to one, or just a favored few, directors that are up for election. This gives the small investor a potentially disproportionate voting weight.

37. The best answer is **C**. An ISO (Intermarket Sweep Order) is a large institutional limit order that is broken apart and routed by the institution to multiple market venues in an attempt to "sweep" the top of each market's display book at the same time to get a fill at the best price. Such an order places the "best execution" requirement in the hands of the institution, not the executing market. ISOs are exempt from the trade-through rule (Rule 611 of Regulation NMS), because of this. ISO orders must be noted as such at order entry, so the regulators and the marketplace know that they have no obligation to re-route the order to the best market, if that market is not posting the best price.

38. The best answer is **A**. If an individual buys a stock; sells it; buys it; sells it; etc., these are "wash trades" that are intended to give the appearance of trading activity because the trades are reported to the tape. However, these trade reports are bogus because there is no ownership change. Painting the tape is similar, but here a group of investors form a trading pool, trading a stock among themselves, either at successively higher or lower prices to manipulate the market. They give the illusion that the price of the stock is moving rapidly up (or down), since the tape is "painted "with these trades. This lures in real investors to buy into the illusory rising market (at which point the pool sells its pre-established long position to them at higher prices); or scares real investors into panic selling in this illusory falling market (at which point, the pool buys back its pre-established short position at lower prices).

39. The best answer is **C**. The "upstairs market" is typically used by institutions for large size orders, where sending the order to the floor of an exchange would be disruptive to the normal order flow and could result in an inferior execution (meaning a bad price). One could argue that price protection is also a valid answer, but prices can move away as a large order is being filled in any market. Finally, there is no difference in margin requirements if a purchase is done OTC in the upstairs market or on an exchange.

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40. The best answer is **D**. Marking the close is the attempt to either raise or lower the closing price of a security. A trader would typically try to do this to create a false profit in his trading account, which gives him more margin availability to trade; or to reduce a loss in his trading account in an attempt to minimize or reduce a margin call.

41. The best answer is **A**. The inside (high) bid is $15.75 and the inside (low) ask is $15.75, thus, the inside market is $15.75 - $15.75. This is an example of a locked market.

42. The best answer is **B**. A short call position on a stock obligates the customer to deliver 100 shares of that stock at the strike price, if exercised.

43. The best answer is **B**. Listed options contracts are only adjusted for 2:1 and 4:1 stock splits. For any fractional splits and stock dividends, there is no adjustment to the contract. Only if there is an exercise, then the "deliverable" is adjusted. If this contract where exercised, the customer would buy 110 shares (100 contract size x 1.1) at $100 each (110 strike / 1.1).

44. The best answer is **B**. The inside (high) bid is $15.95 and the inside (low) ask is $15.75, thus, the inside market is $15.95 - $15.75. This is an example of a crossed market.

45. The best answer is **B**. A long straddle is the purchase of a call and the purchase of a put on the same stock with the same strike price and expiration. A short straddle is the sale of a call and the sale of a put on the same stock with the same strike price and expiration. A spread is the purchase and sale of a call; or the purchase and sale of a put; on the same stock with different strike prices or expirations. A strangle is a straddle at different strike prices. A collar is the purchase of a lower strike put and the sale of a higher strike call against a stock position, establishing a sale price if the market should fall (with the exercise of the put) or rise (with the exercise of the call).

46. The best answer is **A**. Information barriers (Chinese Walls) are required in brokerage firms to stop the flow of inside information that traders could use. They are required between trading and research and trading and investment banking. In addition, they are required between investment banking and research, as a result of the research analyst scandal of 2000, where investment banking used research analysts as "shills" for their investment banking deals. The trading ahead prohibition applies to trading ahead of research reports that are yet to be published. Front running is the prohibited practice of using information obtained from the receipt of a large customer order that might have a market impact to trade for the firm's account in advance of placing that customer order. Marking the close is a market manipulation to either raise or lower the closing price of a stock by placing either buy (or sell) orders just prior to the close. Trading away is the prohibited practice of trading outside of one's clearing firm.

47. The best answer is **D**. Stock trades settle "regular way" 3 business days after trade date.

48. The best answer is **B**. Option trades settle "regular way" 1 business days after trade date.

49. The best answer is **D**. The transfer agent issues new certificates and cancels old certificates when there is a trade that results in an ownership change. In this capacity, the transfer agent is paid by the company, not the buyer and seller, making Choice D incorrect. The transfer agent can also act as paying agent, sending dividends to the shareholders. Again, the company pays for this. Finally, the transfer

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agent can replace lost, stolen or mutilated certificates. In this case, it is the owner of the damaged, lost, or stolen certificates that pays to have them replaced.

50. The best answer is **B**. The OCC assigns exercise notices on a random basis. The member firm, once it receives an exercise notice from the OCC, has a choice of assignment methods - random, FIFO (first in, first out), or any other method that is fair and reasonable. LIFO (last in, first out) is not such a fair and reasonable method.

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