




Uniform Securities Act



 FIRM → R, IA ≠ IAR ← EMPLOYEES

 CORP VS GOVT VS AGGVD VS MUNI

 ↗ NON-EXEMPT ↘ EXEMPT

 FOD + STATE REGISTRATION

UNIFORM SECURITIES ACT


 FED LAW VS STATE LAW

 SEC ACTS OF '33 & '34 VSA NASAA

 TRUST INVESTMENT ACT OF '39

 INVEST CO & ADVISORS ACTS OF '40


Series #63/#65/#66 Uniform Securities Act 1



STATE "BLUE SKY" LAWS REQUIRE REGISTRATION IN THE STATE OF:

- Broker-Dealers (BDs) → FIRM
- Agents of BDs → REG. REP.
- Investment Advisers (IAs) → FIRM
- Agents of IAs a.k.a. Investment Adviser Reps (IARs)


Series #63/#65/#66 Uniform Securities Act 2



STATE "BLUE SKY" LAWS

- Each State requires registration in the State if a BD or its agent; or IA or its IAR:
 - Resides in the State; or
 - Solicits business from the public (not institutions) in the State


Series #63/#65/#66 Uniform Securities Act 4



STATE "BLUE SKY" LAWS

- Thus, there really are "duplicate" registration requirements – registration is required at both the Federal and State levels
 - NSMIA – the National Securities Markets Improvement Act – was passed in 1996 to eliminate this duplicate regulation between the States and the Federal Government only for IAs (not for BDs)
- NSMIA says that if registration is required at the Federal level then the individual States cannot require registration of IAs.
- If the Federal Government does not require registration, then the States can
 - The basic "idea" is to divide up the policing of IAs with the Federal government policing the "big" guys and the State governments policing the "little" guys


Series #63/#65/#66 Uniform Securities Act 5



STATE "BLUE SKY" LAWS

- Another thing NSMIA made clear is that Federal law will always supersede State law
 - In a situation where Federal and State laws conflict (which occurs more often than you would believe), Federal law prevails

Series #63/#65/#66 Uniform Securities Act 6



ADMINISTRATOR

- The Uniform Securities Act provides that each State has an Administrator who "administrates" the Act
- This person can be the State Securities Commissioner, Commissioner, or Secretary of State
- In most States, the Administrator reports to the Secretary of State or is part of the Secretary of State's Department

Series #63/#65/#66 Uniform Securities Act 7



Uniform Securities Act

The State Administrator is supervised by:

- A. the State governor
- B. the State secretary
- C. NASAA
- D. the State treasurer

Series #63/#65/#66 Uniform Securities Act 8

REGISTRATION / LICENSING

Series #63/#65/#66 Uniform Securities Act 9

PERSON

- Anyone who is subject to the provisions of the Uniform Securities Act
- Not only does it include humans (agents and IARs), it also includes Corporations, Partnerships, Trusts, Estates, Municipalities, Issuers, etc...

IF YOU CAN ISSUE OR TRADE SECURITIES = PERSON

Series #63/#65/#66 Uniform Securities Act 10

ISSUER / ISSUER TRANSACTIONS

- Issuer
 - Anyone who issues or proposes to issue a security
- Issuer Transactions
 - A primary transaction, meaning that the proceeds of the offering go to the issuer

Series #63/#65/#66 Uniform Securities Act 11

NON-ISSUER / NON-ISSUER TRANSACTION

- Anyone who engages in a securities transaction that is not the issuer
- Non-issuer transaction is a trade where the proceeds go to someone other than the issuer
 - i.e. the trade is done by someone else in the secondary market

Series #63/#65/#66 Uniform Securities Act 12

INSTITUTIONAL BUYERS

- State law is designed to protect the average investor – i.e. the little person
- Institutional investors who can “watch out for themselves” and don’t need protection under State law, such as:
 - Banks; Savings and Loans; Trust Companies;
 - Insurance Companies;
 - Investment Companies;
 - Pension and Profit Sharing Plans, and;
 - Anyone so-designated by the State Administrator.
 - As long as:
 - 1) a BD or IA is not physically located in the State; and
 - 2) only institutional buyers are solicited in the State;
 - there is no requirement for registering in the State

Series #63/#65/#66 Uniform Securities Act 13



Uniform Securities Act

BROKER-DEALER (BD)

- A person who engages in trades for its own account (proprietary) or someone else's account
- Note: Many State Regulators say M&A (Mergers & Acquisitions) Advisers and Finders (i.e. those that "find" companies to be acquired) are defined as BDs

Series #63/#65/#66

Uniform Securities Act

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PERSONS WHO ARE NOT CONSIDERED TO BE BDs

- Agents (sales employees of BDs, who must register as agents under the USA)
- Deposit-taking institutions (banks, trust companies, etc.)
- Issuers (because they are selling their own securities)

Series #63/#65/#66

Uniform Securities Act

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EXCLUDED FROM THE BD DEFINITION – NON-RESIDENT BDs DEALING WITH INSTITUTIONS

- BDs with no office in that State who deal with institutions (not the general public), such as:
 - Issuers
 - Other BDs
 - Financial Institutions
- Note that this exclusion is only available to BDs that have no office in the State. If a firm has an office in a State, it must register in that State – no ifs, ands or buts!

Series #63/#65/#66

Uniform Securities Act

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CONTACTING VACATIONING CUSTOMERS

- As long as a BD is registered in a State where it has an office, it may contact existing customers who are vacationing in other States
- The State in which the customer is vacationing cannot require the BD to register
 - However, if the BD is contacting a new customer vacationing in another State, then it must register in that State
- If the BD is contacting an existing customer who is temporarily residing (not vacationing), it must register in that State
- Know for the test that this is an exemption from registration under USA as opposed to the exclusions previously covered

Series #63/#65/#66

Uniform Securities Act

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CANADIAN BD EXEMPTION

- Canadian BDs are exempt from registration in the State as long as the firm:
 - Has no office in the State; and
 - Only contacts existing customers who are in the U.S. for less than 183 days a year
- This means that a Canadian BD must register in the state if it:
 - Has an office in the State; or
 - Contacts new clients in that State; or
 - Contacts existing customers temporarily residing in that State for 183 days or more.

Series #63/#65/#66

Uniform Securities Act

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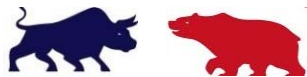
AGENT

- An individual who represents a BD (meaning a registered representative) or an Issuer in the trading of securities
 - Agents are BD employees or independent contractors who effect securities trades for compensation
 - Agents must be registered in each State in which they do business
 - Officers/directors of BDs are automatically registered as agents when the BD application is filed with the State
 - The BD can "override" the default setting of automatic registration if these individuals don't deal with the public (i.e. for outside independent directors)

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Uniform Securities Act

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Uniform Securities Act

Which of the following must be registered as agents of a broker-dealer in the State?

- I Director
- II Sales employee
- III Clerical employee

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

Series #63/#65/#66 Uniform Securities Act 20

A broker-dealer receives critical information about a corporation in which one of his customers has invested. The customer is vacationing in a State in which the broker-dealer is not licensed. Which statement is true?

VS temporarily residing = snowbird

- A. The broker-dealer must be registered in a State to contact anyone in that State
- B. The customer may be contacted only if the information received is going to affect the corporation's securities negatively
- C. The customer may be contacted only if the information received is going to affect the corporation's securities positively
- D. The customer may be contacted while on vacation in the other State regardless of the broker-dealer not being registered in that State

Series #63/#65/#66 Uniform Securities Act 21

An agent of a Canadian broker-dealer has a personal relationship with an individual who the agent has been soliciting to buy securities. The individual has just moved to Minnesota and the agent wishes to continue soliciting this person. Which statement is true?

- A. The agent can solicit the individual in Minnesota without needing to take any further action because there was pre-existing personal relationship
- B. The agent cannot solicit individual in Minnesota unless the agent is registered in the State
- C. The agent cannot solicit the individual in Minnesota unless the broker-dealer is registered in the State
- D. The agent cannot solicit the individual in Minnesota unless both the broker-dealer and agent are registered in the State

Series #63/#65/#66 Uniform Securities Act 22

NON-AGENTS

- Clerical or ministerial personnel of BDs
- Partners, officers, or directors of BDs who do not deal with the public
- Issuer-personnel (not BD-personnel) offering exempt securities for that issuer
 - For example, an individual who conducts a new issue general obligation bond offering for a municipality is not required to register in the State
 - For example, an individual associated with a BD who offers a new issue of general obligation bonds to the public is required to register in the State

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MAJOR EXEMPT SECURITIES

- U.S. and Municipal Governments, Canadian and Foreign Governments
- Bank Issues (CDs)
- Trust Companies
- Commercial Paper issued by corporations (9 month maturity or less) in minimum \$50,000 units

Series #63/#65/#66 Uniform Securities Act 24

A broker-dealer uses summer interns who answer the telephone, give stock quotes, and take messages from clients. The summer interns:

- A. are not required to be registered in the State as agents because of their temporary status
- B. are not required to be registered as agents in the State because they are performing clerical functions
- C. must be registered in the State because they are transacting securities business with the public
- D. must be registered in the State because they are working for a broker-dealer

Series #63/#65/#66 Uniform Securities Act 25



Uniform Securities Act

A broker-dealer uses summer interns who answer the telephone, give stock quotes, and take orders from clients. The summer interns: **RTFQ**

- A. are not required to be registered in the State as agents because of their temporary status
- B. are not required to be registered as agents in the State because they are performing clerical functions
- C. must be registered in the State because they are transacting securities business with the public**
- D. must be registered in the State because they are working for a broker-dealer

Series #63/#65/#66 Uniform Securities Act 26

Which of the following individuals is defined as an "agent" under the Uniform Securities Act?

- I. An individual who represents a broker-dealer selling exempt securities to the public
- II. An individual who represents a broker-dealer selling securities listed on a national stock exchange
- III. An individual who represents an issuer in an exempt transaction**
- IV. An individual who represents an issuer in a transaction with existing employees ~~without~~ accepting a commission

- A. I and II only**
- B. III and IV only
- C. I, II, IV - **IF ACCEPTS COMMISSIONS**
- D. I, II, III, IV

Series #63/#65/#66 Uniform Securities Act 27

INVESTMENT ADVISER (IA)

- A person who for compensation:
 - Gives investment advice directly or indirectly as to the value of securities, or the buying or selling of securities
 - Issues analyses or reports about securities as part of their business
 - Provides advisory services in a **financial planning** business

Series #63/#65/#66 Uniform Securities Act 28

EXCLUDED FROM IA DEFINITION

- Investment Adviser Representatives (IARs - the registered reps of the investment advisory world, who are required to be registered in the State as IARs, not as IAs)
- Banks, Savings and Loans, Trust Companies (excluded since they are regulated under State and Federal banking laws)
- BDs that do not separately charge for investment advice (excluded because they are regulated as BDs not as IAs)
- Publishers of newsletters, magazines, etc., that do not give advice based on specific situations **L.A.F.F.E**
- Professionals (Lawyers, Accountants, Teachers, Engineers) who give advice that is incidental to their practice

Series #63/#65/#66 Uniform Securities Act 29

FEDERAL COVERED ADVISERS (FCAs)

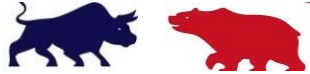
- NSMIA - the National Securities Markets Improvements Act of 1996 - divided responsibility for IA supervision between the SEC and the States
- A FCA is one that registers only with the SEC under the Investment Advisers Act of 1940 and is only subject to SEC regulation
- A FCA cannot be required to be registered in a State. However, the State can require a notice filing and a fee payment (and will because they want the \$)
- FCAs are the "big boys":
 - IAs with at least \$100MM of assets under management (AUM); or
 - An adviser to an investment company.
- Note however, that even though States cannot regulate FCAs, they still have jurisdiction if they suspect fraud or deceit has occurred

Series #63/#65/#66 Uniform Securities Act 30

STATE REGISTERED ADVISERS

- The "little guys":
 - Any adviser with less than \$100MM of AUM must register in the State
- These advisers do not register with the SEC and are not subject to SEC regulation – they are only subject to regulation on the State level

Series #63/#65/#66 Uniform Securities Act 31



Uniform Securities Act

FEDERAL COVERED ADVISERS (FCAs)

- IAs that manage \$100MM or more
 - The SEC says that IAs with between \$100-\$110MM of assets can register either with the SEC or the State
 - Note that once SEC-registered, the IA only has to de-register with the SEC when its assets fall below \$90MM
- Advisers that operate in at least 15 States with at least \$25MM of assets can choose to register with the SEC rather than having to register separately in each State

Series #63/#65/#66 Uniform Securities Act 32

EXCLUSIONS FROM THE IA DEFINITION (NO REGISTRATION WITH SEC OR STATES AS AN IA)

- Banks or Bank Holding companies
- Lawyers, accountants, teachers, engineers who give advice that is incidental to what they do
- BDs who do not charge separately for advice
- Publishers of bona fide newspapers and magazines with general and regular publication
- Any person who advises solely about U.S. Government securities

Series #63/#65/#66 Uniform Securities Act 33

An investment adviser with \$120 million under management has its main office in New York and a branch office in Connecticut. Which statement is true?

- The investment adviser must register in the State of New York only
- The investment adviser must register in both the State of New York and State of Connecticut
- The investment adviser must register with the SEC only
- The investment adviser must register in both the State of New York and State of Connecticut and must register with the SEC

Series #63/#65/#66 Uniform Securities Act 34

IA DE MINIMIS EXEMPTION

LESS THAN 6

- Any IA is exempt from registration in the State as long as:
 - It has no place of business in the State (i.e. an “out-of-state” firm); and
 - It does business with no more than 5 retail clients over a 12 month time period in the State.
- This is known as the “de minimis” exemption
- A fair number of States have their own BD “de minimis” exemption, but since it is not consistently applied and is NOT tested

Series #63/#65/#66 Uniform Securities Act 35

Under the Uniform Securities Act, if an Investment Adviser limits its clientele to insurance companies, which statement is true?

- The investment adviser must register with the State of residence of the insurance company
- The investment adviser is exempt from registration in the State of residence of the insurance company as long as it is not physically located in that State
- An investment adviser dealing with insurance companies is never required to register within a State
- None of the above

Series #63/#65/#66 Uniform Securities Act 36

Which statements are true about an investment adviser with an office in State A?

1940 - FEDERAL LAW

- If the investment adviser's only clients are investment companies, the investment adviser must register with the SEC = *FED LAW*
- If the investment adviser's only clients are investment companies, the investment adviser must register in the State
- If the investment adviser's only clients are insurance companies, the investment adviser must register with the SEC
- If the investment adviser's only clients are insurance companies, the investment adviser must register in the State = *STATE LAW*

- I and III
- I and IV
- II and III
- II and IV

Series #63/#65/#66 Uniform Securities Act 37



Uniform Securities Act

INVESTMENT ADVISER REPRESENTATIVE (IAR)

- Any individual employed by an IA of a State registered or FCA who:
 - Makes recommendations or gives advice about securities
 - Manages accounts and portfolios for customers
 - Solicits, offers, or negotiates the sale of investment advisory services
 - Supervises employees who perform these functions
- Specifically EXCLUDED are individuals who only perform clerical or ministerial functions

Series #63/#65/#66

Uniform Securities Act

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IARs DO NOT REGISTER WITH THE SEC

- FCAs are required to register with the SEC and only give notice in each State in which they do business
- However, there is no SEC registration of IARs
 - The States filled the gap by requiring IARs of any FCA who filed notice in the State to register in the State
- Of course, IARs of State registered advisers must be registered in the State

Series #63/#65/#66

Uniform Securities Act

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IAR SUMMARY

- If the IAR of a FCA is:
 - physically located in the State,
- Then the IAR must register in the State
- If the IAR of a FCA is:
 - NOT physically located in the State, and the FCA files notice in the State (because the IAR is doing business there),
- Then the IAR must register in the State
- All IARs of State registered IAs must register in the State in which they are located and also must register in each State in which they do business

Series #63/#65/#66

Uniform Securities Act

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An investment adviser is registered in State A and State B. An investment adviser representative of that firm:

- A. must register in both State A and State B
- B. must register in any State where he solicits customers to buy investment advice
- C. must register only in the State where the representative has the majority of his or her clients
- D. does not need to register in a State as long as the investment adviser is registered in that State

Series #63/#65/#66

Uniform Securities Act

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All of the following are required to be registered in State A EXCEPT:

- A. IA with \$75MM of assets under management located in State A
- B. IAR located in State A associated with an IA located in State A with \$75MM of assets under management
- C. IA with \$175MM of assets under management located in State A *← SEC REGISTERED*
- D. IAR located in State A associated with an IA located in State A with \$175MM of assets under management

Series #63/#65/#66

Uniform Securities Act

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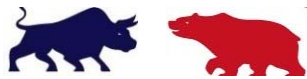
An investment adviser representative of a Federal Covered adviser only has insurance companies as clients. With whom must the investment adviser representative register?

- A. SEC
- B. State
- C. Both the SEC and the State
- D. Neither the SEC nor the State

Series #63/#65/#66

Uniform Securities Act

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Uniform Securities Act

GENERAL REGISTRATION PROCEDURES FOR BDs, AGENTS, IAs, AND IARs

- Consent to Service of Process must be filed with the initial application
 - What this means is if someone wants to sue, the Administrator is served, who will send the notice to the registrant
 - Note that when registration is renewed each year, another consent to service of process is not needed

Series #63/#65/#66

Uniform Securities Act

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"Consent to service of process" means that the:

- A. Administrator is empowered to fine or penalize an agent or broker-dealer
- ✓ B. Administrator is authorized to receive suits on behalf of an agent or broker-dealer
- C. registrant is under the jurisdiction of the Administrator for up to 1 year after withdrawal from registration
- D. registrant cannot be compelled to give testimony in an investigation

Series #63/#65/#66

Uniform Securities Act

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REGISTRATION APPLICATION FOR A BD OR IA

- Type of Business (Corporation, Partnership, Sole Proprietorship)
- Address
- Names, qualifications, and fingerprints of officers, directors, and partners
 - Note that all officers, directors, and partners are automatically registered as agents unless they are not dealing with the public and this is noted on the application
- Officers' financial condition and employment history
- Any injunctions, administrative orders, convictions for misdemeanors related to banking, securities, commodities, theft, etc., or ANY felony against any Officer

Series #63/#65/#66

Uniform Securities Act

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Which of the following is NOT required to be included in the State registration application of a broker-dealer or investment adviser?

- A. Consent to service of process
- B. Business history of applicant
- C. Fingerprints of the officers
- ✓ D. Books and records of the broker-dealer used by the applicant

Series #63/#65/#66

Uniform Securities Act

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When a broker-dealer application becomes effective in a State, who is NOT required to separately register?

- ✓ A. Directors of the broker-dealer
- B. Salespersons of the broker-dealer
- C. Supervisors of salespersons of the broker-dealer
- D. Managing directors that oversee marketing of broker-dealer services

Series #63/#65/#66

Uniform Securities Act

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FULL DISCLOSURE AND DETERMINING IF THE APPLICANT IS A POTENTIAL RISK TO INVESTORS

- Conviction of ANY felony in the past 10 years will result in registration denial
- Conviction of a misdemeanor involving securities, money, theft, etc... in the past 10 years will result in registration denial
- Fingerprints are required in most states so they can do a match against the FBI database searching for criminals
- If any information on the application changes or is found to be inaccurate, it must be corrected promptly

Series #63/#65/#66

Uniform Securities Act

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Uniform Securities Act

FOR AGENT AND IAR REGISTRATION U-4, U-5, & U-6

- **U-4 Application Form** is completed and signed by the individual who is registering
 - Agents of BDs register in CRD (Central Registration Depository)
 - IARs register in IARD (Investment Adviser Registration Depository)
- Registration expires at the end of each year unless renewed along with a payment of a renewal fee
- **U-5 Termination Form** is filed by the ex-employer
 - This must be filed within 30 days of termination by the former employer
- **U-6 Disciplinary Action Form** is filed by the Administrator or Federal regulator
 - This must be filed promptly, but no later than 30 days after the action has been taken
 - Note that serious allegations made in written complaints alleging a felony are reported even though their resolution is still pending!

Series #63/#65/#66

Uniform Securities Act

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TO REGISTER, BDs AND IAs NEED 3 THINGS

- 1) Net Capital/Net Worth
- 2) Surety Bond Coverage
- 3) Passing a Qualification Exam

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Uniform Securities Act

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TO REGISTER, BDs AND IAs NEED 3 THINGS

- 1) Net Capital/Net Worth Standards
 - BDs need minimum Net Capital (minimum liquid Net Worth); while IAs need minimum Net Worth
 - Minimum Net Worth = Assets – Liabilities – Intangibles (i.e. things like trademarks, copyrights, etc...)
 - If the adviser is an individual, the value of ALL personal property (like home, car, etc...) is deducted
 - If the adviser is a partnership or corporation, items used in the business are included, and are NOT deducted
 - Note, once registered, if a BD or IA falls below the minimum net capital required, it must:
 - Notify the Admin the next business day; and
 - File a report the day after.

Series #63/#65/#66

Uniform Securities Act

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A State-Registered Investment Adviser finds that it has fallen below the minimum net worth requirements established by that State. A notification must be made to the State Administrator that the RIA is not in compliance with the State's minimum net worth standards:

- A. the same day
- B. the next business day
- C. within 10 business days
- D. within 30 business days

Series #63/#65/#66

Uniform Securities Act

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An Investment Adviser falls below the minimum net capital required by the State on Monday. The IA must file a report with the Administrator no later than:

- A. Tuesday of that week
- B. Wednesday of that week
- C. Thursday of that week
- D. 10 business days after the event

Series #63/#65/#66

Uniform Securities Act

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TO REGISTER, BDs AND IAs NEED 3 THINGS

- 2) Surety Bond Coverage
 - Money or insurance policy held by the State which the State can use to meet legal claims against the BD or IA
 - Minimum coverage is \$10K for BDs or IAs that exercise discretion; and \$35K for IAs that take custody
 - The State Administrator can waive this requirement
- 3) Qualifying Exam
 - Officers named in the Form BD or Form ADV must pass a State Securities Exam if they deal with the public or supervise people who deal with the public

Series #63/#65/#66

Uniform Securities Act

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Uniform Securities Act

TO REGISTER, AGENTS NEED 2 THINGS WHILE IARs NEED 1 THING

- Agents need to:
 - Pass a qualifying exam
 - Post a surety bond if required by the State
- IARs need to:
 - Pass a qualifying exam
- The Surety Bond requirement is only for BDs, Agents, and IAs
 - There is no surety bond requirement to be registered as an IAR

Series #63/#65/#66

Uniform Securities Act

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EFFECTIVE DATE OF REGISTRATION

- Registration becomes effective within 30 days or sooner
- The general rule is that the State has 30 days to deal with a registration application or withdrawal

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Uniform Securities Act

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REGISTRATION RULES FOR BDs AND AGENTS

- Typically, agents can only work for one firm at a time
- If dual registration is allowed (registration with 2 different BDs at the same time), it must be disclosed on the registration application
- You are not an agent unless you are associated with a BD
 - If an agent solicits business without being associated with a BD, that agent becomes a “statutory BD” requiring their registration as such
- “Agents” who work for exempt or excluded BDs are also exempt from registration and are therefore not official agents
- If an agent ceases employment, both the agent and the broker dealer must notify the State (note the rule differs for IAs and IARs)

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Uniform Securities Act

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REGISTRATION RULES UNIQUE TO IAs AND IARs

- FCAs do not register in the State
 - However, they must file notice with the State and pay that all important fee
- Because there is no Federal registration requirement for IARs, only for IAs, the IARs of FCAs must also register in the State (even though the firm does not)
- When an IAR ceases employment, the employer (not BOTH the employer and the employee as required for BDs) must notify the State
- However, for the IAR of a FCA, it is just the employee who notifies (since only the IAR is registered in the State and not the IA)

FCA STATE IA - REP. NOTICE IA notice - BOTH money

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Uniform Securities Act

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Who is responsible for filing a U-5 Form with IARD when an investment adviser representative is terminated and associates with another advisory firm?

- A. The investment adviser that is the former employer is responsible
- B. The investment adviser that is the new employer is responsible
- C. The investment adviser representative is responsible *← ONLY IF IAR OF FID. COVERED ADVISER*
- D. No one is responsible for notifying IARD when the investment adviser representative is terminated

Series #63/#65/#66

Uniform Securities Act

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REGISTRATION REQUIREMENTS

- CRD is used to register BDs and Agents in each State
 - Form BD for BDs and Form U-4 for Agents
- IARD is used to register IAs and IARs
 - Form ADV for IAs; and Form U-4 for IARs
- Registration must be renewed by December 31st of each year, along with the payment of a fee, in each State in which the BD, Agent, IA, and IAR does business
- There is no reduction of the year’s fee for anyone registering intra-year
 - However, if the firm is sold intra-year, the new firm can take over the paid fee through the end of the year

Series #63/#65/#66

Uniform Securities Act

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Uniform Securities Act

IARD

- IARD is used for both Federal and State registrations
 - FCAs register with the SEC via IARD
 - FCAs file notice in each State in which they do business via IARD
 - State registered advisers register in each State via IARD
 - All IARs of both FCAs or State registered advisers register in each State via IARD

Series #63/#65/#66 Uniform Securities Act 63

IARD

- In addition to paying the annual registration renewal fee at the end of the year, IAs are required to amend the information in their Form ADV
 - The annual renewal amendment must be filed within 90 days of fiscal year end for both FCAs and State registered advisers
- If there is a material change during the year, the Form ADV must be updated with an “other-than-year-end” amendment. This must be filed:
 - Promptly under SEC rules for FCAs; and
 - Within 30 days under NASAA rules for State registered advisers (which is their version of “promptly”)

Series #63/#65/#66 Uniform Securities Act 64

A Registered Investment Adviser (RIA) is formed and registers in the State on October 15th. The RIA would be required to reregister in the State on:

- A. December 31st of the year of registration
- B. January 1st of the year following the year of registration
- C. April 1st of the year following the year of registration
- D. January 1st of the second year following the year of registration

Series #63/#65/#66 Uniform Securities Act 65

A person makes an initial application for State registration on September 30th. Which statement is TRUE regarding the filing fee?

- A. The fee will be pro-rated and only 3/12ths of the annual fee must be paid
- B. The fee will be pro-rated and only 9/12ths of the annual fee must be paid
- C. The annual fee is not pro-rated and the full year filing fee must be paid
- D. No filing fee is due until the annual December 31st renewal

Series #63/#65/#66 Uniform Securities Act 66

WHY WOULD REGISTRATION BE DENIED, REVOKED, OR SUSPENDED?

- This would happen if a person has:
 - Filed an incomplete or inaccurate registration application
 - Been convicted of willfully violating the Act
 - Been enjoined by the courts from engaging in the securities business
 - Had his/her registration suspended or revoked by the Administrator or any other regulator
 - Been convicted of a misdemeanor within the last 10 years involving monies, securities, theft, etc., (other misdemeanors such as littering or jaywalking are OK) or ANY felony

Series #63/#65/#66 Uniform Securities Act 68

WHY WOULD REGISTRATION BE DENIED, REVOKED, OR SUSPENDED?

- This would happen if a person has (cont.):
 - Willfully broken a securities law within the past 10 years
 - Willfully violated the securities or banking laws of a foreign jurisdiction or has been the subject of an order by a foreign regulator denying, suspending, or revoking that person's right to be in the securities business within the past 5 years
 - Engaged in unethical or dishonest business practices
 - Failed to pay any and all fees
 - Failed to properly supervise employees
 - Gone out of business, can't be located, or is adjudicated as being mentally incompetent
 - Been deemed unqualified by the State Administrator based on lack of experience, training, or knowledge (this alone cannot disqualify you)

Series #63/#65/#66 Uniform Securities Act 69



Uniform Securities Act

A B/D application is received by the State Administrator for a new broker-dealer subsidiary of a British securities firm. The application includes the disclosure that the parent firm was suspended from membership on the London Stock Exchange 4 years ago because of unauthorized trading by its Singapore branch. The State Administrator:

- A. cannot deny registration based on a suspension that was imposed by a foreign regulator
- B. can deny registration based on the suspension by the foreign regulator
- C. must grant registration because the U.S. subsidiary is a legally separate entity from the parent company that is based in Britain
- D. can deny registration only if the actions of the parent company were a criminal offense

Series #63/#65/#66 Uniform Securities Act 70

A B/D application is received by the State Administrator for a new broker-dealer subsidiary of a Swiss securities firm. The application includes the disclosure that the parent firm was suspended from membership on the Deutsche Bourse 6 years ago because of unauthorized trading by its Hong Kong branch. The State Administrator:

- A. cannot deny registration based on the suspension that was imposed by a foreign regulator
- B. can deny registration based on the suspension by the foreign regulator
- C. must grant registration because the U.S. subsidiary is a legally separate entity from the parent company that is based in Switzerland
- D. can deny registration only if the actions of the parent company were a criminal offense

Series #63/#65/#66 Uniform Securities Act 71

A broker-dealer registration application CANNOT be denied in a State if the broker-dealer has:

- A. filed an application that is incomplete in any material respect
- B. hired an individual as an agent who has committed a felony
- C. a lack of experience trading securities for its own account or for the account of others
- D. willfully violated a provision of the Uniform Securities Act

Series #63/#65/#66 Uniform Securities Act 72

THE ADMINISTRATOR CAN ALSO POSTPONE OR SUSPEND REGISTRATION

- However, if this is done, the Administrator must:
 - Promptly inform the applicant and the employer that the order was entered and why; and
 - Schedule a hearing within 15 calendar days, if requested.
- If no hearing is requested, the order stands

Series #63/#65/#66 Uniform Securities Act 73

VOLUNTARY RESIGNATION

- If a BD, Agent, IA, or IAR wishes to voluntarily resign, the resignation becomes effective in 30 days (or sooner)
- However, the Administrator retains jurisdiction over the BD, Agent, IA, or IAR if a complaint is filed within the next year
 - Note that this is different than the FINRA rule, which covers complaints filed for up to 7 years after resignation
 - The exam will only ask the State rule, not the FINRA rule

Series #63/#65/#66 Uniform Securities Act 74

Upon filing a withdrawal of registration with the State, the Administrator can commence a revocation or suspension proceeding for up to:

- A. 1 year from the effective date of the withdrawal
- B. 2 years from the effective date of the withdrawal
- C. 3 years from the effective date of the withdrawal
- D. 10 years from the effective date of the withdrawal

Series #63/#65/#66 Uniform Securities Act 75



Uniform Securities Act

OTHER REGISTRATION RULES

- If an existing customer of an agent moves to another State in which the agent is not registered, the agent (and BD) must register in that State within 60 days
- BDs and IAs must submit financial reports as requested by the Administrator
- If information in a filed Form BD, Form ADV, or Form U-4 is incorrect or there is a change, the filing must be corrected promptly (which NASAA defines as within 30 days)
- Advertising and Sales Literature must be filed with the Administrator as requested EXCEPT for material covering exempt securities or exempt transactions

Series #63/#65/#66

Uniform Securities Act

76

A broker-dealer in State A has a customer that lives in State A, whose account is managed by an agent that is registered in State A. The customer moves to State B, a State where the broker-dealer is registered but the agent is not. In order to continue doing business with the customer in State B, the agent:

- A. is not required to be registered in State B
- B. must register in State B within 10 days
- C. must register in State B within 30 days
- D. must register in State B within 60 days

Series #63/#65/#66

Uniform Securities Act

77

BUSINESS CONTINUITY AND SUCCESSION

- The IA must have a "Business Continuity and Succession Plan" that outline actions that must be taken if an unexpected major negative event occurs at the firm
- An issue addressed in the plan is the death/disability of key personnel and the firm being able to service clients if such an instance occurs
- The IA can adopt either an "Internal" or "External" Succession Plan
 - The "Internal" Succession Plan has the IA transferring responsibilities to another IAR currently in the firm
 - The "External" Succession Plan has the IA transferring client management to another IA firm

Series #63/#65/#66

Uniform Securities Act

78

An Investment Adviser has adopted an external Business Succession Plan. Who is responsible for servicing the IA's client accounts if the managing director of the Investment Adviser suddenly dies?

- A. Another Investment Adviser Representative currently in the firm
- B. Another Investment Advisory Firm to which investment management has been transferred
- C. The custodian bank that holds client funds and securities positions
- D. An immediate family member of the deceased managing director

Series #63/#65/#66

Uniform Securities Act

79

An Investment Adviser has adopted an internal Business Succession Plan. Who is responsible for servicing the IA's client accounts if the managing director of the Investment Adviser suddenly dies?

- A. Another Investment Adviser Representative currently in the firm
- B. Another Investment Advisory Firm to which investment management has been transferred
- C. The custodian bank that holds client funds and securities positions
- D. An immediate family member of the deceased managing director

Series #63/#65/#66

Uniform Securities Act

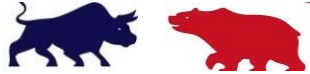
80

	Broker-Dealer	Investment Adviser
REGISTRATION RULES:		
Firm with no office in the state dealing only with institutions	Excluded from Registration in the State	Exempt from Registration in the State
Firm with no office in the state contacting existing customer vacationing in that state	Excluded from Registration in the State	Exempt from Registration in State
Firm with no office in the state that has 5 or fewer clients in that state	Exempt in many states	Exempt in ALL States

Series #63/#65/#66

Uniform Securities Act

81



Uniform Securities Act

	Broker-Dealer	Investment Adviser
RECORD RETENTION	3 Years Except for customer account records which are 5 years	5 years except if firm closes keep all records for 3 extra years
COMPENSATION	Earns commissions –if fixed fees are taken, firm becomes a “statutory” investment adviser	Earns fixed fees –if commissions are taken, firm becomes a “statutory” brokerdealer
BUSINESS PRACTICES:		
Fiduciary Standard	No – only comply with suitability rules	Yes – always looking out for customer best interest
Conflict of Interest Disclosure	Only when making a recommendation to client	Every conflict must be disclosed in Brochure given to client at account opening

Series #63/#65/#66 Uniform Securities Act 82

BUSINESS PRACTICES:	Broker-Dealer	Investment Adviser
Borrowing from Client	No – unless borrowing from a relative who is a client	No – no exceptions
Sharing in Gains/Losses	No – unless joint account with client is open and sharing is in proportion to the capital contributed	No – never
Able to take custody of client funds	Yes – always	No – unless firm notifies Administrator
Discretionary Power of Attorney	At or prior to entering first trade	Verbal discretion is allowed for 10 business days before receiving written POA

Series #63/#65/#66 Uniform Securities Act 83

BUSINESS PRACTICES:	Broker-Dealer	Investment Adviser
Paying Referral Fees	No – because commissions can only be shared with other registered individuals at the same firm	Yes – as long as individual is registered as an IAR
Order Tickets	Time stamped with time of order entry; execution; cancellation	No time stamps since orders are sent to a broker-dealer that keeps the record
Testimonials in Advertising	Yes – must disclose if paid	FCA Yes - must disclose if paid USA – No no exceptions

Series #63/#65/#66 Uniform Securities Act 84

STATE SECURITIES REGISTRATION

- State “Blue Sky” laws require registration in the State of securities offerings
- The fact that the Securities Act of 1933 requires registration of securities offerings with the SEC has nothing to do with State registration rules
- Thus, there is duplicate registration of securities at both the Federal and State level

Series #63/#65/#66 Uniform Securities Act 85

STATE SECURITIES REGISTRATION

- NSMIA (1996) eliminated most, but not all, duplicate registration requirements
- It defines “Federal Covered Securities” as those that only are required to be registered with the SEC (i.e. listed securities)
 - Listed stocks are Federal Covered Securities – they must be registered with the SEC but there is no State registration requirement
 - However, for a Federal Covered Security, the State can (and will) require a notice filing/fee for that issue to be offered in the State
- Securities that are not Federal Covered must be registered with the SEC and in each State where the security is offered
 - OTCBB and Pink Sheet stocks are NOT Federal Covered and must be registered with the SEC and each State where offered

Handwritten notes: "AMEX NASDAQ NYSE" with arrows pointing to "Federal Covered Securities"; "PINK SHEET STOCKS" with arrows pointing to "OTCBB and Pink Sheet stocks".

Series #63/#65/#66 Uniform Securities Act 86

FEDERAL COVERED SECURITIES

- Listed securities
 - Because they must meet stringent exchange listing standards which aren’t applicable to OTCBB and Pink Sheet issues
- Investment company securities
 - Because they are extensively regulated under the Investment Co. Act of 1940
- Securities sold in exempt transactions
 - Like Reg. D Private Placements because these are typically offered to wealthy accredited investors, and not the general public

Handwritten note: "FED LAW" with a red arrow pointing to "Investment Co. Act of 1940".

Series #63/#65/#66 Uniform Securities Act 87



Uniform Securities Act

SECURITIES REGISTRATION RULES

- Securities cannot be offered or sold in a State unless either:
 - The security is registered in the State under USA; or
 - The security is Federal Covered; or
 - The security or transaction is exempt under USA.
- Registration is valid for 1 year, but the Administrator can require quarterly updates
- Fees must be paid in full
- If there is excess demand, registration can be amended within 6 months to increase the size of the offering as long as both an additional fee AND a late fee are paid

Series #63/#65/#66

Uniform Securities Act

90

3 METHODS OF REGISTERING SECURITIES IN THE STATE

- Registration by Filing/Notification *EASIEST / SECONDARY*
- Registration by Coordination
- Registration by Qualification *MOST DIFFICULT BRAND NEW IPO*

Series #63/#65/#66

Uniform Securities Act

91

REGISTRATION BY FILING/NOTIFICATION

- Used for “seasoned” companies that already have securities registered in the State
 - Easiest method of registering securities in the State
- The issuer simply “notifies” the State that it is issuing more securities, along with a payment of a registration fee
- The issuer uses SEC registration forms for State filing
- The application must be on file 5 business days prior to sale
- Remember this only applies to OTCBB and Pink Sheet issues

Series #63/#65/#66

Uniform Securities Act

92

REGISTRATION BY COORDINATION

- Used when an issuer has NOT sold securities in the State before, but is filing a registration application with the SEC
 - Used for OTCBB and Pink Sheet IPOs that are being SEC-registered
 - Remember IPOs of listed securities are Federal Covered, so no State registration can be required
- The SEC registration is used as the State registration document
- The application must be on file for 10 business days
- Registration becomes effective when the SEC registration becomes effective
- One other point: If the Administrator issues a stop order against the issue, the burden of proof is on the Administrator to show why registration should be denied (because the Federal Government is allowing it)
 - This is the opposite of the “burden of proof” requirement for everything else

Series #63/#65/#66

Uniform Securities Act

93

REGISTRATION BY QUALIFICATION

- Used by an issuer that is only selling securities in a single State, so no SEC filing is required
- This is most difficult registration because, unlike the other two where the State accepts the Federal application, the issuer must file a specific State registration application
- The State carefully reviews the application and registration becomes effective when the State says so
- Unlike Registration by Coordination, if the Administrator issues a stop order, the burden of proof is on the issuer to show why the registration should be allowed

Series #63/#65/#66

Uniform Securities Act

94

Use the following choices to answer the questions below:

- A. Registration by Qualification
- B. Registration by Notification/Filing
- C. Registration by Coordination
- D. Registration by Administration *ADMINISTRATOR*

Which securities registration method would be used by a seasoned issuer? **B**

Which securities registration method can be used for an IPO of a Pink Sheet stock? **C**

Which securities registration method can be used for an IPO of a stock sold within 1 State? **A**

Series #63/#65/#66

Uniform Securities Act

95



Uniform Securities Act

Registration of securities in a State by Coordination becomes effective:

- A. when the filing with the State is completed
- B. 2 business days after the filing with the State is completed
- C. 5 business days after the filing with the State is completed
- ✓ D. when the Federal registration becomes effective

Series #63/#65/#66 Uniform Securities Act 96

State registration of a security registered by qualification becomes effective:

- ✓ A. when the Administrator so determines
- B. when the SEC registration becomes effective
- C. 10 business days after filing
- D. 20 calendar days after filing

Series #63/#65/#66 Uniform Securities Act 97

NO REGISTRATION IS REQUIRED IN THE STATE FOR:

- Exempt securities (Gov'ts, Agencies, & Munis)
- Federal Covered Securities (listed and invest co. securities)
- Already regulated issuers (banks, insurance companies, common carriers, etc.)
- Non-profit issues (charitable or benevolent issues)

Series #63/#65/#66 Uniform Securities Act 98

EXEMPT TRANSACTIONS

- The security involved is not required to be State registered, but the BD and Agent who effect the trade **MUST** still be registered
- Exempt Transactions are:
 - Isolated Non-Issuer Transactions: Narrowly defined in most States as being 1 or 2 transactions in a 12 month period
 - Unsolicited Trades
 - Transactions with Financial Institutions: Bank, Trust Co.
 - Fiduciary Transactions: Trades made by a Sheriff, Marshall, Receiver, Guardian, Conservator, or Trustee in a Bankruptcy
 - Issuer/Underwriter Transactions
 - Private Placements: USA defines this as an offer to no more than 10 persons in a 12 month period – completely different than Federal law
 - Offers or Sales of Pre-Organization Subscriptions

Series #63/#65/#66 Uniform Securities Act 99

Under the Uniform Securities Act, an investment adviser with no place of business in a State only does 1 trade in a non-exempt security in the State within a 12 month period. Which statements are TRUE?

- I. The security must be registered in the State
- II. No registration of the security is required because the transaction is exempt
- III. The investment adviser must be registered in the State
- IV. The investment adviser is not required to register in the State because it qualifies for a "de minimis" exemption

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

Series #63/#65/#66 Uniform Securities Act 100

THE ADMINISTRATOR CAN ENTER AN ORDER REVOKING, DENYING, OR SUSPENDING REGISTRATION IF THE:

- Application is incomplete or misleading
- USA has been violated by someone involved in the issue
- Security is subject to a temporary or permanent injunction
- Enterprise is illegal
- Offering would work a fraud on the public
- Terms of the offering are unfair
- Underwriting compensation is unreasonable
- Security was registered by the wrong method
- Applicant didn't pay the filing fees

Series #63/#65/#66 Uniform Securities Act 101



Uniform Securities Act

STOP ORDER

- The Administrator has the power to issue “orders”
- The Administrator can issue an order denying, suspending, or revoking registration if:
 - It is in the public interest; and
 - The offering is illegal, fraudulent, unjust, or abusive
- If the Administrator enters a “stop” order:
 - All parties must be notified promptly with the reason for the order
 - Any party can request a hearing which must be scheduled within 15 days
 - If no hearing is requested, the order stands

Series #63/#65/#66

Uniform Securities Act

102

Upon entry of a "stop order", the Administrator must notify those affected by the order that:

- A. the registration has been revoked
- B. an opportunity for a hearing is available
- C. sale of the issue can continue until any charges are proven
- D. the Administrator has filed criminal charges

Series #63/#65/#66

Uniform Securities Act

103

BUSINESS PRACTICES

- The main intent of State registration laws is to protect the general investing public from swindlers who would fleece the good citizens of a State by selling them worthless securities or worthless investment advice

Series #63/#65/#66

Uniform Securities Act

104

ADVISORY CONTRACT AND ANTI-FRAUD RULES

- USA says that when buying or selling a security (BD or Agent), or when advising about the purchase or sale of a security for compensation (IA or IAR), it is unlawful to:
 - Operate a fraud or deception
 - Make an untrue statement or omit a material fact
 - Engage in an act that would constitute or work a fraud
 - Effect a trade without the customer’s permission
 - Be dishonest or unethical

Series #63/#65/#66

Uniform Securities Act

105

NASAA REQUIRES THAT ADVISORY CONTRACTS:

- Must be in writing
- Must have a fixed life
- Must detail all fees which must either be a percentage of assets or a flat dollar fee; cannot allow for a compensation based on gain or loss (but note that there is a Rich Man’s exemption)
- Must detail the refund or early cancellation policy
- Cannot be assigned without customer permission
- Cannot guarantee a fixed or minimum rate of return
- Cannot contain hedge clauses that eliminate the adviser’s liability for violating the law

Series #63/#65/#66

Uniform Securities Act

106

A clause in an advisory agreement that limits an investment adviser’s liability for the adviser’s gross negligence or willful malfeasance is:

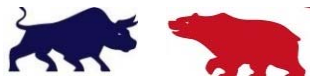
- I a hedge clause
- II a hold harmless clause
- III enforceable under State law
- IV unenforceable under State law

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

Series #63/#65/#66

Uniform Securities Act

107



Uniform Securities Act

An investment advisory contract can include a provision that allows:

- A. the RIA to assign the contract to another RIA without notification to the client
- B. payment of part of the appreciation of the account under management to the adviser as a fee
- C. payment of the adviser's management fees on a quarterly basis by direct deduction from the client's account
- D. the RIA to take custody of client funds without making disclosures to any other party

Series #63/#65/#66 Uniform Securities Act 108

THE BROCHURE RULE

- IAs must provide to customers the adviser's Brochure that gives information about the advisory services offered, fees, client types, management personnel, etc...this is Form ADV Part 2
- Under NASAA Rules, the Brochure must be delivered:
 - At least 48 hours prior to the customer signing the contract - called the "2 Day Free Look"; or
 - When the customer signs the contract on Day 1 and then the customer must be given 5 days to cancel
- In contrast, the SEC Brochure delivery rule for FCAs is different

Series #63/#65/#66 Uniform Securities Act 109

PERMITTED IA SHARING IN GAINS/LOSS

- The "Rich Man Rule" under Federal law states that the IA can be compensated based upon gain or loss if the:
 - Customer has a net worth of at least \$2.2MM; or
 - IA manages at least \$1.1MM of customer assets.
- Note that this is the only situation "permitted" or "possible" for an IA to be compensated based upon gain or loss
- This is an example of supremacy of Federal law

Series #63/#65/#66 Uniform Securities Act 110

For an investment advisory contract, which of the following is true or possible?

- A. Guaranteeing a client specific investment results
- B. Assigning a contract without client consent
- C. Sharing in the investment gains in a client account
- D. Signing a waiver that the client is not required to be notified of any future investment adviser conflicts of interest

Series #63/#65/#66 Uniform Securities Act 111

ADVISORY CONTRACT ASSIGNMENT

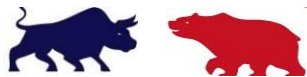
- Form ADV Part 2 details who the key managers of the investment portfolio are and their education and experience
- An IA client is "buying" this expertise
- If someone other than the managers listed in Form ADV Part 2 will be managing the assets, the customers must be advised of the change and approve of it in writing
- Note that such a "change" occurs if a majority of the partners of an advisory firm are replaced – this is called an "involuntary assignment"

Series #63/#65/#66 Uniform Securities Act 112

RECORDKEEPING

- USA states that any records must be kept in compliance with SEC recordkeeping rules
- For State registered advisers, there are no SEC recordkeeping rules
- The NASAA rule for State registered advisers is that records must be kept for 5 years (for the first 2 years, the records must be readily accessible)
- Exception to the 5-year rule
 - Records to be kept for the life of the firm include: Articles of incorporation, minutes of Board of Directors' meetings, stock certificate books, partnership articles and any amendments
 - If the firm shuts down, all records must be retained for an additional 3 years

Series #63/#65/#66 Uniform Securities Act 113



Uniform Securities Act

Under NASAA rules, all of the following records must be retained for at least 5 years by a Registered Investment Adviser EXCEPT:

- A. Cash receipts and disbursements
- B. Order tickets
- C. Written communications
- D. Articles of incorporation

Series #63/#65/#66 Uniform Securities Act 114

Under the NASAA Model Rule covering Investment Adviser records, the adviser's articles of incorporation must be retained for how long after the adviser ceases business operations?

- A. 1 year
- B. 2 years
- C. 3 years
- D. 5 years

Series #63/#65/#66 Uniform Securities Act 115

IA COMPENSATION

- Aside from a flat dollar amount or a percentage of AUM, advisers can also charge wrap fees, that "wrap" all services, including trading commissions into the flat fee
- The adviser can send its portfolio trades to an affiliated BD as long as this conflict is disclosed to the IA's clients
- In addition, an affiliated BD can earn:
 - Commissions for executing these trades
 - 12b-1 fees
- Also, the executing BD can rebate some of its commissions back to the IA in the form of "soft-dollars", such as providing the IA with research

Series #63/#65/#66 Uniform Securities Act 116

An investment adviser may be compensated with all of the following EXCEPT:

- A. wrap fees
- B. soft dollars
- C. bid-ask spreads
- D. asset-based fees

Series #63/#65/#66 Uniform Securities Act 117

IA CUSTODY RULES

- The IA cannot take custody of client assets if the Administrator has a rule prohibiting this
- Definition of custody includes:
 - Accepting customer funds or securities
 - Acceptance of pre-paid advisory fees, 6 months or more in advance of rendering services: of:
 - \$1,200 or more for a FCA; or
 - \$500 or more for a State registered adviser.
 - An account that gives full power of attorney to the IA, which allows the IA to withdraw funds
 - Trustees, who are always deemed to take custody
- Note: If the IA is given a limited power of attorney (i.e. giving the IA authority to trade only), this is NOT considered "taking custody"

Series #63/#65/#66 Uniform Securities Act 118

An investment adviser is considered to "take custody" of funds or securities of the customer if it:

- A. exercises discretionary authority by placing trades of securities for that customer
- B. accepts a check from the customer made payable to the fund custodian to buy a mutual fund
- C. accepts commissions for effecting trades for that customer's account through an affiliated broker-dealer
- D. is appointed as trustee for a customer's trust account under a legally binding trust document

Series #63/#65/#66 Uniform Securities Act 119



Uniform Securities Act

IA CUSTODY RULES

- To take custody (i.e. holding customer funds or securities; or the ability to appropriate or obtain possession of them), the:
 - Administrator must be notified that custody is being taken on Form ADV
 - Securities must be held by a qualified custodian, which is a:
 - FDIC institution
 - Registered BD
 - Registered Commodity Futures Merchant
 - Foreign Financial Institution which holds foreign assets
 - Customer must be notified promptly in writing as to which qualified custodian is holding their assets
 - Customer must receive a quarterly statement
 - Custodian must be audited annually on a surprise basis and the audited results must be filed with the Administrator
 - A copy of the audit is sent to the State Administrator within 120 days of completion of the audit

Series #63/#65/#66 Uniform Securities Act 120

Which of the following is NOT a qualified custodian under NASAA rules?

- A. FDIC Insured Bank
- B. Registered Broker-Dealer
- C. Foreign Financial Institution
- D. National Securities Clearing Corporation

Series #63/#65/#66 Uniform Securities Act 121

IA CUSTODY RULES

- The IA is NOT deemed to have taken custody if:
 - An overpayment or a security is received in error from a client, and it is returned within 3 business days; or
 - A check made out to a "third party" is received from a client and it is forwarded to the payee within 3 business days.

Series #63/#65/#66 Uniform Securities Act 122

An investment adviser is opening that day's mail and receives a check from a customer made out to the "Jones Cleaning Service" - the check was mailed in error to the adviser. Five business days later, the investment adviser mails the check back to Jones Cleaning Service. Under NASAA rules, the investment adviser:

- I is deemed to have taken custody of the customer's funds
- II has not taken custody of the customer's funds
- III must keep a record of the check received
- IV is not required to keep a record of the check received

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

Series #63/#65/#66 Uniform Securities Act 123

CUSTOMER IDENTIFICATION PROGRAM (CIP)

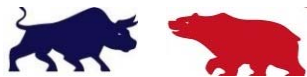
- 4 Critical Pieces of Information when Opening an Account
 - Customer name
 - Street address
 - Date of birth
 - Social security number
- The customer's identity must be verified promptly after account opening (though most firms verify it before account opening)

Series #63/#65/#66 Uniform Securities Act 124

MARGIN ACCOUNTS

- The customer must sign the Hypothecation/Margin Agreement
- Under NASAA rules, the customer must sign the margin agreement promptly, after the first trade
- In addition to a customer signature on a margin account, the signature of the agent and the manager are also required on the new account form
- Note that the customer signature is NOT required on a new account form

Series #63/#65/#66 Uniform Securities Act 125



Uniform Securities Act

According to NASAA rules, which of the following does a broker-dealer require in order to establish a margin account for a client? The broker-dealer requires the client to:

- A. sign a Margin Agreement prior to executing any transactions in the account
- B. sign a Margin Agreement promptly after the initial transaction in the account
- C. file financial statements to determine the suitability of a margin account for the client
- D. first establish a cash account with the firm for a period of time to establish the client's credibility

Series #63/#65/#66 Uniform Securities Act 126

NO UNAUTHORIZED TRADING

- When a customer opens an account only that customer is authorized to place trades
 - Unauthorized trading is unethical and (obviously) prohibited
 - A third party can only place trades if the customer gave the third party a power of attorney in writing

Series #63/#65/#66 Uniform Securities Act 127

JOINT ACCOUNTS

- All account owners must sign a Joint Account Agreement
- Any single owner can enter a trade
- Any single owner can demand that a check be drawn
 - Any check drawn on a joint account must be made out to the "full account name"

Series #63/#65/#66 Uniform Securities Act 128

DISCRETIONARY ACCOUNTS

- A trade is only discretionary, requiring a written power of attorney, if the agent selects either the size of the trade or the security to be traded
- Price and time of execution can be selected by the agent without the need for a written power of attorney
 - The FINRA (Federal) rule for BDs requires a written power of attorney prior to exercising discretion
 - The NASAA (State) rule for IAs says that discretion can be exercised with verbal authorization for up to 10 business days before written authorization is required – know this for the test
- Any power of attorney given in writing by a customer "dies" when the customer dies

Series #63/#65/#66 Uniform Securities Act 129

An IAR discusses a trading strategy with one of her clients, who tells the IAR to sell her ABC stock position whenever the IAR sees an opportunity. After this conversation, the client leaves the IAR's office for a vacation. Two days later, the IAR sees that ABC stock has risen in price and believes that this is an opportune time to sell the position. The IAR should:

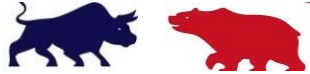
- A. not place the order and try and contact the client
- B. place the trade and notify the client in writing within 2 business days
- C. place the trade and get written discretionary authority from the customer within 10 business days
- D. get approval from his or her direct manager before placing the trade

Series #63/#65/#66 Uniform Securities Act 130

An investment adviser representative has discretion over a customer account. Which of the following must be guaranteed to the customer?

- A. Best return
- B. Preservation of principal
- C. Custom tailored allocation
- D. Current income

Series #63/#65/#66 Uniform Securities Act 131



Uniform Securities Act

BD "SUITABILITY" STANDARD VS IA "FIDUCIARY" STANDARD

- BDs can only recommend suitable investments to customers and when recommending that a customer buy a security, the BD can be the one selling that security out of its inventory to that customer
 - BDs earn commissions, NOT flat fees
- IAs are held to a fiduciary standard and can only take the same side of the trade as the client
- If an Investment Adviser recommends that a client buy a stock, the IA cannot be the one selling it to the client
 - IAs earn flat fees, NOT commissions

Series #63/#65/#66

Uniform Securities Act

132

PAYMENT

- Regulation T of the Federal Reserve sets margin on non-exempt securities
- When a customer buys securities, payment must be obtained "promptly", but no later than 4 business days past trade date
- If payment is NOT received, the unpaid securities are sold, and the account is frozen for 90 days
- When the account is frozen, all trades require money up front
 - Many firms call it putting a "CUF", as in Cash Up Front, on the account
- After 90 days, the freeze comes off the account and the customer is back to paying "promptly"

Series #63/#65/#66

Uniform Securities Act

133

MARGIN

- Lending money to a customer in contravention of Reg. T requirements is prohibited (i.e. any loan percentage that is greater than Reg. T is a violation)
 - Note the customer must deposit 50% based upon the long or short market value
- The BD places customer margin securities in "street name" – i.e. the name of the BD, not the customer
 - This way if the customer does not pay off the loan on demand, the BD can simply sell the securities without needing a customer signature

Series #63/#65/#66

Uniform Securities Act

134

To determine the "loan value" of marginable equity securities, one would:

- A. multiply the market value by 50%
- B. divide the market value by 50%
- C. multiply by the Rule of 72
- D. divide by the Rule of 72

Series #63/#65/#66

Uniform Securities Act

135

COMMINGLING RULES

- A BD can commingle one customer's margin securities with those of another
 - A BD or Agent CANNOT commingle proprietary securities with customer securities
 - A BD or Agent CANNOT take customer funds or securities and keep/use them personally
- Fully paid customer securities must be segregated and kept in safekeeping
 - If requested by the customer, the securities can be transferred from street name to customer name and shipped directly to the customer

Series #63/#65/#66

Uniform Securities Act

136

RULES FOR BD ORDER TICKETS

- Order tickets cannot be entered without the following information:
 - Customer name or account #
 - Agent's name or #
 - Buy or sell
 - If sale – long or short
 - Whether it is a solicited or unsolicited trade
 - Number of shares or bonds to be traded
 - Description of the security to be traded
 - Execution price if a limit or stop order (if it is a market order, a designation of "MKT")
- SEC rules require time stamps of order receipt, execution, and/or cancellation (if canceled)
- Note that there is no requirement for customer address, date of birth, or social security # on an order ticket

Series #63/#65/#66

Uniform Securities Act

137



Uniform Securities Act

RULES FOR IA ORDER TICKETS

- Name of the person at the IA who recommended the transaction
- Name of the person who placed the order
- Date of order entry
- Name of account for which the order was entered
- Name of BD or bank to which the order was sent for execution
- Whether the order was discretionary

Series #63/#65/#66

Uniform Securities Act

138

LIMIT ORDER DISPLAY RULE

- Market makers that receive customer limit orders that are better priced than their "displayed quote", must show the better priced quote in the market (note this is only for systems that are not capable of displaying each order discretely, like the OTCBB)

- If a market maker's quote is:

<i>MARKET ORDERS TO SELL</i> →	<u>Bid</u>	<u>Ask</u>	<i>← MARKET ORDERS TO BUY</i>
	15.00	15.50 (4 X 3)	

- Here the market maker is willing to buy 400 shares at \$15.00; and sell 300 shares at \$15.50

Series #63/#65/#66

Uniform Securities Act

139

LIMIT ORDER DISPLAY RULE

- If the market maker receives a customer limit order to BUY 200 shares at **\$15.20**, the market maker must update its "BID" quote to:

<i>LIMIT ORDERS TO BUY</i>	<u>Bid</u>	<u>Ask</u>
	15.20	15.50 (2 X 3)

- If the market maker then receives a customer limit order to SELL 400 shares at **\$15.30**, the market maker must update its "ASK" quote to:

<i>LIMIT ORDERS TO SELL</i>	<u>Bid</u>	<u>Ask</u>
	15.20	15.30 (2 X 4)

- Note that each time a customer order is displayed, the bid ask spread narrows, which improves the market

Series #63/#65/#66

Uniform Securities Act

140

BORROWING FROM A CUSTOMER

- A BD is prohibited from borrowing money or securities from a customer
 - However, the BD can borrow customer securities if the customer signs a loan consent agreement
 - Agents and IARs cannot personally borrow money from a customer
 - However, if the customer is a lending institution, lending to the Agent or IAR under the same terms as it gives anyone else, then borrowing is permitted
 - Regarding borrowing money from customers who are immediate family members:
 - NASAA rules prohibit this for IARs and Agents
 - However, FINRA (Federal) rules permit Agents (not IARs) to borrow from customers who are relatives
- Know the NASAA rule for the exam!*

Series #63/#65/#66

Uniform Securities Act

141

An Agent or Investment Adviser Representative (IAR) is permitted to borrow money from:

- A. a close relative *AS LONG AS NOT A CUSTOMER!*
- B. a customer, as long as the loan is disclosed to the investment adviser
- C. a customer that is defined as an accredited investor
- D. no one

Series #63/#65/#66

Uniform Securities Act

142

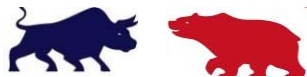
LENDING TO A CUSTOMER

- Agents, IAs, and IARs cannot lend money or securities to customers
- BDs can lend money to customers using securities as collateral under Reg. T and can lend securities to customers who wish to effect short sales
- Banks can lend money to customers (because that is what they do)

Series #63/#65/#66

Uniform Securities Act

143



Uniform Securities Act

Who can make a loan to an IAR?

- A. A customer with a net worth of \$2 million
- B. A customer that is another registered investment adviser
- C. A customer that is a bank
- D. A customer that is a broker-dealer

Series #63/#65/#66 Uniform Securities Act 144

A Federal Covered Adviser makes a loan to one of her clients for the purpose of buying a residence for personal use. The loan is secured by a lien on the house. Which statement is TRUE?

- A. This is not permitted because an adviser cannot place a lien on assets
- B. This is not permitted because the value of the security for the loan may change in relation to the principal amount of the loan
- C. This is permitted because the adviser can make a loan secured by real estate
- D. This is not permitted because an adviser cannot make a loan to a client

Series #63/#65/#66 Uniform Securities Act 145

SHARING IN A CUSTOMER ACCOUNT

- A BD or Agent cannot share in the gains and losses of a customer account unless:
 - A joint account is opened;
 - Sharing is in proportion to capital contributed; and
 - Manager approval is obtained.
- IAs and IARs are outright prohibited from sharing in customer accounts because of their fiduciary obligation
 - They are prohibited from opening joint accounts with customers!

Series #63/#65/#66 Uniform Securities Act 146

GUARANTEEING A CUSTOMER ACCOUNT

- A BD, Agent, IA, or IAR cannot guarantee a customer account against loss
 - Recommendations of put options to hedge are not a prohibited guarantee
 - Repurchase agreements using exempt securities as collateral are not a prohibited guarantee

Series #63/#65/#66 Uniform Securities Act 147

CHARGES TO CUSTOMERS

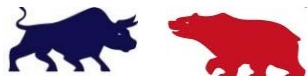
- Any unusual charges must be disclosed verbally at the time the trade is placed
- A BD can charge for clerical services such as the safekeeping or appraisal of securities, but it CANNOT charge separately for recommendations (because then the BD becomes a statutory IA subject to IA rules)
- Excessive advisory fees are prohibited
 - Fees must be comparable to other IAs for similar services
- If a discount is offered to customers, any customer that meets the qualifications for that discount must be given the discounted rate
 - The IA Brochure (Form ADV Part 2A) must disclose the availability of any discounts

Series #63/#65/#66 Uniform Securities Act 148

A customer wishes to buy 1 share of Walt Disney Company stock, which she intends to frame and give to her 6-year old nephew as a present. The stock is trading for \$25 per share; however the commission for executing the trade will be \$100 since this is an odd lot. Which statement is TRUE?

- A. Prior to buying the share, the written permission of one of the parents of the nephew must be obtained
- B. Prior to buying the share, the fact that the commission will be unusually high must be disclosed
- C. Prior to buying the share, another customer must be located to buy the remaining 99 shares, so that a round lot of 100 shares can be traded
- D. Prior to buying the share, the nephew must provide proof of identity so that the share can be registered in his name

Series #63/#65/#66 Uniform Securities Act 149



Uniform Securities Act

STATEMENTS TO CLIENTS

- An IA can call itself an “investment counsel” if it is the firm’s primary business
- An asset allocation program cannot be “proven and tested” if no one has ever used it
- A mutual fund can only call itself “no load” if it charges 12b-1 fees of no more than .25% (furthermore, the max. annual 12b-1 fee is .75%)

Series #63/#65/#66

Uniform Securities Act

150

MISCELLANEOUS VIOLATIONS

- Failing to bring written complaints to the attention of the BD
 - A complaint is one in writing (e-mail counts!)
 - The written complaint must be resolved under the supervision of a manager
 - Original copies of all written complaints with their resolution must be retained
- Soliciting orders for unregistered non-exempt securities
 - For example, soliciting orders for unregistered common stocks is prohibited
 - But soliciting orders for unregistered municipal bonds is okay
- Not following customer instructions
 - Orders for customers must be filled according to the customer’s instructions
 - If the Agent believes it is unsuitable, the customer must be told this, and, if the customer insists, the trade must be done – i.e. Just Do it!

Series #63/#65/#66

Uniform Securities Act

151

A customer submits a written complaint to your broker-dealer. Later, he changes his mind and asks that the complaint be returned. You should:

- A. do nothing unless the customer makes a written request
- B. return the original written complaint to the client
- C. return a copy of the complaint to the client and retain the original complaint in the firm’s files
- D. return the original complaint to the client and retain a copy of the complaint in the firm’s files

Series #63/#65/#66

Uniform Securities Act

152

MISCELLANEOUS VIOLATIONS

- Recommending stock of a publicly traded parent company of a BD or IA
 - However, if the conflict is disclosed verbally at the time of recommendation and in writing on the confirm, then it is permitted
- Giving the customer someone else’s (third party) research or recommendations without disclosing that it was prepared by a third party
- Not disclosing mutual fund Breakpoints and Letter of Intent provisions

Series #63/#65/#66

Uniform Securities Act

153

CUSTOMER MAIL

- Customer confirms and accounts statements must be sent to a customer at the mailing address provided by the customer (e-mail is fine)
- Customer mail cannot be suppressed and cannot be sent to a branch office or a PO box designated by an Agent

Series #63/#65/#66

Uniform Securities Act

154

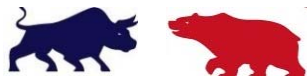
CUSTOMER INCAPACITATION

- If a customer gave a durable power of attorney, it continues if the customer is mentally incapacitated
- If a customer gave a non-durable power of attorney, it ceases if the customer is mentally incapacitated
- If a customer dies, all power of attorneys are revoked

Series #63/#65/#66

Uniform Securities Act

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Uniform Securities Act

CUSTOMER DEATH

- When a customer dies, the firm must:
 - Cancel open orders;
 - Note the date of death on the account;
 - Freeze the account from removal of assets; and
 - Wait for the proper paperwork needed to transfer the account or assets to an executor or beneficiary.

Series #63/#65/#66

Uniform Securities Act

156

TRADING RULES

- Front Running - Prohibited
 - After receiving a large customer order that is likely to have a market impact once entered, the Agent places an order for his/her own account, in front of the customer's order
- Trading Ahead of Research - Prohibited
 - A BD cannot trade ahead for its own account based on information that is received from its research or underwriting departments prior to the report actually being publicized
 - The research department of either a BD or IA must be "walled off" from the firm's sales and trading activities

Series #63/#65/#66

Uniform Securities Act

157

TRADING RULES

- Painting the Tape - Prohibited
 - Effecting a series of wash trades – e.g., buy, sell, buy, sell – to give the impression that trading activity exists without any change in ownership
- Trading Away - Allowed
 - When a client who usually places trades with one executing BD, instead, places trades with another executing BD
 - For example, a hedge fund knows that one BD is good at executing equity trades; and another BD is good at executing fixed income trades; and directs its trades appropriately

Series #63/#65/#66

Uniform Securities Act

158

An institutional customer places a very large order to buy a thinly-traded security. The trader who receives the order believes that it will push the market price of the stock up and, prior to entering the order, places an order to buy that stock for the firm's trading account. This is an example of:

- A. front running
- B. trading ahead
- C. high frequency trading
- D. block trading

Series #63/#65/#66

Uniform Securities Act

159

Intentional conduct designed to deceive investors by controlling or artificially affecting the market for a security is:

- A. churning
- B. market manipulation
- C. a wash sale
- D. market bashing

Series #63/#65/#66

Uniform Securities Act

160

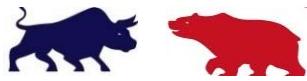
An investment adviser representative (IAR) actively trades his client accounts, concentrating on equity and ETF trades, normally routing the trades through ABC Brokerage, a broker-dealer affiliated with the RIA. The IAR gets a new large customer, who wants a large portion of her portfolio invested in municipal bonds. ABC Brokerage does not have a municipal bond trading desk, so the IAR sends his municipal bond trades for the client to XYZ Brokerage, which specializes in municipal bonds of the client's State. This is an example of:

- A. trading away
- B. haircutting
- C. trading ahead
- D. diversifying

Series #63/#65/#66

Uniform Securities Act

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Uniform Securities Act



An investment advisory firm does its own research, using a group of dedicated employees and has a separate staff of investment adviser representatives (IARs) who solicit new accounts. In an effort to maintain confidentiality between the research staff and sales staff, the investment adviser must:

- A. establish a Chinese Wall between the research personnel and the sales personnel
- B. register both the research personnel and the sales personnel in each State where the IA's services are offered
- C. cross-train the research personnel and the sales personnel in each others' functions so that in the event of a confidentiality breach, one can take over the functions of the other
- D. establish two separate IA firms registered with the State with one only having research personnel and the other only having sales personnel

Series #63/#65/#66

Uniform Securities Act

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