

Chapter 5

Options

VEIN EXERCISE TAX CONSEQUENCE

* BUY CALL → BUY STOCK → COST BASIS
 BUY PUT → SELL STOCK → SALES PROCEEDS
 SELL PUT → BUY STOCK → COST BASIS
 SELL CALL → SELL STOCK → SALES PROCEEDS

BUY CALL → SELL
 BUY PUT → BUY
 SELL PUT → SELL
 SELL CALL → BUY

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Options Contract have Two Parties

Buyer <ul style="list-style-type: none"> • Holder • Owner • Long • Pays Premium • Has a right 	Seller <ul style="list-style-type: none"> • Writer • Grantor • Short • Receives Premium • Has an obligation
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Why Use Options?

1. Speculation
2. Income
3. Hedging/Protection

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ABC is the underlying stock 50 is the Strike Price Premiums are quoted in increments of \$.05 (a nickel) Quoted on a per SHARE basis

1 ABC Jan 50 Call @ 5

of contracts Call is the type of option
 1 contract = 100 shares

January is the expiration - on the 3rd Friday of the month at 11:59 PM EST

223

1 ABC Jan 50 Call @ \$5

- 1 contract, covering 100 shares
- ABC is the underlying stock
- January is the expiration - on the 3rd Friday of the month at 11:59 PM EST
- 50 is the Strike Price
- Call is the type of option (the other is a Put)
- Maximum expiration is 9 months
- Premiums are quoted in increments of \$.05 (a nickel)
- Calls are in the money when the market price is above the strike price

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1 ABC Jan 50 Put @ \$5

- 1 contract, covering 100 shares
- ABC is the underlying stock
- January is the expiration - on the 3rd Friday of the month at 11:59 PM EST
- 50 is the Strike Price
- Put is the type of option (two types calls & puts)
- Maximum expiration is 9 months
- Premiums are quoted in increments of \$.05 (a nickel)
- Puts are in the money when the market price is below the strike price

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"In the Money" and Intrinsic Value

- **Intrinsic value** = the amount the contract is "in the money"
- The premium is not a factor when determining if an option is "in the money"
- Whether the customer is the buyer or seller is not a factor for "in the money" or "out the money"
- All **calls** (buyer or seller is irrelevant) are **"in the money" when the market price is above the strike price**
- All **puts** (buyer or seller is irrelevant) are **"in the money" when the market price is below the strike price**

"In the money" does not mean "making money". It means the contract is worth exercising

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Intrinsic Value = "in the money amount"

1 ABC Jan 50 Call

- If ABC is at 55, contract is "In the Money" by \$5 and Intrinsic Value = 5
- If ABC is at 50, contract is "At the Money" and Intrinsic Value = 0
- If ABC is at 45, contract is "Out the Money" by \$5 and Intrinsic Value = 0

Anytime a call contract is at the money or out the money it has NO intrinsic value

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Intrinsic Value = "in the money amount"

1 ABC Jan 50 Put

- If ABC is at 45, contract is "In the Money" by \$5 and Intrinsic Value = 5
- If ABC is at 50, contract is "At the Money" and Intrinsic Value = 0
- If ABC is at 55, contract is "Out the Money" by \$5 and Intrinsic Value = 0

Anytime the contract is at the money or out of the money there is NO intrinsic value

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Intrinsic Value

Sell 1 ABC Jan 50 Call @ 7

ABC = 55

Intrinsic value = 5
Time Value = 2
Premium = Intrinsic Value + Time Value

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A customer sells 1 ABC ~~Oct 50~~ Call @ \$4 when the market price is \$51.50. The intrinsic value of the contract is:

ABC = 54

A. 0
B. -1.50
C. +1.50
D. +2.50 = Time Value

SIE Options 230

ABC = \$50

TRADE **EXERCISE**

1 ABC 50 Call @ \$5

-5 X 100 = (-500) + commission -5 X 100 = -500 + commission

ABC = \$60

1 ABC 50 Call @ \$10 -50 X 100 = -5,000 + commission

+10 X 100 = +1,000 + commission +60 X 100 = +6,000 + commission

+500 ROI = 100% less 2 commissions +500 ROI = 9.09% less 3 commissions

Options 231

Opening & Closing Transactions

Every options order ticket must be marked "Open" or "Close" so that the OCC (which keeps the record of the contract) knows what to do

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Opening & Closing Transactions (cont.)

How is the order ticket marked to establish a long call options contract?

- A. Opening Purchase
- B. Opening Sale
- C. Closing Purchase
- D. Closing Sale

SIE Options 233

Opening & Closing Transactions (cont.)

How is the order ticket marked to establish a short call options contract?

- A. Opening Purchase
- B. Opening Sale
- C. Closing Purchase
- D. Closing Sale

SIE Options 234

Opening & Closing Transactions (cont.)

How is the order ticket marked to liquidate a long call options contract?

- A. Opening Purchase
- B. Opening Sale
- C. Closing Purchase
- D. Closing Sale

SIE Options 235

Opening & Closing Transactions (cont.)

How is the order ticket marked to liquidate a short call options contract?

- A. Opening Purchase
- B. Opening Sale
- C. Closing Purchase
- D. Closing Sale

SIE Options 236

Opening & Closing Transactions (cont.)

How is the order ticket marked to establish a long put options contract?

- A. Opening Purchase
- B. Opening Sale
- C. Closing Purchase
- D. Closing Sale

SIE Options 237

Opening & Closing Transactions (cont.)

How is the order ticket marked to establish a short put options contract?

- A. Opening Purchase
- B. Opening Sale
- C. Closing Purchase
- D. Closing Sale

SIE Options 238

Opening & Closing Transactions (cont.)

How is the order ticket marked to liquidate a long put options contract?

- A. Opening Purchase
- B. Opening Sale
- C. Closing Purchase
- D. Closing Sale

SIE Options 239

Opening & Closing Transactions (cont.)

How is the order ticket marked to liquidate a short put options contract?

- A. Opening Purchase
- B. Opening Sale
- C. Closing Purchase
- D. Closing Sale

SIE Options 240

All of the following would be considered an opening options transaction EXCEPT:

- A. Assuming a long ABC Dec 50 Call position *OPEN BUY*
- B. Assuming a short ABC Dec 50 Call position *OPEN SALE*
- C. Going long an ABC Dec 50 Put as an initial option transaction *OPEN BUY*
- D. Going long an ABC Dec Put after going short an ABC Dec 50 Put *CLOSING BUY*

SIE Options 241

Option Chart—Speculation

	Long (Right to Buy)	Short (Obligation to Sell)
Call	<p><i>-S.P.</i></p> <p>Max Gain = Unlim.</p> <p>Max Loss = Prem.</p> <p>BE = Strike + Prem</p>	<p><i>+S.P.</i></p> <p>Max Gain = Prem.</p> <p>Max Loss = Unlim.</p> <p>BE = Strike + Prem.</p>
Put	<p><i>+S.P.</i></p> <p>Max Gain = BE to 0</p> <p>Max Loss = Prem.</p> <p>BE = Strike - Prem</p>	<p><i>-S.P.</i></p> <p>Max Gain = Prem</p> <p>Max Loss = BE to 0</p> <p>BE = Strike - Prem</p>

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Options - Using the T-Chart

Do options in two steps:

- Set up initial transactions
- Determine if the contracts are exercised;
 - if they are, use the S.P. sign in the chart

Calls are exercised if $Mkt Price > Strike Price$
 Puts are exercised if $Mkt Price < Strike Price$

SIE Options 243

Which of the following positions could give a maximum potential gain of unlimited?

- A. long call
- B. long put
- C. short call
- D. short put

SIE Options 244

Which of the following positions could give a maximum potential loss of unlimited?

- A. long call
- B. long put
- C. short call
- D. short put

SIE Options 245

Speculative Strategies Long Calls

A customer buys 1 ABC Jan 30 Call @ \$4 when ABC = \$29. ABC goes to 47 and the customer exercises the call selling the stock in the market. What is the:

- MPG
- MPL
- B/E 34
- gain or loss in this situation

Handwritten notes: B = OPTION PREMIUM, MPL, S = STOCK TRANSACTION

ABC Price	Q	S	Q	S	Q	S
0	-4	+30	-4	+30	-4	+30
\$1MM						
\$47						
Gain/Loss	-4	+30	-4	+30	-4	+30
Calculation	-4 X 100 = -400	+30 X 100 = +3000	-4 X 100 = -400	+30 X 100 = +3000	-4 X 100 = -400	+30 X 100 = +3000
MPG						
MPL						
B/E	34		34		34	

SIE Options 246

Speculative Strategies Short Calls

A customer sells 1 ABC Jan 30 Call @ \$4 when ABC = \$29. ABC goes to 47 and the customer is exercised delivering the stock. What is the:

- MPG
- MPL
- B/E 34
- gain or loss in this situation

ABC Price	Q	S	Q	S	Q	S
0	+4	-30	+4	-30	+4	-30
\$1MM						
\$47						
Gain/Loss	+4	-30	+4	-30	+4	-30
Calculation	+4 X 100 = +400	-30 X 100 = -3000	+4 X 100 = +400	-30 X 100 = -3000	+4 X 100 = +400	-30 X 100 = -3000
MPG						
MPL						
B/E	34		34		34	

SIE Options 247

Speculative Strategies Long Puts

A customer buys 1 ABC Jan 30 Put @ \$4 when ABC = \$31. ABC goes to 14 and the customer exercises the put buying the stock in the market. What is the:

- MPG
- MPL
- B/E 26
- gain or loss in this situation

ABC Price	Q	S	Q	S	Q	S
0	-4	+30	-4	+30	-4	+30
\$1MM						
\$14						
Gain/Loss	-4	+30	-4	+30	-4	+30
Calculation	-4 X 100 = -400	+30 X 100 = +3000	-4 X 100 = -400	+30 X 100 = +3000	-4 X 100 = -400	+30 X 100 = +3000
MPG						
MPL						
B/E	26		26		26	

SIE Options 248

Speculative Strategies Long Puts

A customer buys 1 ABC Feb 50 Put @ \$7 when the market price of ABC is 49. If the stock goes to \$41 and just prior to expiration, the holder closes out the position with a closing sale at intrinsic value, the gain or loss is:

- A. \$200 gain
- B. \$200 loss
- C. \$700 loss
- D. \$900 gain

ABC Price	Q	S
0	-7	+50
41		
Gain/Loss	-7	+50
Calculation	-7 X 100 = -700	+50 X 100 = +5000
MPG		
MPL		
B/E	43	

SIE Options 249

Speculative Strategies Short Puts

A customer sells 1 ABC Jan 30 Put @ \$4 when ABC = \$31. ABC goes to 14 and the customer is exercised. What is the:

- MPG
- MPL
- B/E 26
- gain or loss in this situation

ABC = 0	ABC = \$14	ABC = \$14
$\begin{matrix} O & S \\ +4 & -30 \end{matrix}$	$\begin{matrix} O & S \\ +4 & -30 \end{matrix}$	$\begin{matrix} O & S \\ +4 & -30 \end{matrix}$
$+4 + -30 = -26$	$+4 \times 100 = +400$ MPG	$+4 + -16 = -12$
$-26 \times 100 = -2600$ MPL		$-12 \times 100 = -1200$

SIE Options 250

Speculative Strategies Short Puts

A customer shorts 1 ABC Jul 40 Put at \$6 when the market price of ABC is 38. ABC stock rises to \$60 and stays there through July. The customer:

- A. gains \$600
- B. loses \$600
- C. gains \$1400
- D. loses \$1400

$\begin{matrix} O & S \\ +6 & -40 \end{matrix}$	$\begin{matrix} O & S \\ +6 & -40 \end{matrix}$
$+6 \times 100 = +600$	

SIE Options 251

Which of the following options strategies has ever increasing gain as the market keeps rising?

- A. long call
- B. short call
- C. long put
- D. short put

SIE Options 252

Which of the following options strategies has ever increasing loss as the market keeps rising?

- A. long call
- B. short call
- C. long put
- D. short put

SIE Options 253

Buying a put

Long 1 ABC Oct 50 put @ 2

Maximum Loss?

Maximum Gain?

Breakeven?

MP goes to 27 per share and the put is exercised. What is the investor's gain or loss?

ABC = 0	ABC = \$14	ABC = \$27
$\begin{matrix} O & S \\ -2 & +50 \end{matrix}$	$\begin{matrix} O & S \\ -2 & +50 \end{matrix}$	$\begin{matrix} O & S \\ -2 & +50 \end{matrix}$
$-2 + +50 = +48$	$-2 \times 100 = -200$ MPL	$-2 + +23 = +21$
$+48 \times 100 = +4800$ MPG		$+21 \times 100 = +2100$

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Hedging/Protection & Income Strategies

- To create a **hedging strategy**, **buy the option** with the opposite strategy of the stock position
- To hedge Long stock (Bullish), buy a put (Bearish)
- To hedge Short stock (Bearish), buy a call (Bullish)
- To create an **income strategy**, **sell the option** with the opposite strategy of the stock position
- To create income for long stock (Bullish) sell a call (Bearish) – aka covered calls!!!
- To create income for a short stock (Bearish) sell a put (Bullish) – aka covered puts!!! (riskier than it's worth)
- The strategy of the stock position determines the strategy of the overall position (Bullish or Bearish)

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Stock with Options Strategies

SIE Options 256

Stock with Options Strategies (cont.)

Which of the following give a MPG of unlimited?

- A. Long Stock / Short Call
- B. Long Stock / Long Put
- C. Short Stock / Long Call
- D. Short Stock / Short Put

Handwritten notes: B is circled in blue. Next to B: 'call = MPG = Any x TWD'. Next to C: 'call = MPG = Any x TWD'.

SIE Options 257

Stock with Options Strategies (cont.)

Handwritten notes: 'Strategy Strategy' in red.

Which of the following give a MPL of unlimited?

- A. Long Stock / Short Call
- B. Long Stock / Long Put
- C. Short Stock / Long Call
- D. Short Stock / Short Put

Handwritten notes: D is circled in red. Next to D: 'call = MPL = Any x TWD'.

SIE Options 258

SELL for income

A customer has bought stock and wishes to generate some additional income as the market is anticipated to remain flat over the next few months. The appropriate strategy is:

- ~~A. long call~~
- ~~B. short call~~
- ~~C. long put~~
- ~~D. short put~~

SIE Options 259

SELL for income

A customer has sold short stock and wishes to generate some additional income as the market is anticipated to remain flat over the next few months. The appropriate strategy is:

- A. long call
- ~~B. short call~~
- ~~C. long put~~
- ~~D. short put~~

SIE Options 260

BUY for protection

A customer has bought stock. To protect the stock position in a falling market, the appropriate strategy is to:

- ~~A. buy a call~~
- ~~B. sell a call~~
- ~~C. buy a put~~
- ~~D. sell a put~~

SIE Options 261

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A Ceph Company

BUY for protection

A customer has sold stock short. To protect the stock position in a rising market, the appropriate strategy is to:

- A. buy a call
- B. sell a call
- C. buy a put
- D. sell a put

SIE Options 262

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Long the stock and short the call is an appropriate strategy in a:

- A. declining market
- B. rising market
- C. stable market
- D. fluctuating market

SIE Options 263

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A Ceph Company

Long Stock / Short Call (cont.)

Customer Buys 100 ABC @ \$50 and sells 1 ABC Jan 50 Call @ 5. ABC goes to 65 and the customer is exercised. What is:

- 1) MPG \rightarrow hedge/income/spread/straddle
- 2) MPL \rightarrow bull/bear/neutral
- 3) B/E \rightarrow exercise/expire
- 4) gain/loss

MAKE #

	ABC = 0	ABC = \$1MM	ABC = \$65
B/E = 45	Q S +5 -50 +0	Q S +5 -50 +50	Q S +5 -50 +50
gain/loss	-4,500	-500	+500

SIE Options 264

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A Ceph Company

Long Stock / Short Call (cont.)

Customer Buys 100 ABC @ \$48 and sells 1 ABC Jan 50 Call @ 4. ABC goes to 65 and the customer is exercised. What is:

- MPG \rightarrow hedge/income/spread/straddle
- MPL \rightarrow bull/bear/neutral
- B/E \rightarrow exercise/expire
- gain/loss

	ABC = 0	ABC = \$1MM	ABC = \$65
B/E = 44	Q S +4 -48 +0	Q S +4 -48 +50	Q S +4 -48 +50
gain/loss	-4,400	-48	+600

SIE Options 265

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A Ceph Company

Long Stock / Long Put (cont.)

Customer buys 100 ABC @ \$50 and buys 1 ABC Jan 50 Put @ 5. ABC goes to 36 and the customer exercises the put. What is:

- MPG \rightarrow hedge/income/spread/straddle
- MPL \rightarrow bull/bear/neutral
- B/E \rightarrow exercise/expire
- gain/loss

	ABC = 0	ABC = \$1MM	ABC = \$36
B/E = 55	Q S -5 -50 +50	Q S -5 -50 +1MM	Q S -5 -50 +50
gain/loss	-500	+unlt.	-500

SIE Options 266

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A Ceph Company

Long Stock / Long Put

Customer buys 100 ABC @ \$53 and buys 1 ABC Jan 50 Put @ 5. ABC goes to 13 and the customer exercises the put. What is:

- MPG \rightarrow hedge/income/spread/straddle
- MPL \rightarrow bull/bear/neutral
- B/E \rightarrow exercise/expire
- gain/loss

	ABC = 0	ABC = \$1MM	ABC = \$13
B/E = 58	Q S -5 -53 +50	Q S -5 -53 +1MM	Q S -5 -53 +50
gain/loss	-800	-3	+1MM

SIE Options 267

Short Stock / Long Call

- short 100 ABC @ 50 and buy 1 ABC Jan 50 Call @ 5, what is the:

MPG = hedge/income/spread/straddle
 MPL = bull/bear/neutral
 B/E = exercise/expire

	ABC = 0		ABC = SIMM	
B/E = 45	Q	S	Q	S
	-5	+50	-5	+50
		-0		-5
	+4,500	+50		-500

SIE Options 268

Short Stock / Long Call (cont.)

- short 100 ABC @ 48 and buy 1 ABC Jan 50 Call @ 4, what is the:

MPG = hedge/income/spread/straddle
 MPL = bull/bear/neutral
 B/E = exercise/expire

	ABC = 0		ABC = SIMM	
B/E = 44	Q	S	Q	S
	-4	+48	-4	+48
		-0		-50
	+4,400	+48		-2 -600

SIE Options 269

Income Strategy

MAKE \$ WHEN Mkt RISES
LOSE \$ WHEN Mkt RISES
LOSE \$ WHEN Mkt Falls
MAKE \$ WHEN Mkt Falls

- Long Stock / Short Call**
 - Covered Call Writing Strategy
- Short Stock / Short Put**
 - Covered Put Writing Strategy
 - the PUT contract that you sold is COVERED by your short stock position

SIE Options 270

Short Stock / Short Put

- short 100 ABC @ 50 and sell 1 ABC Jan 50 Put @ 5, what is the:

MPG = hedge/income/spread/straddle
 MPL = bull/bear/neutral
 B/E = exercise/expire

	ABC = 0		ABC = SIMM	
B/E = 55	Q	S	Q	S
	+5	-50	+5	+50
		-5		-1MM
	+500			-unlt

SIE Options 271

Short Stock / Short Put (cont.)

- WHAT?! The MPL was unlimited! How is this a Covered Put Writing Strategy?!?
 - As already indicated the PUT CONTRACT that was sold is COVERED by the SHORT STOCK POSITION
 - as the Put gets exercised, it is covered by the short stock position

SIE Options 272

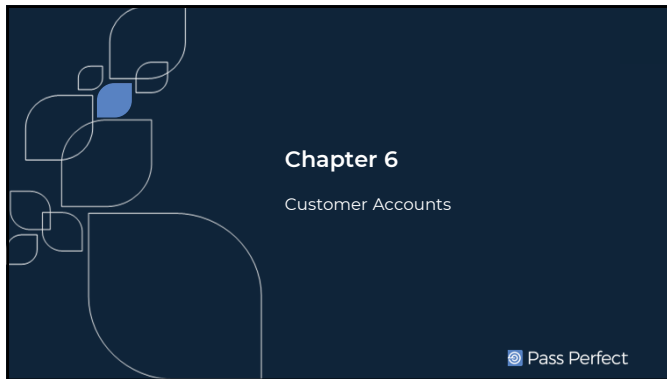
Short Stock / Short Put (cont.)

- short 100 ABC @ 68 and sell 1 ABC Jan 65 Put @ 5, what is the:

MPG = hedge/income/spread/straddle
 MPL = bull/bear/neutral
 B/E = exercise/expire

	ABC = 0		ABC = SIMM	
B/E = 73	Q	S	Q	S
	+5	+68	+5	+68
		-65		-1MM
	+800	+3		-unlt

SIE Options 273



REGULATION BI (BEST INTEREST)

- requires broker-dealers (BDs) and investment advisers (IAs) to always put customer interests before their own and to minimize conflicts of interest
- BDs, regulated by FINRA, are held to a suitability standard, whereby BDs can sell a recommended stock out of its inventory to a customer
 - › BDs charge commissions and mark-ups for transactions
- IAs, regulated by either states (smaller IAs) or the SEC (larger IAs), are held to a fiduciary standard, whereby if the IA recommends a customer to buy a security, it cannot be the one selling it to that customer from its inventory
 - › IAs charge fees

SIE Customer Accounts 275

FORM CRS

- retail customers (not institutions) are required to receive **Form CRS (Customer Relationship Summary)** at the earlier of making a recommendation or account opening; the Form CRS must be “on top”, if the client is presented with several documents; and it also must be posted on the firm’s website

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Form CRS must be provided to customers at the earlier of:

- making a recommendation
- account opening
- implementing an investment strategy
- any of the above

SIE Customer Accounts 277

When providing a Form CRS along with other documentation to a new client, the Form CRS:

- can be included anywhere in the ordering of documents presented
- must be packaged separately from the other documents presents
- must be the first among any documents delivered
- can be included by reference to its availability on the firm’s website

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New Account Form

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graph TD
    A[New Account Form] --> B[Customer's Name]
    A --> C[Customer's Physical Address]
    A --> D[Customer's SS# or Tax ID]
    A --> E[Customer's Date of Birth]
  
```

These are the 4 critical pieces of information, and these must be verified promptly after account opening by either:
matching to a valid government issued photo ID; or
using a database service to do the match

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A customer wishes to open a new account, but refuses to give her social security number and date of birth, claiming that the release of such information would allow the customer's identity to be stolen. Which statement is true?

- A. As long as the customer signs a statement to the effect that she is the true account owner, then the account can be opened
- B. The account can be opened as long as the firm is able to verify the customer's identity
- C. The account can be opened as long as the manager approves
- D. The account cannot be opened

SIE Customer Accounts 281

New Account Form

Customer citizenship:

- If the customer is a non-U.S. citizen, then to prove identity the firm must obtain:
 - a copy of the customer's foreign passport; and
 - the customer's U.S. Tax ID number

Suitability Determination:

- Required if recommendations are being made to the client; not required if the customer makes own investment decisions. Covered later in this section.

Occupation and Employer:

- If the customer is employed by another financial services firm, the employing firm must be notified.

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New Account Form: Associated Person

<p>FINRA Rule</p> <p>If an associated person of another FINRA member firm wishes to open a securities account:</p> <ul style="list-style-type: none"> Prior written consent of the employing member firm must be obtained; The executing member must be notified in writing of the employee's association with another member firm; and The executing member must provide duplicate confirmations and statements to the employer member upon written request <p><small>Note the rule doesn't apply if the person simply wants to buy investment company securities (like mutual funds) or 529s</small></p>	<p>MSRB Rule</p> <p>If an associated person of another MSRB member firm wishes to open a securities account:</p> <p>Duplicate confirms must be sent to the employer</p>
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The Self Regulatory Organizations (SROs) are:

- A. private companies
- B. government sponsored enterprises
- C. membership organizations
- D. publicly traded companies

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New Account Form

Who Signs the New Account Form	Registered Representative Principal
Who is Not Required to Sign the New Account Form	Customer

However, almost all firms have the customer sign an arbitration agreement

Customer must be sent a copy of the new account profile, including Suitability Info, within 30 days of account opening for review. New account profile must be sent to customer every 36 months thereafter for review

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Predispute arbitration agreements between member firms and their customers are:

- A. prohibited under FINRA rules
- B. permitted only if the firm provides the customer with a copy of the agreement at the time of signing and gets written customer acknowledgement of receipt
- C. permitted only if the firm provides the customer with a copy of the agreement within 30 days of signing and gets written customer acknowledgement of receipt
- D. permitted without restriction or condition

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FINRA Suitability Measures

If recommendations are going to be made, a suitability determination must be completed. The rules on suitability are both general and specific. The FINRA general rule is:

FINRA Rule – 3 Levels of Suitability

Reasonable Basis: (aka Product Level Suitability) Before a security can be recommended to a client, the BD must determine that the recommendation has the best risk/return characteristics of other similar products.

Customer-Specific: Once a security has cleared "reasonable basis" suitability, it cannot be recommended to all customers – only to those for which it is suitable.

Quantitative Suitability: Once a security clears "customer-specific" suitability, it cannot be recommended unless that customer can afford it.

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Suitability

Specific suitability rules are set for recommendations of different products and for specific investor groups. These specific rules typically arose because of "problems" that occurred. These are recommendations of (or to):



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Suitability: OPTIONS ACCOUNT

- Reasonable efforts must be made to obtain:
 - Investment Objective
 - Investment Experience
 - Financial Situation
 - Financial Needs
 - Income
 - Net Worth
 - Liquid Net Worth
 - Marital Status
 - # of Dependents
 - Tax Status
- Account must be approved by Registered Options Principal (ROP)
- The RR must put the date on the New A/C Form that the customer was given the latest ODD – **Options Disclosure Document**
- The customer must be sent the **Options Agreement** for signature and return within **15 days**. If not returned, closing trades only

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OPTIONS ACCOUNT LEVELS

- most firms have different levels of options trading for which the customer is qualified
 - i.e. Level 1 allows for selling covered calls and maybe buying puts to hedge
 - Level 2 – buy calls and puts to speculate
 - Level 3 – engage in spreads
 - Level 4 – all options trading allowed including selling naked options

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Customer Accounts

290

Special Statement for Uncovered Options Writers

- for the customer to move up in levels of options trading, the suitability determination is redone and a new Options Agreement is sent for the customer's signature and returned within 15 days
 - to move to the last level of options trading, the customer is given the Special Statement for Uncovered Options Writers which discloses:
 - naked call writers have unlimited loss potential; and naked put writers have a greater loss as the market goes to zero
 - if the broker demands additional margin, the broker may liquidate customer positions without prior notice if the margin isn't received
 - if a secondary market in options were to become unavailable, the writer is still subject to exercise at any time until expiration

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Customer Accounts

291

Suitability: MUNICIPAL BONDS

To recommend municipal bonds to a client, other than the usual suitability information, the client must be asked:

- State of residence
- Tax bracket

If customer does not give suitability information, recommendations cannot be made, but unsolicited trades can still be accepted

If a client tells a representative to do a trade that the rep believes is unsuitable, the rep must discuss this with the client and if the client still says "Do it!" – then "Do it."

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Suitability: SENIOR CITIZENS

Rather than a product type that has specific suitability requirement, FINRA has a rule for elderly investors

When making a recommendation to a senior citizen, the RR should take into account, the senior citizen's:

- Lowered risk tolerance
- Shortened investment time horizon
- Need for continuing income in retirement

Certain recommendations are usually unsuitable:

- Variable annuities, equity indexed annuities, and DPPs
- Structured products
- Mortgaging residence to obtain funds for investment purposes
- Using retirement monies to make risky investments

Pass Perfect

Suitability: SENIOR CITIZENS

Risky investments can still be recommended to sophisticated, wealthy, non-risk averse senior citizens

FINRA strongly discourages the use of high-pressure "free lunch seminars" when soliciting seniors

Bogus certification on business cards, like "Certified Senior Investment Specialist" are prohibited

- If a senior citizen appears to be "out of it," then:
- The matter should be escalated to compliance;
- Next of kin (if known) should be contacted about this

Pass Perfect

Suitability: SENIOR CITIZENS

Financial Exploitation

- FINRA allows a firm to place a temporary 25-day hold on disbursements from the client's account when fraud is suspected – and if it is believed that the client is being exploited, the hold can be extended for another 30 business days

Trusted Contact Person

- If a hold is placed on the account, the firm must document the reasoning and notify the "trusted contact person" named on the account
- This person is a resource when administering the customer's account and protecting the customer's assets if the firm suspects the customer isn't "with it"

Pass Perfect

An 80-year old customer with an existing individual account comes into a branch office and tells his representative that: "My son has been telling me that I need to give him a power of attorney over my account because of my advanced age, and I want to keep him happy and keep him from putting me in a retirement home." What should the representative do?

- The representative should give the customer a power of attorney form, naming the son as attorney over the account, and have the customer sign the form
- The representative should contact the son and get permission to have the customer sign a power of attorney
- The representative should escalate the matter to the branch manager or compliance department of the firm
- The representative should freeze the account until it can be determined that the customer is not mentally incapacitated

SIE Customer Accounts 296

An elderly customer normally comes into your branch office each week on Monday to discuss his account and place trades. This week, he comes in on Wednesday, looking confused and disoriented. However, the trade that he wishes to place conforms to his normal investment practice. The representative should:

- place the trade for the customer, since it conforms with his normal investment practice
- contact the firm's compliance department for guidance on how to handle the situation
- contact the customer's next of kin to discuss the situation
- refuse the order from the customer

SIE Customer Accounts 297

Opening Paperwork

At account opening, the customer must be provided with:

- Regulation S-P (Statement of Privacy)
- SIPC Brochure
- BrokerCheck Information

Customer information is private and cannot be used for marketing or other purposes. At account opening the customer must be provided with a "Privacy Statement" that details the types of information collected by the firm and how it is used

The customer has the right to "opt out" of the collection and use of the information by the firm

↑ 30 DAYS

Pass Perfect

Opening Paperwork

Regulation S-P

- The privacy statement must be provided annually thereafter
- Information that is not linked to a specific client, such as averaged or aggregated info., is not private
- If FINRA, the SEC, or the IRS wants client information, hand it over – the privacy rule does not apply!

SIPC Brochure

- The customer must be given the web site address and contact information for Securities Investor Protection Corporation – SIPC – which insures customer accounts against loss due to failure of the broker-dealer; and it must be provided annually thereafter

Pass Perfect

Customers must be given information about SIPC:

- A. at, or prior to, account opening
- B. on the first trade confirmation sent after account opening
- C. on the first account statement sent after account opening
- D. semi-annually on the account statement

SIE Customer Accounts 300

Opening Paperwork

BrokerCheck
by FINRA

- BrokerCheck is run by FINRA. FINRA maintains the database (called CRD – Central Registration Depository) of all member firm records and registered representative records.
- BrokerCheck uses the CRD files to create a publicly accessible record where customers can “check out” member firms and associated persons.
- The BrokerCheck information for associated persons includes:
 - Licenses Held
 - States Where Registered
 - 10 Year Employment History
 - Disciplinary Record
 - Pending Serious Customer Complaints
 - Outside Business Activities

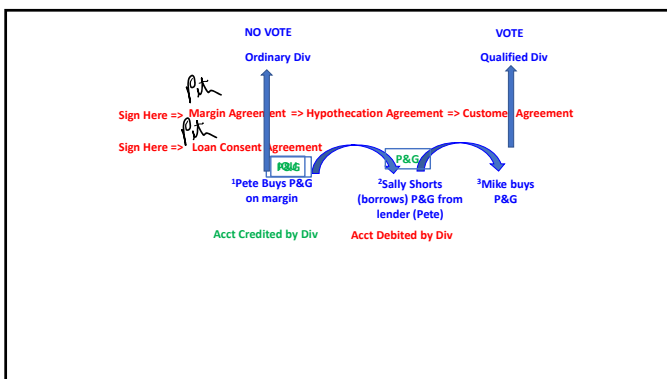
Pass Perfect

Documentation for Margin Accounts

If the account will be a margin account, the customer:

- Must sign the **Margin (Hypothecation) Agreement**. The customer pledges the securities in the account to the broker in return for the margin loan. The securities go into street name (so the broker can sell them at will)
- Is usually required to sign a **Loan Consent Agreement**, where the customer permits his or her securities to be lent out on short sales
- Must be provided with a **Credit Disclosure Statement** that explains how the loan is computed and interest charged
- Must be provided with a **Margin Risk Disclosure Document** that explains the risks of leverage

Pass Perfect



Which of the following are true regarding fully paid customer securities held by a brokerage firm?

- I the securities cannot be commingled with customer margin securities
- II the securities cannot be commingled with firm positions
- III the securities cannot be rehypothecated to a bank

A. II, III
 B. I, II
 C. I, III
 D. I, II, III

SIE Customer Accounts 304

A customer has opened a margin account and has signed both the hypothecation agreement and the loan consent agreement. The brokerage firm can do all of the following with the customer's securities EXCEPT:

- A. commingle the customer's securities with those of other customers
- B. lend the stock to another customer who wishes to effect a short sale
- C. commingle the customer's securities with securities owned by the brokerage firm
- D. pledge the customer's securities to a bank for a loan

SIE

Customer Accounts

305

What document, once signed, permits a broker dealer to borrow customer securities to effect short sales for other clients?

- A. Hypothecation agreement
- B. Loan consent agreement
- C. Form 15g-2
- D. Option agreement

SIE

Customer Accounts

306

Account Procedures

INDIVIDUAL ACCOUNT

- No special paperwork needed

INDIVIDUAL AC - TOD - (TRANSFER ON DEATH)

- States allow an individual account to be held TOD, where the customer names the account beneficiary at account opening.
- This allows the customer to maintain control over the account, but upon death the assets transfer to the named beneficiary, avoiding probate. No one can contest the transfer



Account Procedures

JOINT ACCOUNT

Each named owner signs a joint account agreement and can enter orders and can draw checks to full account name

JTWROS - JOINT TENANTS WITH RIGHTS OF SURVIVORSHIP

Each party 100% owns account. If one dies, the other 100% owns account. Typical for a husband and wife. Transfer bypasses the will and probate, but not necessarily death tax

TENANTS IN COMMON

Each party has a specified ownership %. If that person dies, the % goes to the estate - not to the other owners

Under CIP, a Social Security number collected for each owner, but all tax reporting done under a single "primary" SS#



For IRS reporting purposes, the opening of a joint account for a husband and a wife requires that the social security number be obtained from the:

- I Husband
- II Wife
- III Beneficiary

- A. I
- B. II
- C. I or II
- D. I, II, III

309

Assets in which of the following accounts would go through probate in the event of the death of one of the owners.

- I. TOD
- II. Individual
- III. TIC
- IV. JTWROS

- A. I & II
- B. II & III
- C. III & IV
- D. I & IV



310

Other Account Paperwork

CORPORATE ACCOUNT	PARTNERSHIP ACCOUNT
<ul style="list-style-type: none"> A corporate resolution, naming the individuals authorized to trade, signed by the Corporate Secretary, must be obtained. This must have the corporate seal A copy of the corporate charter is required to prove customer identity 	<ul style="list-style-type: none"> A copy of partnership agreement must be obtained. It will contain a paragraph stating that what type of account can be opened and who is authorized to trade. If the account is for a limited partnership, the only signature required to open the account is that of the general partner

Pass Perfect

Other Account Paperwork

Which statement is true regarding corporate accounts?

- Only members of the Board of Directors are allowed to trade the account
- Only officers of the company are allowed to trade the account
- Only employees of the company's treasurer's department are allowed to trade the account
- Anyone authorized in the resolution can trade the account

SIE Customer Accounts 312

Other Account Paperwork

A limited partnership account is being opened at your firm. The general partner has provided the partnership tax identification number and has signed the appropriate paperwork. What other documentation is needed to open the account?

- Social security number of each limited partner
- Signature of each limited partner
- Certificate of limited partnership
- Authorizing resolution

SIE Customer Accounts 313

Other Account Paperwork

PRIME BROKERAGE ACCOUNT

Many times institutions (like hedge funds) maintain accounts with a number of different broker-dealers because some firms are better at executing stock trades versus bond trades (for instance)

In return for sending commission trades to different firms, the institution gets research or recommendations from the broker-dealers

In that there are different firms executed trades, the institution's assets are "scattered" across different broker-dealers

The prime brokerage account designates a single broker as "primary"

A place where all assets are consolidated

The institution names its executing brokers in advance to its "prime broker" who settles all trades, maintains custody, and provides lower financing costs on margined positions

Pass Perfect

Other Account Paperwork

FIDUCIARY ACCOUNTS

Name a 3rd party who manages the account for a beneficiary.

Unless the account documentation says otherwise:

Cannot be margin accounts – they are set up as cash accounts

Cannot have 3rd party trading authorizations, because there already is a 3rd party to the account

TRUST ACCOUNT

A copy of the Trust Document must be obtained. The Trustee has authority over the account. The account is set up as a cash account unless the Trust Document permits.

All trades have to be done for the benefit of the beneficiaries...

Options transactions are permitted (test point) – for example, in a cash account, covered call writing is a safe income strategy

Pass Perfect

Other Account Paperwork

GUARDIAN ACCOUNT

A court appointed guardian manages the account for an orphan or incompetent.

A copy of the court order is required

CUSTODIAN ACCOUNT

UGMA/UTMA

No special paperwork needed

Can be opened by any adult for any minor

Any adult can donate – all gifts are irrevocable

All securities registered in account name: 1 Custodian For 1 Minor

Minor's SS# used on the account for tax purposes

No Margin or short-selling

Pass Perfect

Under the Uniform Gifts To Minor's Act, which of the following statements are true?

- I only adults related to the minor may open a custodian account
- II any adult can open a custodian account for a minor
- III only gifts that have a gain are irrevocable
- IV all gifts are irrevocable

- A. I and III
- B. I and IV
- C. II and III
- D. II and IV

SIE

Customer Accounts

317

A minor can open which of the following accounts?

- A. custodial account
- B. joint with rights of survivorship
- C. UGMA account
- D. a minor cannot open an account

SIE

Customer Accounts

318

Which statement is true about a minor in a custodial account reaching legal age?

- A. the account must be transferred into the name of the new adult
- B. the account is transferred into the name of the new adult when requested by the custodian
- C. the account is transferred into the name of the new adult when requested by the parents
- D. the account must be liquidated and the proceeds paid to the new adult

SIE

Customer Accounts

319

When a custodian account is opened under UTMA (Uniform Transfers to Minors Act), the assets in the account must be:

- A. transferred to the new adult at legal age
- B. transferred to the new adult at the age specified by the custodian
- C. liquidated when the new adult reaches legal age and the proceeds given to the new adult
- D. transferred into a Trust if no action is taken by the new adult at legal age

SIE

Customer Accounts

320

Discretionary Accounts

POWERS OF ATTORNEY

The parties to an account are:

- 1st Party: Broker
- 2nd Party: Customer(s)
- 3rd Party: Anyone Else

A customer can enter trades and draw checks to account name

A customer can give a written power of attorney to either a 3rd Party or the 1st Party

3rd Party Trading Authorization names the 3rd party who can trade, signed by the client.

This is a Power of Attorney that can be:

- Durable or Non-Durable: Durable continues on customer incapacitation; non-durable ceases on mental incapacitation
- Full or Limited: Full allows 3rd Party to draw checks and trade; limited is trading only

 Pass Perfect

When opening a new account, a customer requests that duplicate confirmations and statements be sent to her attorney. What action should the representative take?

- A. The representative should note the request on the new account form, along with the contact information for the customer's attorney
- B. The representative should send the request to the firm's P & S Department to process the necessary paperwork
- C. The representative must have the customer sign a power of attorney naming the attorney as authorized to receive the duplicate statements
- D. The representative must get approval of the branch manager in order to request duplicate confirmations and statements

SIE

Customer Accounts

322

Discretionary Accounts

1st Party Trading Authorization names broker as the person authorized to trade, signed by the client. This is a discretionary account. The rules for Discretionary Accounts are

- Signed Power of Attorney (Limited) must be obtained
- Every order ticket must be marked as "Discretionary"
- The manager must review and endorse the orders at the end of the day (NOT before they are entered)

End of day approval is OK because transactions are not recorded in customer accounts until settlement (T + 2), so it can be fixed

There is NO requirement to renew the POA annually
If the customer dies, the POA dies as well (true for all POAs)

Pass Perfect

Discretionary Accounts

When writing an order, other than buy or sell, the following must be chosen:

- Size of trade
- Security to be traded
- Price of execution
- Time of execution
- A written POA in a discretionary account is only needed if the RR chooses Size or Security.

The RR can choose Price and Time without needing a written POA from the client – this is the same as a Market-Not Held order

If RR chooses Price and/or Time, trade must be performed that day for a retail client; for institutional clients, trade can occur anytime

Pass Perfect

A customer calls his broker and says, "I am going on vacation for 2 weeks. Do whatever you think is necessary for my account". Which statement is true?

- A. The broker can exercise discretion in the account
- B. The broker cannot exercise discretion in the account
- C. The broker can exercise discretion in the account only if each trade is approved in advance by the branch manager
- D. The broker can exercise discretion in the account only if each trade is approved by the NYSE

SIE

Customer Accounts

325

Which one of the following orders requires specific customer authorization?

- A. Customer's order is to sell 100 shares of KO at the market
- B. Customer's order is to buy as much of GE at \$40 during this trading day
- C. Customer's order is to buy 100 shares of IBM at \$125
- D. Customer's order is to sell 100 shares of GE when it gets to a certain level or lower

SIE

Customer Accounts

326

An individual customer says the following to his broker: "Buy 100,000 shares of ABC stock whenever you think the time is best. This order is good unless I call you to cancel." Which statement is true about the handling of this order?

- A. An executed power of attorney must be obtained from the customer prior to accepting the order
- B. The order must be executed by the close of the market on that trading day
- C. The order can be accepted as given, and can be executed at the discretion of the brokerage firm at any time or day
- D. This order can only be accepted if the customer places it via fax or e-mail

SIE

Customer Accounts

327

An institutional customer says the following to his broker: "Buy 100,000 shares of ABC stock whenever you think the time is best. This order is good unless I call you to cancel." Which statement is true about the handling of this order?

- A. An executed power of attorney must be obtained from the customer prior to accepting the order
- B. The order must be executed by the close of the market on that trading day
- C. The order can be accepted as given, and can be executed at the discretion of the brokerage firm at any time or day
- D. This order can only be accepted if the customer places it via fax or e-mail

SIE

Customer Accounts

328

Accounts for Investment Advisers

Omnibus Account
Individual new account forms and trading authorizations for each customer

1

2

Wrap Accounts
• Not a BD product → used by IA firms (investment advisers)
• IAR license required to offer IA accounts

 Pass Perfect

Numbered/Coded Accounts

- For customers who want to retain anonymity
 - Example: 1Z3431k23
- The firm must keep on file the name of the customer
- The firm must keep on file a written statement signed by the customer showing the customer owns the account

 Pass Perfect

Account Maintenance

Confirmations must be sent to clients that day after trade date for regular way trades

Confirmations must be sent to a client on the trade date for cash trades

- Error on confirmation – correct and reconfirm (aka *cancel and rebill*)
- Error in execution – customer gets correct price if trade could have been executed per the customer's instructions

 Pass Perfect

Account Maintenance

Statements must be sent:

- Quarterly if there is no account activity
- Monthly if a trade occurred in that month

Duplicate confirmations and statements can be sent to another party with written customer consent

All mail must be sent to the address provided by the customer; cannot be sent to the branch office or RR

 Pass Perfect

Account Maintenance

Customer mail cannot be held UNLESS the customer requests this in writing.

If the customer wants the mail held for longer than 3 months, the customer must state the reasoning why, and "convenience" is not an acceptable reason.

Customer mail can be sent to a PO Box if the customer requests in writing.

 Pass Perfect

Death of a Customer

If an RR is notified that a customer has died, then:

- All open orders must be canceled;
- The account is frozen;
- The date of death is noted on the account;
- Wait for further instructions from the executor (not spouse or beneficiary)

The notification must come from next of kin. If the notice is from someone further removed, a copy of the death certificate should be obtained before taking these actions

The paperwork needed to transfer the account assets to a beneficiary depends on how the account is titled

If it's a TOD or JTWROS: The beneficiary is known – only need death certificate

If Individual account or tenants in common: Don't know beneficiary – need death certificate; will; and probate court filing

 Pass Perfect

A registered representative is notified verbally by an immediate family member of one of her customers that the customer has passed away. Which statement is true regarding freezing the assets in the account?

- A. The assets in the account can be frozen based on this verbal information
- B. The family member must give a notarized written statement in order to freeze the assets in the account
- C. The family member must provide a certified copy of the customer's death certificate before the assets in the account can be frozen
- D. The assets in the account cannot be frozen under any circumstances

SIE

Customer Accounts

335

When a customer dies, the registered representative is responsible to do all of the following activities EXCEPT:

- A. Await further instructions from the attorney for the estate
- B. Liquidate all securities positions
- C. Mark the account as "deceased"
- D. Cancel all open orders

Series #7

Customer Accounts

336

Account Transfer

ACCOUNT TRANSFER (to another firm)

- ACAT process is handled by DTCC
- Customer completes a Transfer Instruction Form (TIF) to DTCC detailing positions to be transferred, signs it, and signature is guaranteed
- New/receiving firm must submit instructions to DTCC **immediately**
- Upon receipt of transfer form, old/carrying firm must:
 - Cancel open orders – all orders now go through the receiving firm
 - Validate the positions within **1 business day**
 - Transfer the positions in another **3 business days**



A customer has completed an account transfer instruction form at broker dealer "B", instructing that his account be transferred from broker-dealer "A". Upon receipt of the form, which broker-dealer, if any, should freeze the account?

- A. Broker-dealer "A"
- B. Broker-dealer "B"
- C. Both Broker-dealer "A" and Broker-dealer "B"
- D. Neither Broker-dealer "A" nor Broker-dealer "B"

SIE

Customer Accounts

338

A customer has completed an account transfer instruction form at broker dealer "B", instructing that his account be transferred from broker-dealer "A". What should happen to all of the open orders still at broker-dealer "A"?

- A. all open orders must be canceled at broker-dealer "A"
- B. all open orders would be left at broker-dealer "A" until they were executed
- C. all open orders would be automatically transferred to broker-dealer "B"
- D. there would now be two sets of open orders - 1 order at broker-dealer "A" and another identical order at broker-dealer "B"

SIE

Customer Accounts

339

A customer has completed an account transfer instruction form at broker dealer "B", instructing that his account be transferred from broker-dealer "A". Any new orders must be placed through:

- A. Broker-dealer "A"
- B. Broker-dealer "B"
- C. Both Broker-dealer "A" and Broker-dealer "B" until all securities are transferred
- D. Neither Broker-dealer "A" nor Broker-dealer "B" until the securities are transferred

SIE

Customer Accounts

340

Assets in a customer account may be subject to a delay in transfer to another brokerage firm if they are held in:

- A. the name of that customer
- B. street name at DTCC (Depository Trust and Clearing Corporation)
- C. proprietary products at that broker-dealer
- D. non-proprietary products at that broker-dealer

SIE Customer Accounts 341

When a customer completes and signs an ACATS form, it must be forwarded to the carrying broker:

- A. immediately
- B. within 1 business day
- C. within 3 business days
- D. within 5 business days

SIE Customer Accounts 342

Brokerage Firm Departments

- Order Department**
 - Receives orders from RRs
 - Makes sure they are complete and correct
- Purchase and Sales Department**
 - Prepares customer confirmation to be sent out
- Margin Department**
 - Responsible for keeping customer account records

Pass Perfect

Brokerage Firm Departments

- Cashier**
 - Receives and delivers cash and securities
- Proxy Department**
 - Sends out voting material to beneficial owners in a margin account
- Reorganization department**
 - Communicates any odd situation to the customer

Pass Perfect

AML Rules- Patriot Act

To thwart terrorism, every new customer name must be matched to the terrorist watch list

- If a customer deposits or withdraws cash totaling over \$10,000 within a 2 week window, a CTR (Currency Transaction Report) must be filed with FinCEN
- If you are suspicious about a client, an SAR (Suspicious Activities Report) must be filed with FinCEN within 30 days

Examples of suspicious activities:

- Dealing in cash
- Making multiple wire transfers of small amounts to Third World countries
- No regard for the cost of transactions
- "Structuring" – customers depositing or withdrawing cash in amounts under \$10,000 thinking it won't be reported

Pass Perfect

Which one of the following customer actions could be an indicator of money laundering?

- A. Depositing \$50,000 of registered stock into the account and directing that it be transferred into street name
- B. Buying a security in advance of the ex-date and selling after the record date in order to receive a cash dividend
- C. Buying and selling the same security over a short period of time, incurring significant commission costs
- D. Buying a security and selling short an equivalent convertible security to lock in a price difference

SIE Customer Accounts 346

Which of the following is a potential money laundering activity?

- A. Laddering
- B. Structuring
- C. Diversifying
- D. Amortizing

SIE

Customer Accounts

347

Regulation SP

- Privacy notice delivered
 - At account opening
 - Every year after
- Acceptable opt-out notices
 - Reply form together with the opt-out notice
 - Providing a toll free number to call and opt-out
- Unacceptable opt-out notices
 - Have the customer write a letter exercising her right to opt-out
 - Check-off box form only included in the initial notice

Pass Perfect

SEC Regulation SP 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

SIE

Customer Accounts

349

Margin

Pass Perfect

REGULATION T

- Reg. T does not apply to exempt securities – Gov'ts, Agencies, municipals – these are only subject to FINRA minimum margins
- Reg. T sets the Initial Margins for stock positions. These are:

Long	Short
50%	50%
- After initial margin has been deposited, the account must be marked to market at the end of the day. If the account loses value, then the FINRA minimum margins kick in.
- The FINRA Minimum Maintenance margins are:

Long	Short
25%	30%

Pass Perfect

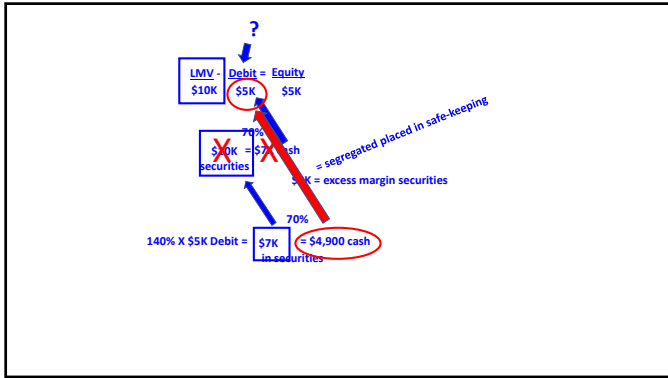
Regulation T applies to transactions in all of the following securities EXCEPT:

- A. U.S. Government Bonds
- B. American Depositary Receipts
- C. Warrants
- D. Convertible Corporate Bonds

SIE

Customer Accounts

353



Long Account

50% or greater

Long Account	Existing Reg. T (50%)	New Customer Deposit
100 @ \$50	\$2,500	\$2,500
100 @ \$40	\$2,000	\$2,000
100 @ \$30	\$1,500	\$2,000
100 @ \$20	\$1,000	\$2,000
100 @ \$17	\$850	\$1,700*

SIE Customer Accounts 355

Short Account

Short Account	Existing Reg. T (50%)	New Customer Deposit
100 @ \$50	\$2,500	\$2,500
100 @ \$40	\$2,000	\$2,000
100 @ \$30	\$1,500	\$2,000
100 @ \$20	\$1,000	\$2,000
100 @ \$17	\$850	\$2,000*

SIE Customer Accounts 356

Cheap Stock Rule

Deposit for Stock Priced at:
 \$10 or higher = 50%;
 \$5-\$10 = \$5/shr;
 <\$5 = greater of 100% of Mkt or \$2.50/shr

Short Account	Customer Deposit
1000 @ \$11	\$5,500
1000 @ \$10	\$5,000
1000 @ \$9	\$5,000
1000 @ \$8	\$5,000
1000 @ \$7	\$5,000
1000 @ \$6	\$5,000
1000 @ \$5	\$5,000
1000 @ \$4	\$4,000
1000 @ \$3	\$3,000
1000 @ \$2	\$2,500
1000 @ \$1	\$2,500

50% or greater

SIE Customer Accounts 357

A customer sells short 1,000 shares of ABC stock at \$4 in a margin account. The customer must deposit:

A. \$2,000
 B. \$2,500
 C. \$4,000
 D. \$5,000

SIE Customer Accounts 358

A customer sells short 1,000 shares of ABC stock at \$2.75 per share in an initial transaction in a new account. The customer must deposit:

A. \$1,375
 B. \$2,500
 C. \$2,750
 D. \$5,000

SIE Customer Accounts 359

A customer sells short 1,000 shares of ABC stock at \$6 per share in an initial transaction in a new account. The customer must deposit how much per share?

A. \$1.80
 B. \$2.50
 ✓ C. \$5.00
 D. \$6.00

SIE Customer Accounts 360

Margin calculations

- The basic equation is $LMV - Debit = Eq$
- Reg T requires minimum initial of 50% equity
- SMA is a line of credit based on excess equity (equity > 50%)
- SMA = 50% of MV - Debit

Example: how much is SMA if:
 LMV = \$30,000
 DR = \$10,000
 Answer: $30,000 \times .50 = \$15,000$
 $\$15,000 - \$10,000 = \$5,000$
 SMA = \$5,000

Handwritten notes: EO MV, \$20K 10K = 10K 50%, \$30K 10K = 20K 67%, 50% SMA, CASH, 500K, 30K 15K, 40K 20K, 20K 50%

Taxation

Pass Perfect

Taxation: 3 Categories

- Earned Income:**
 - Wages, salaries, commissions, tips (any payment for work)
- Portfolio Income:**
 - Dividends from stock
 - Interest from bonds
 - Capital gains from buying and selling securities
 - Capital gains = proceeds - cost basis
 - Capital gains can be long term: more than 1 year holding period or short term 1 year or less holding period
 - Short term capital gains are taxed at regular income tax rate
 - Long term capital gain is taxed at preferential rate (15/20%)
- Passive income**
 - Income from real estate and limited partnerships
 - Any passive losses are fully deductible against your passive income

Pass Perfect

Royalties received from an oil and gas program are:

A. partnership income
 ✓ B. passive income
 C. earned income
 D. portfolio income

Taxes 364

All of the following would be defined as "earned income" under IRS regulations EXCEPT:

✓ A. Long term capital gains
 B. Pension payments
 C. Royalty payments
 D. Bonus payments

Handwritten note: RTF Question

Taxes 365

A writer writes a book (the "Quick SIE") and receives royalties from the publisher. These royalties are:

A. earned income
 B. portfolio income
 C. passive income
 D. active income

Cliff Notes

Taxes 366

Net Capital Loss Deduction

Step 1) IRS allows you to NET your gains and losses – NET capital loss \$320,000

Step 2) Bonus – you can deduct a maximum of \$3,000 of the net capital against your INCOME

Step 3) Double bonus – any remaining loss you carry it forward to next year = \$317,000

Buy 1,000 shares of ABC stock at \$10 (cost basis)
 Sell 1,000 shares of ABC stock at \$50 (sales proceeds)
 Report to the IRS a capital gain – \$40,000

Buy 1,000 shares of GME at \$460 (cost basis)
 Sell 1,000 shares of GME at \$100 (sales proceeds)
 Report to the IRS a capital loss – \$360,000

Pass Perfect

A customer has \$20,000 in passive losses from a limited partnership investment. If the customer has no other passive income for that tax year, the customer may deduct:

A. 0
 B. \$3,000
 C. \$17,000
 D. \$20,000

Taxes 368

A customer has \$20,000 in passive losses from a limited partnership investment. If the customer has \$20,000 of passive income for that tax year, the customer may deduct:

A. 0
 B. \$3,000
 C. \$10,000
 D. \$20,000

Taxes 369

A customer buys \$23,000 of ABC stock in March of 2021. On January 31, 2022, the stock is valued at \$10,000. The customer will be able to deduct how much on this year's tax return?

A. 0
 B. \$3,000
 C. \$6,500
 D. \$13,000

Taxes 370

A customer buys \$23,000 of ABC stock in March of 2021. On January 31, 2022, the stock is valued at \$19,000 and the customer sells the position. The customer will be able to deduct how much on this year's tax return?

A. 0
 B. \$1,500
 C. \$3,000
 D. \$4,000

Taxes 371

A customer has \$3,000 of capital losses and \$7,000 of capital gains in a tax year. On that year's tax return, the investor has:

- A. no loss to put on his tax return - 3K
+ 7K
+ 4K gain
- B. a \$3,000 capital loss deduction with no loss carryforward
- C. a \$3,000 capital loss deduction and a \$4,000 loss carryforward
- D. a \$7,000 capital loss deduction with no loss carryforward

Taxes

372

A customer has \$7,000 of capital losses and \$3,000 of capital gains in a tax year. On that year's tax return, the investor has:

- A. no gain or loss to put on his tax return - 7K
+ 3K
- 4K
- B. a \$3,000 capital loss deduction with no loss carryforward
- C. a \$3,000 capital loss deduction and a \$1,000 loss carryforward
- D. a \$7,000 capital loss deduction with no loss carryforward

Taxes

373

A customer in the 28% tax bracket has \$6,000 of capital gains and \$9,000 of capital losses. How much unused loss is carried forward to the next tax year?

- A. 0
- B. \$3,000
- C. \$6,000
- D. \$9,000

Taxes

374

Cost Basis VS Sales Proceeds

- investor is considered owner of stock or seller of his position on trade date (not settlement date)
- Cost Basis** is established when you **buy** a security
 - this would include any commissions that you paid for the security
- Sales Proceeds** is established when you **sell** a security
 - this would also include any commissions that you paid for the security

Taxes

375

SPECIFIC IDENTIFICATION OF SHARES

- if an investor holds a large stock position which has been accumulated over a period of time at varying prices, specific identification of shares being sold can be made, which method **must be selected by settlement date**
 - if specific identification is not used, the IRS mandates FIFO (first in first out) accounting

Taxes

376

In January, 20XX a customer buys 100 shares of ABC stock at \$30 per share and pays a \$2 commission per share. The customer receives \$1 in cash dividends during the year. The customer's cost basis in the stock is:

- A. \$28 per share
- B. \$30 per share
- C. \$31 per share
- D. \$32 per share

Taxes

377

In January, 20XX a customer sells 100 shares of ABC stock at \$30 per share and pays a \$2 commission per share. The customer's sales proceeds in the stock is:

- A. \$28 per share
- B. \$30 per share
- C. \$31 per share
- D. \$32 per share

Taxes

378

An investor holds shares of a stock that declares a 10% stock dividend. Which of the following are true regarding the stock position after the dividend is paid?

- I The cost basis per share is adjusted
- II The cost basis per share remains the same
- III The distribution is taxable
- IV The distribution is not taxable

- A. I and III
- B. I and IV
- C. II and III
- D. II and IV

20% more
100 shares + 20% = 120 shares

500 ABC @ \$30 = 15K
20% stock div.
100 ABC @ \$35

Taxes