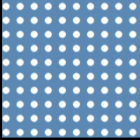


Pass Perfect  
A Cerifi Company

## NEW ISSUES



417

Pass Perfect  
A Cerifi Company

## CORPORATE UNDERWRITINGS



418

### UNDERWRITING COMMITMENTS

<b>FIRM COMMITMENT</b>	<ul style="list-style-type: none"> <li>Investment banker acts as principal, buying issue from company and then resells issue to public, earning the spread</li> <li>Underwriter assumes full financial liability</li> </ul>
<b>BEST EFFORTS</b>	<ul style="list-style-type: none"> <li>Investment banker acts as "agent," taking no financial liability</li> <li>If part of issue is unsold, it remains with issuer</li> </ul>

Pass Perfect  
A Cerifi Company

### UNDERWRITING COMMITMENTS (cont.)

**BEST EFFORTS (cont.)**

- All or none
  - Deal is contingent on entire issue being sold; deal is canceled otherwise
- Mini-maxi
  - Minimum amount must be sold, so all or none on minimum amount
  - Underwriter continues to sell issue up to a maximum portion of deal
  - This "maxi" is on a best effort's basis

Pass Perfect  
A Cerifi Company

### UNDERWRITING COMMITMENTS (cont.)

<b>STANDBY UNDERWRITING</b>	<ul style="list-style-type: none"> <li>Used when company attempts to sell additional shares through a rights offering</li> <li>Underwriter stands by on a firm commitment basis to "pick up" unsubscribed shares at subscription price</li> </ul>
<b>Negotiated underwriting</b>	<ul style="list-style-type: none"> <li>Typical for corporate underwritings; terms are negotiated between issuer and underwriter</li> </ul>

Pass Perfect  
A Cerifi Company

### FORMING THE SYNDICATE

**AGREEMENT AMONG UNDERWRITERS**

- Investment banker will invite other firms into syndicate, sharing selling responsibility and liability
- Formal agreement is called the Syndicate Agreement
- Can be set up either as a(n):
  - Eastern Account: Undivided selling responsibility and liability;
  - Western Account: Divided selling responsibility and liability

Firm takes 10% of \$5,000,000 underwriting in a Western Account. At the termination of the offering, \$1,000,000 is unsold in the account. The firm sold \$300,000. The firm's remaining liability is? \$200,000 (Responsible for \$500,000; sold \$300,000; liable for \$200,000 more)

Firm takes 10% of \$5,000,000 underwriting in an Eastern Account. At the termination of the offering, \$1,000,000 is unsold in the account. The firm sold \$300,000. The firm's remaining liability is: \$100,000 (10% of \$1,000,000 unsold)

Pass Perfect  
A Cerifi Company



A syndicate member in a Western account takes \$500,000 out of a \$5,000,000 underwriting. At the termination of the syndicate, \$750,000 of the issue remains unsold while the member sold \$400,000. For how much is the member responsible?

- A. \$100,000
- B. \$350,000
- C. \$400,000
- D. \$750,000

423



A syndicate member takes a 5% participation in a \$10,000,000 issue set up as a Western account. At the termination of the syndicate, \$2,000,000 remains unsold in the account. The syndicate member sold \$500,000. The syndicate member's remaining liability is:

- A. 0
- B. \$50,000
- C. \$100,000
- D. \$200,000

424



A syndicate member takes a 5% participation in a \$10,000,000 issue set up as an Eastern account. At the termination of the syndicate, \$2,000,000 remains unsold in the account. The syndicate member sold \$375,000. The syndicate member's remaining liability is:

- A. \$25,000
- B. \$50,000
- C. \$100,000
- D. \$125,000

425



A syndicate member takes a 10% participation in a \$15,000,000 issue set up as an Eastern account. At the termination of the syndicate, \$2,000,000 remains unsold in the account. The syndicate member sold \$1,450,000. The syndicate member's remaining liability is:

- A. 0
- B. \$50,000
- C. \$100,000
- D. \$200,000

426

## FORMATION OF THE SYNDICATE (cont.)

### MANAGING UNDERWRITER

- The Agreement Among Underwriters gives manager of syndicate full control over syndicate decisions
- Manager is responsible for researching issuer and for ensuring full disclosure to investors- called "due diligence"
- Manager determines each member's share of profit or loss after underwriting is completed
- For handling underwriting, the manager gets a management fee which is a portion of spread

## Components of the Spread

### Spread

- Difference between what the public pays for the issue and what the issuer receives
- The "spread" is broken into pieces that are earned by the syndicate and selling group members, and other member firms, when then sell the securities

### Components of \$1 Spread

S  
P  
R  
E  
A  
D

.05
.30
.55
.10

*Reallowance*

*Additional Takedown*

*Selling Concession*

*Management Fee*

}

*.35*

*.90*

}

}

What  
Syndicate  
Members  
Earn if  
Issue is  
sold  
directly to  
public -  
**Total  
Takedown**  
**.90**

429

Syndicate members earn which of the following discounts for new issue offerings?

- A. Selling concession
- B. Spread
- C. Takedown
- D. Selling scale

430

When a syndicate member sells a new issue directly to the public, what does he earn?

- A. the selling concession
- B. the spread
- C. the additional takedown
- D. the total takedown

431

HOW TAKE DOWN CONCESSIO REALLOWANCE  
 STOCKBROKER TRAINERS ANY REST

In a new issue underwriting, which of the following is largest?

- A. Reallowance
- B. Selling Concession
- C. Spread
- D. Underwriter's Concession

432

### ISSUER'S FUNCTIONS

- Company prepares the issue for the sale
- Process is regulated under Securities Act of 1933 which controls issuance of non-exempt securities in the U.S.
- Registration statement must be filed with SEC by issuer
  - Most of registration statement is copy of Prospectus which gives complete disclosure about issue
  - When registration statement is filed, issue enters 20 day cooling off period - aka "Quiet Period"

Pass Perfect  
A South Company

### FILING THE REGISTRATION STATEMENT

- There's a 20-day cooling off period under Act of 1933
- This gives the SEC time to review the filing for "full and fair disclosure"
- During the cooling off period, the issue cannot be sold or promoted

Prohibited Activities	Allowed Activities
sales of the issue	distributing red herring
soliciting	accepting indications of interest
advertising	publishing tombstones

Pass Perfect  
A South Company

## ONCE REGISTRATION IS EFFECTIVE

EFFECTIVE DATE	<ul style="list-style-type: none"> <li>At end of 20 day cooling off period, underwriters set POP based on indications of interest received and a final price amendment is filed with SEC</li> <li>When registration is effective, sale of issue permitted with the Final Prospectus</li> <li>Electronic delivery of Prospectus is allowed as long as you have an e-mail address for all securities EXCEPT mutual funds</li> </ul>
TOMBSTONE ANNOUNCEMENT	<ul style="list-style-type: none"> <li>Publicizes the issue with very limited information - is not considered "an advertisement or offer"</li> </ul>

Which of the following can be found in an initial public offering preliminary prospectus?

- A. The public offering price of the issue
- B. The current market price of the issue
- C. The financial statements of the issuer
- D. The SEC statement of approval of the issue

A preliminary prospectus may first be sent to a customer:

- A. prior to the filing of a registration statement with the SEC
- B. once the registration statement has been filed with the SEC
- C. once a final price amendment has been filed with the SEC
- D. once registration is effective

Distribution of a preliminary prospectus during the 20-day cooling off period for a new issue that is in registration with the SEC is:

- A. prohibited under the Securities Act of 1933
- B. used to determine the level of investor interest in the issue
- C. used to solicit customers to buy the issue
- D. used to recommend the purchase of the issue to customers

Once registration is effective for a non-exempt new issue, customers that previously received a preliminary prospectus during the 20-day cooling off period are:

- A. automatically confirmed with a purchase of the issue
- B. contacted by the underwriter to see if they wish to purchase the issue
- C. obligated to buy an amount of the issue determined by the underwriter
- D. permitted to make a competitive bid for the issue

When a customer buys a new stock issue from a syndicate member, the customer pays:

- A. the public offering price as stated in the prospectus plus a commission
- B. the public offering price as stated in the prospectus plus a mark-up
- C. the public offering price as stated in the prospectus without any commission
- D. any price since this is a negotiated market offering

## FINRA IPO RULE

As of the effective date, the issue starts trading in the secondary market. If the issue becomes "hot" – with the price rising in the secondary market, anyone who can get in at the POP will be a big winner

To stop industry insiders from cornering the "good ones" that come out, FINRA prohibits industry insiders from buying common stock IPOs from underwriters – no ifs, and, or buts.

Prohibited from buying a common stock IPO from an underwriter are:

- FINRA member firms for their own accounts, their officers, employees and immediate family;
- Fiduciaries to member firms, like outside attorneys and accountants and their immediate family
- Institutional portfolio managers buying personally and their immediate family

## FINRA IPO RULE

To enforce the rule, FINRA requires any purchaser of an IPO to sign a letter that they are NOT prohibited; and if they are continuing to buy IPOs from the member firm, this letter must be renewed annually

The initial IPO signed letter must be a positive affirmation; the annual renewals thereafter can be a negative affirmation

Note that the IPO rule applies to all common stock IPOs – not just the "Hot" ones; but does not apply to preferred stock or bond issues

If related to a FINRA member, which of the following can purchase a common equity IPO under the Rule 5130?

- A. mother-in-law
- B. aunt
- C. father
- D. sister

In order to open a new account for a customer that wishes to buy IPOs, the:

- A. customer must sign a representation letter
- B. registered representative must sign a representation letter
- C. branch manager must sign a representation letter
- D. all of the above

## MUNICIPAL UNDERWRITINGS

## Negotiated Underwriting

Mostly for revenue bond underwritings

Issuer selects underwriter based on track record, etc.

The compensation earned is negotiated between the issuer and underwriter – **spread IS disclosed**

### Competitive Bid Underwriting

- Mostly for general obligation underwritings
- Issuer uses a Financial Advisor to help structure the issue which will be sold at a yield auction
- The lowest net interest cost win the bid
- The Financial Adviser cannot bid and cannot be the underwriter
- Winning underwriter buys the bonds at par with the winning interest rates set as the coupon rates on the bonds and then reoffers the bonds at a slight premium above par – **spread is NOT disclosed**

G.O. - CD - NO SPREAD DISCLOSURE  
 SR Revenue - B.O. - NEGOTIATED SPREAD IS DISCLOSED

All of the following are determining factors when making a competitive bid for municipal issues EXCEPT:

- A. Type of income source backing the bonds
- B. Yields of similar bonds in the market
- C. Maturities of the bonds
- D. Par value of the bonds

### Official Notice of Sale

An advertisement placed in the Bond Buyer, it announces the auction of the bonds by requesting bids from underwriters and institutional investors who wish to buy directly

#### Official Notice of Sale includes:

- Dollar Amount of Bonds Offered By Maturity
- Good Faith Check Amount (typically 1-2% of par)
- Backing of the Bonds (e.g., G.O., Revenue)
- Minimum Bid Increments in Yield (e.g. .05 increments)
- Name of Bond Counsel and that unqualified opinion will be given
- Method of Awarding Bid
  - Net Interest Cost: Weighted Average Yield
  - True Interest Cost: YTM across all bonds, considering time value
- Dated Date
- Award Date
- Bid is All or None; Right to Refuse All Bids

All of the following information is found in the Official Notice of Sale EXCEPT:

- A. maturities of the bonds
- B. interest rate on the bonds
- C. dated date on the bonds
- D. award date of the bonds

### FINAL OFFICIAL STATEMENT

There is no prospectus for municipal new issues because they are exempt

The disclosure document given to purchasers is called the "Official Statement" (don't confuse with Official Notice of Sale)

Any purchaser of a new issue must be delivered the Official Statement by settlement under MSRB rules

A copy of the Official Statement is also posted electronically on the MSRB's EMMA (Electronic Municipal Market Access) website

All of the following bonds are most often sold through negotiated sales EXCEPT:

- A. Industrial Revenue
- B. General Obligation
- C. Revenue
- D. Corporate Bonds

Which of the following statements are true regarding new municipal offerings?

- I General obligation bonds are usually offered through competitive bid
- II General obligation bonds are usually offered through a negotiated offering
- III Revenue bonds are usually offered through competitive bid
- IV Revenue bonds are usually offered through a negotiated offering

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

SIE New Issues & Regulations 453

Under MSRB rules for new issues, the dealer:

- I must disclose the underwriter's spread to customers in a competitive bid issue
- II does not have to disclose the underwriter's spread to customers in a competitive bid issue
- III must disclose the underwriter's spread to customers in a negotiated offering
- IV does not have to disclose the underwriter's spread to customers in a negotiated offering

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

SIE New Issues & Regulations 454

All of the following items are associated with a competitive bid offering of General Obligation bonds EXCEPT:

- A. Official Notice of Sale
- B. Official Statement
- C. Legal Opinion
- D. Prospectus

SIE New Issues & Regulations 455

### BOND BUYER STATS

The Bond Buyer publishes statistics on the health of the new issue municipal market

**VISIBLE SUPPLY** - Dollar value of all new issue muni bonds coming to market over the next 30 days. Excludes short-term notes


**PLACEMENT RATIO** - Shows how well the market is absorbing new municipal issues

$$\frac{\text{Bonds Sold (to Public)}}{\text{Bonds Issued (by Muni)}}$$

- a high ratio, indicates the bonds are selling well!


**BOND BUYER INDEX** – YTM of 20 selected G.O. bonds with 20 years to maturity, rated A or better

**REVDEX** – YTM of 25 selected Revenue bonds with 30 years to maturity, rated A or better

 Pass Perfect  
A Cerifi Company

The Placement Ratio has been steadily increasing over the last 30 days. This is an indication that: municipal

- A. interest rates are likely to fall
- B. interest rates are likely to rise
- C. dealers have a decreasing inventory position
- D. dealers have an increasing inventory position

 Pass Perfect  
A Cerifi Company

## UNDERWRITING US GOVERNMENT SECURITIES

456

## US Government Auctions

- The U.S Government sells its debt at auctions
- Auctions are yield base- the lowest bid yield rate wins
- The Federal Reserve acts as agent
- T- bill auctions are weekly
- T-notes, T-bonds & TIPS are also monthly
- Cash management bills are sold as need
- Primary Dealers compete in a competitive bid
- All others submit non-competitive bid but receive the rate of the winning competitive bids

## REGULATIONS

## SECURITIES ACT OF 1933

The wording of the Securities Act of 1933 states that if:  
 an interstate offer;  
 of a non-exempt security;  
 is made in a non-exempt transaction; then  
 the issue must be registered with the SEC

Registration is time-consuming and expensive, and the way to avoid it comes out of this wording

If an offer is made **INTRASTATE**, it is exempt.

If the securities are **EXEMPT**, then there is no registration. The act specifies the exempt securities.

If the securities are offered in an **EXEMPT TRANSACTION**, there is no registration

## EXEMPT SECURITIES

U.S. Gov'ts, Agencies, Munis, & Sovereign Gov't Debt – because we trust our governments, so we don't put the burden of SEC registration on them!

Money Market Instruments - Banker's Acceptances and Commercial Paper as long as the maturity is 270 days or less – because it is mainly an institutional market and they can protect themselves!

Issuers already regulated under other laws – so they are already being tortured by another regulator!

- Bank issues
- Insurance company offerings (EXCEPT variable annuities)
- Common Carrier Issues (i.e., railroads, trucking companies,...)
- Public Utility issues

Miscellaneous – Non-for-profit issues like church bonds, and SBICs – Small Business Investment Co.'s - which fund minority businesses

## EXEMPT TRANSACTIONS

### RULE 147 – INTRASTATE EXEMPTION

Federal government only has jurisdiction crosses state lines  
 If transaction stays within 1 state, then only that state's law applies  
 80% of issuer's sales or assets or proceeds in that state  
 100% of purchasers must be state resident  
 Issuer must be state resident  
 Resale is "locked-up" within state for 1st 6 months after offering is completed

## EXEMPT TRANSACTIONS

### REGULATION D – PRIVATE PLACEMENTS

An offering of any dollar amount made in any state to a maximum of 35 non-accredited investors and an unlimited number of accredited investors

Accredited investors are wealthy:

- Annual Income \$200,000 year (\$300,000 couple); or
- Net Worth: \$1,000,000 (not including the investor's private residence); or
- Institution with \$5,000,000 for investment; or
- Officer or Director of issuer

Purchasers get "restricted" private placement stock – cannot be traded



All the following are accredited investors EXCEPT:

- A. an individual who earns \$200,000 a year
- B. a couple who earns \$300,000 a year
- C. a couple who agrees to buy \$150,000 of the securities in 5 years
- D. an individual with a \$1,000,000 net worth

SIE New Issues & Regulations 465

Under Regulation D, regarding private placements, how many accredited investors are allowed to invest in the offering?

- A. 0
- B. no more than 35
- C. exactly 35
- D. an unlimited amount

SIE New Issues & Regulations 466

To be defined as an "accredited investor" under Regulation D, an individual that wishes to purchase a private placement offering must earn a minimum of:

- A. \$200,000
- B. \$300,000
- C. \$400,000
- D. \$1,000,000

SIE New Issues & Regulations 467

### EXEMPT TRANSACTIONS

#### RULE 144 – PUBLIC RESALE OF RESTRICTED STOCK

Assume you go to work for a start-up venture capital financed company. They give you a "so-so" salary, but they also give you stock – and this is restricted stock because the company is not public.

If the company goes public, you can either sell your restricted stock by registering it with the SEC and selling with a prospectus (time consuming and expensive) or you can use Rule 144

In a Rule 144 sale, the transfer agent is authorized to remove the restriction legend from the shares and issue clean registered stock to the buyer, so Rule 144 is the easier way to sell

Pass Perfect  
A South Company

### EXEMPT TRANSACTIONS

To do a Rule 144 sale, hurdles must be cleared:

- The company must have gone public and it must be current in its SEC filings
- The seller must have held the stock fully-paid, at risk, for 6 months
- The seller must file a Form 144 notice of sale with the SEC at or prior to sale. The Form 144 can be filed every 3 months
- On the Form 144, the maximum permitted sale is calculated. It is the GREATER of:
  - 1% of the outstanding shares; or
  - Weekly average of the prior 4 weeks' trading volumes

Pass Perfect  
A South Company

Diagram illustrating the calculation of the maximum permitted sale under Rule 144:

- 1 can sell: 1% of the outstanding shares
- 4 the average of the last 4 weeks trading volume
- 4 can be done 4 times a year (every 90 days)

whichever is greater

SIE New Issues & Regulations 470


### EXEMPT TRANSACTIONS

**RULE 144 (cont.)**

Rule 144 limits are also placed on control persons (key officers, directors) that wish to sell their registered shares. They are not subject to the 6-month hold (since these shares are registered) but must file the Form 144 and sell within the volume restrictions

**HOW TO AVOID RULE 144 (ONLY IF PUBLIC COMPANY)**

- 1) Die! – The estate can sell the shares without restriction
- 2) Sell Small Amount! - A maximum of 5,000 shares worth a maximum of \$50,000 can be sold every 3 months
- 3) Leave Company! – An officer that leaves the company can sell all shares without restriction if 6-month hold is met and officer is out of company for 3 months



*RTFQ QUESTION*  
*END*

*REGISTERED*

Under Rule 144, control stock that is purchased in the open market can be sold:

- A. immediately
- B. after a 6 month holding period has elapsed
- C. after a 2 year holding period has elapsed
- D. after a 3 year holding period has elapsed

SIE New Issues & Regulations 472

KMG corporation has 17,000,000 shares outstanding. An officer of KMG wishes to sell KMG stock on October 20. The prior weeks' trading volumes are:

Volume	Week Ending
150,000	October 16
190,000	October 9
200,000	October 2
185,000	September 25
175,000	September 18

If the Form 144 is filed on October 20, the maximum sale is:

1% X 17,000,000 = 170,000

OR

$\frac{150,000 + 190,000 + 200,000 + 185,000}{4} = 181,250$

- A. 170,000 shares
- B. 180,000 shares
- C. 181,250 shares
- D. 187,500 shares

SIE New Issues & Regulations 473

KMG corporation has 17,000,000 shares outstanding. An officer of KMG wishes to sell KMG stock on October 20. The prior weeks' trading volumes are:

Volume	Week Ending
150,000	October 16
190,000	October 9
200,000	October 2
185,000	September 25
175,000	September 18

If the Form 144 was filed the preceding week, the maximum sale is:

1% X 17,000,000 = 170,000

OR

$\frac{190,000 + 200,000 + 185,000 + 175,000}{4} = 187,500$

- A. 170,000 shares
- B. 180,000 shares
- C. 181,250 shares
- D. 187,500 shares

SIE Investment Banking 474

All of the following restricted securities are subject to the 6 month holding period rule under Rule 144 EXCEPT securities:

- A. received as a gift through a donor
- B. acquired through a private placement
- C. held by an estate for a person since deceased
- D. held in a trust for a beneficiary

SIE New Issues & Regulations 475

### EXEMPT TRANSACTIONS

**RULE 144A**


Has nothing to do with Rule 144!

Allows issuers to sell minimum \$500,000 blocks of private placements to QIBs – Qualified Institutional Buyers

144A issues can be traded from QIB to QIB on the PORTAL Market, so the problem of private placement illiquidity is eliminated

A QIB is an institution with at least \$100,000,000 for investment

*Note:* There are more 144A issues than there are registered offerings – but this is not tested!



## EXEMPT TRANSACTIONS

### REGULATION CROWDFUNDING

Allows start-ups to raise capital by issuing private placement unregistered securities to any type of investor (accredited or not) with a minimum investment of \$2,200.

Max amount that can be raised is \$5MM (indexed for inflation) sold through FINRA-registered b-ds or FINRA-registered crowdfunding portals

The maximum amount that one can invest is \$107,000.



Regulation Crowdfunding is intended as a means of raising capital for:

- A. Start-up companies
- B. Small capitalization companies
- C. Mid-capitalization companies
- D. Large-capitalization companies

Crowdfunding offerings are typically purchased by:

- A. small investors
- B. accredited investors
- C. institutional investors
- D. qualified investors



The maximum amount that can be raised by an issuer under Regulation Crowdfunding is:

- A. \$100,000
- B. \$500,000
- C. \$5,000,000
- D. \$50,000,000

## OTHER SEC REGISTRATION RULES

### EZ-REGISTRATION IS ALLOWED UNDER TWO RULES: REGULATION A and RULE 415

#### REGULATION A – SMALL DOLLAR OFFERINGS

To make it easier/less costly for smaller start-ups to raise up to \$75MM of capital, a simplified registration statement is filed with the SEC and a 20-day review period must be completed. No prospectus is required, but a disclosure document called an **Offering Circular** must be delivered to customers at least 48-hrs prior to sale.

Lastly, to obtain investor interest, Reg A allows issuers to distribute promotional materials to prospective purchasers prior to the registration statement and throughout the 20-day review period (note that this is PROHIBITED for regular registered offerings)

## OTHER SEC REGISTRATION RULES

### RULE 415 – SHELF REGISTRATION

Seasoned issuers can file a “blanket” registration statement with the SEC, good for 3 years. Then that issuer just gives 2-day notice to the SEC and sells with a Prospectus Supplement

Cheaper, faster than a regular registration and allows the issuer to “time the market” because there is no minimum 20-day cooling off period

### RULE 145

States that issuer must file registration statements with the SEC for mergers and divestitures, but NOT for stock splits or stock dividends

Under SEC Rule 145, which of the following corporate reorganizations will typically require the filing of a registration statement?

- I Stock split
- II Change in the par value of common stock
- III Merger of two issuing corporations
- IV Exchange of securities between a new issuer and an existing issuer

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

SIE

New Issues &amp; Regulations

483

## SECURITIES EXCHANGE ACT OF 1934

- **M**anipulation
- **I**nsiders
- **S**EC created
- **S**hort Sale Rules
- **P**roxy Rules
- **E**xchanges must register with the SEC
- **R**eports annual and quarterly financial reports
- **M**argin control over credit on securities given to Federal Reserve
- **S**tabilization

 Pass Perfect  
A South Company

## EXCHANGE ACT OF 1934

### MANIPULATION

Manipulating markets is fraudulent

Rule 10b-5 is most famous – the catch-all fraud rule – whatever you dream up can be fraud under Rule 10b-5, even if the Act does not explicitly prohibit it!

Manipulation rules apply to ALL securities – exempt and non-exempt

All the other '34 Act rules only apply to non-exempt issues

### INSIDER RULES

The Act defines an insider as an officer, director or 10% shareholder. Insiders must report their:

- insider status to the SEC;
- trades in the company's stock in 2 business days

 Pass Perfect  
A South Company

## EXCHANGE ACT OF 1934

### INSIDER RULES (cont.)

Insiders cannot:

- Sell their own company's stock short;
- Retain short-swing profits trading own company's stock (profit achieved within 6 months); and
- Trade based on material non-public information

### INSIDER TRADING ACT AMENDMENTS OF 1988

Put in the "Tipper-Tippee" Doctrine – the tipper is liable as well as the tippee who traded – brokerage firms can be held as tipplers if their employees inside trade unless they put in Chinese Walls

Penalties for violations – treble damages, \$ fines (paid to Treasury), jail, and liability to shareholders of company

Informer bounty of 10-30% of the take if you rat on an insider and they wind up paying big fines!

 Pass Perfect  
A South Company

## EXCHANGE ACT OF 1934

### SHORT SALE RULES

Regulation SHO was written to regulate the impact of short sales on the market

### SEC CREATED

The Act created the SEC and gave it enforcement power over the Securities markets. All exchanges and SROs register with the SEC and have their rules approved by the SEC (there are only 13 exchanges, plus FINRA and the MSRB are SROs).

 Pass Perfect  
A South Company

## EXCHANGE ACT OF 1934

### PROXY RULES

These are rules that make sure shareholders are not denied their right to vote

The only part of the rules that must be known is Rule 13D – anyone who accumulates a 5% or greater holding in a company with the intention of exercising control (like asking for a vote to get a seat on the Board) must file a Form 13D with the SEC (public document) within 10 business days of crossing the 5% threshold

### EXCHANGE REGISTRATION

Exchanges register with the SEC and become SROs – Self Regulatory Organizations – under SEC oversight. FINRA and MSRB are non-exchange SROs Member firms (BDs) register; their officers register; and their salespersons and traders (you!) register – hence the term registered representative

 Pass Perfect  
A South Company

## EXCHANGE ACT OF 1934

### REPORTS FROM ISSUERS

Issuers must prepare and file audited annual financial reports (10Ks) and quarterly unaudited financial reports (10Qs)  
If a significant event occurs at a company (merger, divestiture, bankruptcy, change in Board of Directors), an 8K filing is required with the SEC within 4 business days of the event

### MARGIN ON SECURITIES

The Federal Reserve was given the power to set margin on securities – but only non-exempts!

- Reg. T: Credit on securities from broker to customer  
Reg. U: Credit on securities from bank to broker

### STABILIZATION

Allows the managing underwriter of a new issue to prevent the market from tanking when the new issue opens for trading in the secondary market



## OTHER FEDERAL ACTS

### TRUST INDENTURE ACT OF 1939

Requires non-exempt debt issues (corporates) over \$50,000,000 to have a Trust Indenture.

Trustee must be commercial bank or trust company – not a trust attorney, not a broker-dealer

### INVESTMENT ADVISERS ACT OF 1940

Requires all advisers to investment companies and other big advisers with over \$100 mil of assets under management to register with the SEC as an RIA – Registered Investment Adviser

Smaller advisers (under \$100 mil assets) are only required to register with the State – not the SEC

Excluded from registration are banks, broker-dealers, and professionals who give incidental advice



The Trust Indenture Act of 1939 protects:

- A. municipal bondholders from being taken advantage of by the issuing municipality
- B. corporate bondholders from being taken advantage of by the issuing corporation
- C. government bondholders from being taken advantage of by the issuing governmental unit
- D. all bondholders from being taken advantage of by the issuing entity

Which of the following must be registered with the SEC as an investment adviser under the Investment Advisers Act of 1940?

- A. Broker-dealer
- B. Bank
- C. Senior Editor of an investment magazine
- D. Accountant who gives investment advice to clients for a fee

## OTHER FEDERAL ACTS

### SECURITIES INVESTOR PROTECTION ACT OF 1970

Created SIPC, which protects customer accounts from BD failure

Coverage limit is \$500,000 of equity per customer name, inclusive of \$250,000 maximum cash coverage

Customer has account with \$600,000 of securities and \$200,000 debit at failed BD. Coverage = \$400,000

Customer has account with \$200,000 of fully paid securities and \$300,000 free credit at failed BD. Coverage = \$450,000

Uncovered claims – General creditor of failed BD

Does NOT cover commodities or futures accounts (“Non-Securities Credit Account”)



A customer has an account with \$350,000 in securities and \$350,000 of cash. What is the coverage amount in a SIPC liquidation?

- A. \$500,000
- B. \$450,000
- C. \$350,000
- D. \$150,000

In a SIPC liquidation, if a customer still has claims above the covered amount, the customer becomes a:

- A. secured creditor
- B. general creditor
- C. limited partner
- D. general partner

SIE New Issues & Regulations 495

Mike Jones has two accounts at a failed brokerage firm; a cash account with \$350,000 of cash and a margin account with \$600,000 in securities. Which of the following statements is true regarding SIPC coverage limits?

250 COVERED 250 COVERED

- A. The customer is covered for the total amount of \$950,000
- B. The customer is covered for \$250,000 for the cash account and \$500,000 of the securities
- C. The customer is covered for a total of \$500,000 in securities only
- D. The customer becomes a general creditor for \$100,000 of cash and \$350,000 in securities

SIE New Issues & Regulations 496

A customer has an account with a brokerage firm that is in receivership. The account holds \$220,000 of securities and has a \$90,000 debit. Which statement is true regarding SIPC coverage?

- A. The customer must deposit \$90,000 to receive the \$130,000 of securities
- B. The account is covered for \$100,000
- C. The account is covered for \$130,000
- D. The account is covered for \$220,000


SIE New Issues & Regulations 497

### OTHER FEDERAL ACTS

#### FEDERAL TELEPHONE CONSUMER PROTECTION ACT

Original Act requires companies (BDs) to maintain Do Not Call lists  
 Unsolicited cold calls cannot be made before 8 AM nor after 9 PM in the time zone of the recipient  
 If recipient says, "Don't Call Me!" = put him or her on the Firm Do Not Call List

Later, the Federal Do Not Call List was created – so now there are 2 lists to deal with!  
 The rules boil down to this:  
 If the person is on the Firm Do Not Call list, you can't call him – period  
 If the person is on the Federal List, but NOT the Firm List, you can't call him UNLESS:  
 He or she is a family member or friend;  
 He or she invites you to call; or  
 There is an Established Business Relationship – meaning that he did a trade with your firm in the last 18 months or has an account

 Pass Perfect  
 A World Community

Which of the following callers is EXEMPT from the provisions of the Federal Telephone Consumer Protection Act of 1991?

- A. Telemarketing firm
- B. Real estate company
- C. Non-profit organization
- D. Securities firm

SIE New Issues & Regulations 499

Primary responsibility for enforcement of the Federal Telephone Consumer Protection Act rests with the:

- A. SEC
- B. FTC
- C. FCC
- D. FINRA

SIE New Issues & Regulations 500

A newly registered representative is making solicitation calls to potential clients. The representative is told by his father that his brother, the representative's uncle, might be interested in getting investment advice. When the representative enters the telephone number of his uncle, it comes up as blocked since this person is on the National "Do Not Call" list. Which statement is true?

A. Because the referral was made by an immediate family member, the uncle can be solicited by the representative

B. Because a personal relationship exists between the uncle and the representative, the solicitation may be made

C. Because the representative is newly registered and has not "seasoned" for 18 months, the solicitation cannot be made

D. Because the uncle is on the National "Do Not Call" list, no solicitation by the representative is permitted

SIE New Issues & Regulations 501

A satisfied customer gives his representative a client referral. Which statement is true?

A. The representative should check the Do Not Call list before acting on the referral

B. The representative is not required to check the Do Not Call List prior to acting because the client was referred

C. The referred client may only be contacted between the hours of 8:00 AM and 9:00 PM

D. The representative is not permitted to contact the referred client unless the referred client initiates the contact

SIE New Issues & Regulations 502

## SRO – RR RULES

**Licensing Test**  
Test is confidential – cannot disclose content. If flunk test, wait 30 days; if flunk 3X, wait 180 days

**Full Time Employment Obligation**  
If you want to engage in any outside business activity (including not-for-profit work like going on your Coop's Board of Directors), you must notify the firm in writing and follow firm's instructions

**Continuing Education Obligation**  
Firm Element: Annual training by firm  
Regulatory Element: On 2nd anniversary of registration and every 3 years thereafter; FINRA training. If don't show up, suspended without pay.

Pass Perfect  
A Smith Barney

## SRO – RR RULES

**Borrowing From / Lending To Clients**  
RR cannot borrow money from or lend money to a client. RR can borrow from immediate family, or a "significant other" who is a client if written notice given to firm and firm's instructions are followed

**Gift Limit**  
\$100 give or get, related to your work, per person per year. Does not apply to business entertainment. (meaning you are there with the client)– then follow firm policies

Pass Perfect  
A Smith Barney

## SRO – RR RULES

**Political Contribution Limit:**  
MSRB limits MFPs (Municipal Finance Professionals) to a \$250 contribution to an elected official's campaign in which the MFP is entitled to vote.  
If the MFP gives more than \$250; or  
The MFP gives ANY \$ amount to a campaign where the MFP can't vote, then;  
The firm is banned for 2 years doing municipal securities business (negotiated underwritings) with that issuer

If a check is written on a joint checking account to an elected official's campaign where one party to the account is an MFP, the MSRB counts the contribution as ½ only if BOTH SIGN the check

**MFP:** a registered person who performs financial advisory work or underwriting for municipalities; i.e. a reg. rep. who deals with retail clients is NOT an MFP; i.e. a reg. rep. who negotiates underwriting terms with a municipality is defined as an MFP subject to the rule

Pass Perfect  
A Smith Barney

## SRO – RR RULES


**Intra-Industry Disputes:**  
When you signed the U-4 Form to become registered, you also signed an arbitration agreement, mandating arbitration to settle disputes with member firms or other RRs. Note that you can still sue for sexual harassment and discrimination claims, however!

**Correspondence With Clients:**  
Defined as any communication sent to 25 or fewer existing or prospective clients, including e-mails and IMs. All correspondence must be approved in advance before going out UNLESS the firm implements correspondence compliance procedures that include training of RRs and audit of communications. If so, then correspondence is subject to "post-use review and approval."

All correspondence must be retained for 3 years and you must retain both personal and business correspondence sent from the same device

Pass Perfect  
A Smith Barney

A registered representative would like to increase her production by working from home at nights and on weekends. As part of this effort, the representative wants to use her home e-mail account to send her customers information and recommendations. This action is:



A. permitted as long as the rep uses her personal e-mail account

B. permitted with the prior permission of the branch manager

C. not permitted because the member firm has no way of auditing the rep's personal e-mail account


D. not permitted because the rep has not registered her personal e-mail account with the SEC

SIE New Issues & Regulations 587


### SRO – RR RULES

**Leave Business:**  
If an RR leaves the business, then all licenses lapse after being out for 2 years. If you re-enter after 2 years out, must take all tests again! Parking or hanging your license with a "friendly BD" while you are out of the business to avoid this is explicitly prohibited

**Military Duty:**  
If you are called up for military duty, registration goes into "special inactive" status, which is basically "standstill." So you don't lose licenses because you are out for 2 years or more! When you return, the clock starts counting again from where you left off. Can be paid and can share commissions with another RR in firm who services your accounts while you are away.



A registered representative that has been called to active duty in Afghanistan can share commissions during the period of military service:



A. under no circumstances

B. with another representative at the same firm that will handle that representative's customers

C. with another representative at any registered broker-dealer that will handle that representative's customers


D. with the prior approval of the principal

SIE New Issues & Regulations 509

### SRO – RR RULES

**Reportable Events:**  
If bad things are happening to you, FINRA wants to know about it. Any registered person must report to FINRA promptly, but no later than 30 days after the event, if the RR is:

- suspended or expelled by another regulator;
- sued under the Securities Acts;
- enjoined by a court of law from being in the securities business;
- the subject of a really, bad customer complaint (essentially a complaint alleging a felony, like theft or embezzlement)
- the subject of a customer complaint settled for more than \$15,000
- the subject of withheld commissions or fines by firm of more than \$2,500
- arrested or indicted (except for misdemeanor traffic and DUIs – ALL felonies MUST be reported and would subject one to statutory disqualification)




### SRO – CUSTOMER RULES

**BD Financials:**  
The BD must send its balance sheet and computed net capital (liquid net worth) to customers 2X a year, annual audited and mid-year unaudited. No requirement to send an income statement

**FINRA Manual:**  
The FINRA manual must be in each branch office, available for customer inspection. Giving the customer access to the FINRA web site satisfies this requirement

**Charges to Customers:**  
BD cannot separately charge for recommendations – included in commission or mark-up (if your firm unbundles and charges separately for recommendations, it becomes, and Investment Adviser is subject to all the IA rules)


Can charge for clerical services such as safekeeping, appraisals of securities, collection of dividends – but cannot charge for distribution of proxies because this is paid by the issuer



### SRO – CUSTOMER RULES

**Customer Disputes:**  
Handled by arbitration only if the customer signed a "pre-dispute" arbitration agreement. If not, the customer can choose to arbitration, can use the FINRA Code of Procedure for settling disputes or can sue

**Private Placement Offerings:**  
Private placements (Reg. D) are not registered with the SEC, there is no explicit due diligence obligation and there is no prospectus. As private placement offerings have become more popular, FINRA fixes this by requiring either the member firm or RR offering a private placement offering, to perform due diligence on the offering





## SRO – CUSTOMER RULES

### Prohibited Practices

**Selling Away:** Selling a customer a security that is NOT being offered by your firm – meaning it is being offered by another firm. You can't "sell away" from your firm UNLESS you ask your firm in writing if this is OK; your firm approves in writing; and your firm supervises the transaction

**Backing Away:** Giving a customer a firm quote and then not honoring it

**Selling Dividends:** Telling a customer that a stock is about to go ex-dividend, so he must buy it NOW or he will lose out and not get the dividend. Since the price is reduced on ex-date for the dividend the customer will not get, this basically a lie



## SRO – CUSTOMER RULES

### Prohibited Practices

**Breakpoint Sales:** Not making the customer aware that they are close to a breakpoint when purchasing mutual funds

**Sharing In Customer Account:** Not permitted unless joint account is opened with customer; manager approves; and sharing is in proportion to capital contributed

**Guaranteeing Customer Account:** Not permitted, but recommending put options to hedge is not a prohibited guarantee; and a repurchase agreement using exempt securities as collateral is not a prohibited guarantee



A mutual fund has the following breakpoint schedule:

Purchase Amount	Sales Charge
\$0 - \$10,000	6%
\$10,001-\$25,000	5%
\$25,001-over	4%

Which of the following single purchase amount would be considered a "breakpoint sale"?

- A. \$1,000
- B. \$11,000
- C. \$24,000
- D. \$26,000

SIE

New Issues &amp; Regulations

515

All of the following actions by a registered representative are prohibited under FINRA rules EXCEPT:

- A. spreading rumors of a sensational character that might be expected to influence prices on the exchange
- B. lending money to a customer where investment securities will be the collateral for the loan
- C. sharing in the gain or loss of a customer account
- D. accepting unsolicited orders from non-established customers

SIE

New Issues &amp; Regulations

516

## COMMUNICATIONS RULES

### Defined Retail Communications With The Public

**Advertising:** Intended for the general public – includes TV, radio, magazines, billboards, non-password protected websites and internet bulletin boards. In advertising, NO recommendations

**Sales Literature:** Intended for a specific audience – includes research reports, market letters, speeches about investing to an audience, password-protected websites, form letters or communications to more than 25 existing or prospective clients (if less, it is correspondence). Recommendations CAN be made in sales literature

Every piece of advertising and sales literature must be approved by a principal prior to use and be retained for 3 years



A registered representative presents a seminar to a group of prospective investors about investing in mutual funds. At the seminar, he makes recommendations of various funds, based on their objectives and performance. The seminar is defined by FINRA as:

- A. correspondence
- B. an internal memorandum
- C. advertising
- D. sales literature

SIE

New Issues &amp; Regulations

518

## COMMUNICATIONS RULES

### FILING OF RETAIL COMMUNICATIONS

For a member firm's first year of operations, generally, all retail communications must be filed 10 business days in advance of use (exceptions are forthcoming)

Thereafter, no filing is required, but the firm is subject to spot checks

**Retail Communications always filed 10 Business Days IN ADVANCE**

Options retail communications; and Mutual fund retail communications with member-prepared performance rankings

**Retail Communications always filed 10 Business Days AFTER First Use**

- All other mutual fund retail communications;
- CMO retail communications; and
- DPP retail communications

FINRA name can be used on websites, stating that the firm is a "member." The FINRA name must be smaller than the firm name and hyperlinked to FINRA web site. (Also note, RR cannot say he or she is a FINRA member – only the firm is!)



## COMMUNICATIONS RULES

### CMO ADVERTISING

#### Required Disclosures:

Coupon; anticipated yield and average life; specific tranche ID - # and class; final maturity date; and underlying collateral

The statement:

"The yield and average life shown above consider prepayment assumptions that may or may not be met. Changes in payments may significantly affect yield and average life."

#### Optional Disclosures:

Minimum denomination; rating; agency/Gov't backing; income payment structure; generic tranche description (i.e. PAC, TAC, Companion Class); and YTM of CMOs offered at Par



## COMMUNICATIONS RULES

When a recommendation is made (which is only permitted in Sales Literature and Correspondence – NOT in advertising):

The price of the security at the time must be disclosed;

There must be a basis in fact for making the recommendation;

Every conflict of interest known to man must be disclosed, such as if the:

- Firm or its officers own the recommended stock;
- Firm is a MM in the stock;
- Firm has been an underwriter for that company in the past 12 months;
- Firm intends to seek underwriting business from that company in the upcoming 3 months, etc.



## COMMUNICATIONS RULES

### Research Analyst / Research Report Rules

The Analyst that wrote the recommendation must certify that this is his or her honest, pure un-conflicted, pure-as-the-driven snow, opinion (Regulation AC – Analyst Certification)

If a registered representative:

Gives a presentation to **15** or more persons; and

The information presented allows the attendees to form a buy or sell opinion on a security; then

The RR is subject to the Research Analyst Disclosure Rules and Trading Prohibitions!



Regulation AC applies to the recommendations of:

- Common stock issues
- Preferred stock issues
- Convertible debt issues
- Non-convertible debt issues

- I only
- I and III
- II and IV
- I, II, III, IV

SIE

New Issues &amp; Regulations

523

A representative wishes to invite 10 of her best customers to an intimate dinner, to be followed by a presentation that the rep. will make on investing. If the rep. includes analyses of specific stocks in the speech; and the attendees use this information to determine whether to invest in those securities, then the:

- presentation is considered to be a research report
- presentation is not considered to be a research report
- rep. is required to make all of the disclosures required of research analysts
- rep. is not required to make all of the disclosures required of research analysts

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

SIE

New Issues &amp; Regulations

524

A representative wishes to invite 30 of her best customers to a buffet dinner, to be followed by a presentation that the rep. will make on investing. If the rep. includes analyses of specific stocks in the speech; and the attendees use this information to determine whether to invest in those securities, then the:

- I presentation is considered to be a research report
- II presentation is not considered to be a research report
- III rep. is required to make all of the disclosures required of research analysts
- IV rep. is not required to make all of the disclosures required of research analysts

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

SIE

New Issues &amp; Regulations

525

A representative is asked by the local PTA to make a speech on investing. About 100 people are expected to attend. If the rep. includes analyses of specific stocks in the speech; and the attendees use this information to determine whether to invest in those securities, then the speech is considered to be:

- A. advertising
- B. a research report
- C. sales literature
- D. public forum

SIE

New Issues &amp; Regulations

526

## COMMUNICATIONS RULES

### Research Analyst / Research Report Rules

If an issuer is doing an underwriting for a company, it cannot issue a research report on that company once registration is effective, since a favorable report could manipulate the price up

IPO – No research reports by underwriter for **10 days** following effective date

Add-On (Secondary) – No research reports by underwriter for **3 days** following effective date

### Public Appearance / Public Forum

An unscripted, spontaneous appearance, such as participation in a seminar, forum (including electronic venues, such as internet chat rooms), radio, TV, or other public appearance

A public appearance attended by more than 25 investors follows rules for retail communications; 25 or fewer follows the rules for correspondence

Pass Perfect  
A Smith Barney Company

## MISCELLANEOUS ITEMS

### MSRB

#### To Whom MSRB (Municipal Securities Rulemaking Board) Rules Apply

- o The MSRB writes rules for municipal market participants that deal in municipal securities including:
  - Municipal brokers;
  - Municipal dealers; and
  - Bank municipal bond departments
- o The MSRB has no authority over municipal issuers, that is, the municipalities
- o The MSRB just writes rules – they don't enforce them – FINRA enforces MSRB rules. When FINRA audits BDs, it audits for MSRB compliance.

Pass Perfect  
A Smith Barney Company

## MISCELLANEOUS ITEMS

### MSRB Annual Notice To Customers

Annually each customer must be sent:

A statement that the broker-dealer is registered with the SEC and MSRB;  
The website for the MSRB; and

A statement as to the availability of an MSRB "Investor Brochure" – which details the procedures to be followed for filing a complaint with FINRA (as the MSRB does not enforce its own rules)

### Complaint

One in writing – a written record of any complaint must be kept on file for 6 years

Pass Perfect  
A Smith Barney Company

## MISCELLANEOUS ITEMS

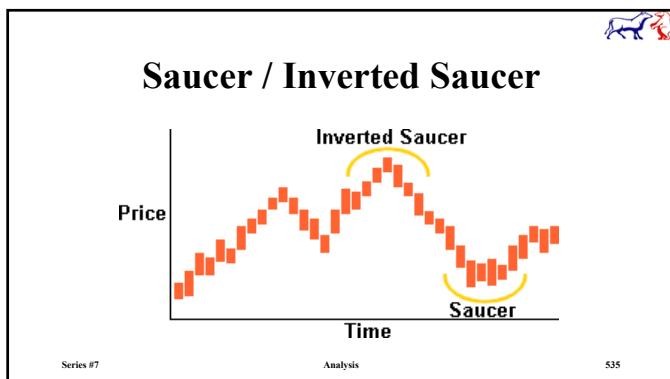
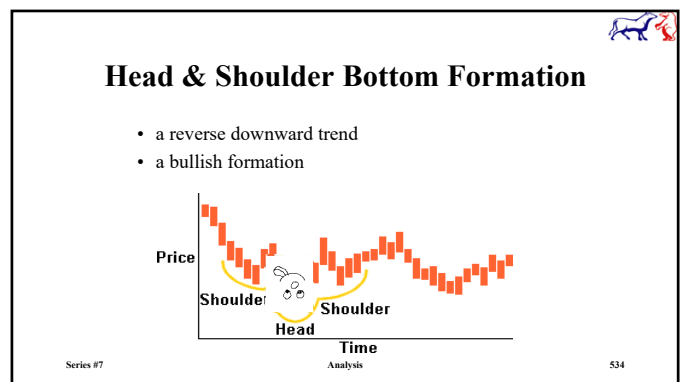
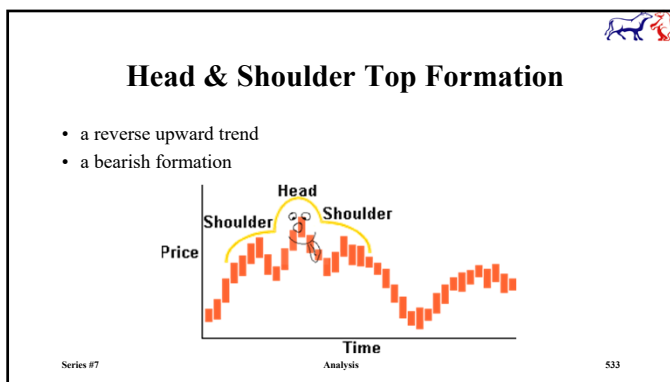
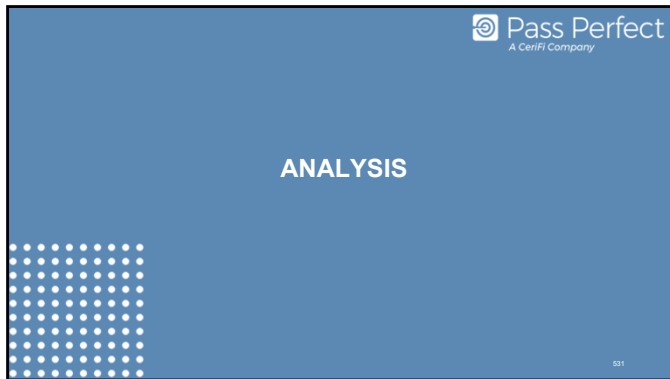
### EMMA

Electronic Municipal Market Access - created by the MSRB for retail customer use - it gives investors access to municipal new issue disclosure documents (Official Statements) and municipal trade reports

#### EMMA includes:

- Official Statements for new municipal issues
- Pre-refunded bond information
- 529 plans, auction rate securities, and variable rate demand note information
- Municipal bond trade reports via RTRS (Real Time Reporting System)
- Municipal short-term note trade reports via SHORT (Short-term Obligation Rate Transparency System)

Pass Perfect  
A Smith Barney Company



- ### A Saucer Formation is:
- Bullish
  - Reverse Downward Trend
  - Bearish
  - Reverse Upward Trend
- A. I and II  
 B. I and IV  
 C. II and III  
 D. III and IV
- Series #7 Analysis 536

Pass Perfect  
A Cerifi Company

# FUNDAMENTAL ANALYSIS



537

## FUNDAMENTAL ANALYSIS

### FUNDAMENTAL FACTORS

ANALYST EXAMINES:

- 1 Outlook for industry
- 2 Management of company
- 3 Product lines of company
- 4 Anticipated introduction of new products
- 5 Market share of the company

Pass Perfect  
A Cerifi Company

## 3 FINANCIAL STATEMENTS

ANALYST EXAMINES:

- 1 Balance Sheet
- 2 Income Statement
- 3 Statement of Changes to Retained Earnings (i.e. the Cash Flow Statement)

Pass Perfect  
A Cerifi Company

## BALANCE SHEET

- "Snapshot" of company's assets and liabilities
- NET WORTH = Assets - Liabilities
- ASSETS = Liabilities + Net Worth

**ASSETS**

- o arranged in order of liquidity
- o those assets that are quickly convertible to cash are listed first

**LIABILITIES**

- o arranged in order of liquidity
- o those liabilities that must be paid promptly are listed first

Pass Perfect  
A Cerifi Company

PASS PERFECT


## BALANCE SHEET

	<b>Current Assets</b>	<b>Current Liabilities</b>	
CASH	Cash \$20,000	Acct Payable 4,000	CASH
RECEIVABLES	Mkt Sec 10,000	Wages 2,000	RECEIVABLES
INVENTORY	Acct Rec 30,000	Dividends payable 4,000	INVENTORY
	Inventory 10,000	Note Payable 5,000	
		Interest Payable 2,000	
	<b>Current Assets Total: 70,000</b>	<b>Current Liabilities Total: 17,000</b>	
	<b>Fixed Assets</b>	<b>Long Term Liabilities</b>	
VEHICLES	Vehicles 4,000	Mortgage Payable 100,000	VEHICLES
REAL ESTATE	Real Estate 400,000		REAL ESTATE
DEPRECIATION	Depreciation -300,000		DEPRECIATION
INTANGIBLE ASSETS / GOODWILL	Intangible Assets / Goodwill 800,000		INTANGIBLE ASSETS / GOODWILL
LOGOS	Logos -20,000		LOGOS
	<b>Fixed Assets Total: 924,000</b>		
	<b>Total 994,000</b>	<b>Total 994,000</b>	

STOCKHOLDERS' EQUITY

	<b>Stockholder's Equity</b>		
	Common at Par 40,000		COMMON AT PAR
	Paid in Surplus 500,000		PAID IN SURPLUS
	Retained Earnings 337,000		RETAINED EARNINGS
	<b>Stockholder's Equity Total: 877,000</b>		

541



All assets minus all liabilities equals:

- A. net worth
- B. net working capital
- C. book value
- D. net tangible assets

Series #7 Analysis 542

Current assets minus current liabilities equals:

- A. net worth
- B. net working capital
- C. book value
- D. net tangible assets

Series #7 Analysis 543

The Current Ratio measures:

- A. debt service coverage
- B. liquidity
- C. leverage
- D. profitability

Series #7 Analysis 544

ABC Corporation Income Statement	
For the year ending 12-31-XX	
(\$000)	
Gross Sales	4,000
Expenses	<u>2,000</u>
Operating Income	2,000
Bond Interest	<u>200</u>
Net Income Before Tax	1,800
Taxes	<u>800</u>
Net Income After Tax	1,000
Preferred Dividend	<u>100</u>
Earnings for Common	900
Common Dividend	<u>500</u>
Retained Earnings	400

*RESERVE EARNINGS FOR COMMON*  
*BUTTER*  
*THE*  
*PROBLEM*

"GONNER"  
 "EBTPC" = Every Body Trades Puts and Calls

Series #7 Analysis 545

All of the following items are found on a company's income statement EXCEPT:

- A. Depreciation Expense
- B. Current Liabilities
- C. Cost of Goods Sold
- D. Bond Interest Expense

Series #7 Analysis 546

A company has reported earnings per share of \$5.00. If the company paid a common dividend of \$1.00, what is the dividend payout ratio?

- A. 10%
- B. 20%
- C. 50%
- D. 60%

<u>Div. Paid</u>	
Earnings Available for Common	$\frac{1}{5}$

Series #7 Analysis 547

A company has reported earnings per share of \$5.00. If the company paid a preferred dividend of \$2.00 and a common dividend of \$1.00, what is the dividend payout ratio?

- A. 10%
- B. 20%
- C. 33%
- D. 40%

<u>Div. Paid</u>	
Earnings Available for Common	$\frac{1}{5}$
To get Earnings, you BTP	

Series #7 Analysis 548

Pass Perfect  
A Cerifi Company

## ECONOMIC ANALYSIS




549

## ECONOMIC ANALYSIS

**GROSS NATIONAL PRODUCT (GNP)**

- Sum of all goods and services produced in country
- Consists of consumer spending plus Gov't spending plus business investment
- Proper term is Gross Domestic Product (GDP), but GNP is usu. used on exam!
- Real GNP
  - Any effects of inflation on prices are eliminated to achieve a valid measure (Real GNP = Nominal GNP – Inflation)

Pass Perfect  
A Cerifi Company



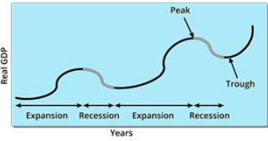
GNP consists of all of the following EXCEPT:

- A. Consumer spending
- B. Government spending
- C. Foreign Government spending
- D. Fixed investment

Series #7 Analysis 551

## Business Cycle

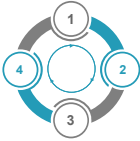
Business activity tends to expand in a cyclical fashion



Pass Perfect  
A Cerifi Company

## Business Cycle (cont.)

**Recovery**  
Business decline bottoms out before starting next expansion phase




**Prosperity**  
As expansion ages, it tends to reach a peak

**Recession**  
Business contraction  
When GNP drops 2 consecutive quarters (if GNP drops for 6 quarters, it's a depression)

Pass Perfect  
A Cerifi Company

553



Which of the following occurs between a recession and a recovery?

- A. expansion
- B. depression
- C. trough
- D. prosperity

Series #7 Analysis 554



The usual order of the economic cycle is:

- A. expansion, recession, recovery, peak
- B. recession, recovery, peak, expansion
- C. expansion, peak, recession, recovery
- D. peak, recession, expansion, recovery

Series #7

Analysis

555



During which phase of the economic cycle would one most likely find monetary "inflation" starting to occur?

- A. Expansion
- B. Prosperity
- C. Recession
- D. Recovery

Series #7

Analysis

556



A six month mild decline in economic activity is a(n):

- A. recession
- B. depression
- C. correction
- D. expansion

Series #7

Analysis

557

## GROWTH IS AFFECTED BY:

### Fiscal Policy

- Gov't actions (set by Congress) that influence economic activity
- Can be used to increase or decrease take home pay of American public by:
  - Changing tax rates
  - Changing transfer payments (such as Social Security)
  - Changing Gov't spending on goods and services

 Pass Perfect  
A Smart Company

## GROWTH IS AFFECTED BY:

### Monetary Policy

- Action taken by Fed. Reserve to influence growth of money supply
- By expanding money supply, credit is loosened, and interest rates lowered (this stimulates economy)
- By contracting money supply, credit is tightened, and interest rates raised (this dampens economy)
- 4 tools of Fed - "DORM"
  - Discount Rate
  - Open Market Operations
  - Reserve Requirements
  - Margin on Securities

 Pass Perfect  
A Smart Company



## ROLE OF THE FEDERAL RESERVE (cont.)

- **Setting Discount Rate**
  - discount rate is rate that Fed. Reserve charges member banks to borrow reserves
  - to tighten credit, Fed. increases discount rate
  - to loosen credit, Fed. lowers discount rate

Series #7

Analysis

560



## ROLE OF THE FEDERAL RESERVE (cont.)

- Conducts **Open Market Operations**
  - Fed. Reserve trading desk in NY adjusts credit availability daily through repurchase and reverse-repurchase agreements with Gov't dealers
  - under a "repo", Fed. gives dealer funds in return for temporary pledge of Gov't securities
  - under a "reverse-repo", Fed. gives dealer a temporary pledge of Gov't securities in return for cash, tightening credit

Series #7

Analysis

561

If the Federal Reserve Open Market Committee authorizes its trading desk to enter into system wide repurchase agreements, the effect will be to:

- I Increase yields
- II Decrease yields
- III Raise debt prices
- IV Lower debt prices

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

Series #7

Analysis

562

## ROLE OF THE FEDERAL RESERVE (cont.)

- Setting **Reserve Requirements**
  - Fed. sets level of reserves that member banks must maintain
  - if reserve requirement is set at 10%, then bank can lend 90%
  - increasing reserve requirement would tighten credit
  - reducing reserve requirement would loosen credit

Series #7

Analysis

563

## ROLE OF THE FEDERAL RESERVE (cont.)

- Setting **Margins on NonExempt Securities**
  - Fed. sets initial margin rates for nonexempt securities under Reg. T
  - to tighten credit, Fed. can increase margins
  - to loosen credit, Fed. can lower margins

Series #7

Analysis

564

Fiscal Policy is set by:

- A. Supreme Court decisions
- B. Congressional action
- C. Presidential edict
- D. Federal Reserve action

Series #7

Analysis

565

To stimulate the economy using Fiscal Policy which of the following actions could be taken?

- I Tax rates could be reduced
- II Tax rates could be increased
- III Government spending could be reduced
- IV Government spending could be increased

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

Series #7

Analysis

566

## ECONOMIC THEORIES TO EXPLAIN BUSINESS CYCLE

- 1 **Keynesian Theory**  
To stimulate consumption, Keynes advocated increased Gov't spending and transfer payments to individuals. To get the money to spend, the Gov't borrows
- 2 **Monetarist Theory**  
Actions of Fed. Reserve are driving force behind economic cycles
- 3 **Supply Side Theory**  
• I.e. Reaganomics  
• Tax cuts and reduced government spending stimulate "supply" and cause the economy to grow

Pass Perfect  
A Great Company

Keynesian Theory states that the economy is stimulated by:

- A. the actions of the Federal Reserve
- B. increased Government spending
- C. decreased Government spending
- D. lowered tax rates

Series #7 Analysis 568

Monetarist Theory states that:

- A. increased government spending will stimulate the economy
- B. tax rate reductions and lower government spending will stimulate the economy
- C. the actions of the Federal Reserve control the level of economic output
- D. tax rate increases and increased transfer payments will stimulate the economy

Series #7 Analysis 569

Supply Side Theory states that:

- A. increased government spending will stimulate the economy
- B. tax rate reductions and lower government spending will stimulate the economy
- C. the actions of the Federal Reserve are the driving force behind the economy
- D. tax rate increases will stimulate the economy

Series #7 Analysis 570

The Federal Reserve Board is charged with the responsibility for establishing:

- A. Fiscal policy
- B. Monetary policy
- C. Foreign policy
- D. Tax policy

Series #7 Analysis 571

## ECONOMIC INDICATORS

To determine what monetary action to take, the FRB looks at the "Leading Economic Indicators" such as:

- Housing Starts
- Durable Goods Orders
- S & P 500 Index
- Money Supply Levels
- Consumer Goods Orders
- Initial Unemployment Claims

To deal with test questions, there is only 1 "Coincident" Economic Indicator used – Index of Industrial Production - and 2 "Lagging" Indicators used – Reported Corporate Profits and Consumer Debt Levels. If it isn't one of these 3, it is a LEADING indicator!

Money Supply Levels measured by M1, M2, M3 and L (M1 is narrowest measure; L is broadest measure)

Pass Perfect  
A Great Company

### Market analysis

- Balance of Payments
  - ✓ A surplus is more money flowing into the US than out
  - ✓ A deficit is more money flowing out of the US than in
- Balance of Trade
  - ✓ Balance of trade is the main influencer of balance of payments
  - ✓ A surplus in the trade balance means the US is exporting more than it imports causing more money flow into the US
  - ✓ A deficit in the balance of trade means the US is importing more than it exports causing more money to flow out of the US
- Surpluses strengthen the US economy
- When the economy strengthens so does the dollar

Pass Perfect

### Practice question

Which of the following would tend to strengthen the value of the dollar

- Surplus in balance of payments
- Deficit in balance of payments
- Deficit in balance of trade
- Surplus in balance of trade

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

Pass Perfect

If the U.S. dollar depreciates against foreign currencies, which statements are true?

- U.S. exports should increase
- U.S. exports should decrease
- Any trade deficit should narrow
- Any trade deficit should widen

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

Series #7 Analysis 575

<u>EVENT</u>	<u>EFFECT ON U.S. DOLLAR</u>
Inflation Increases	↓
Inflation Decreases	↑
Trade Deficit Widens	↓
Trade Deficit Narrows	↑
Fed. Raises Interest Rates	↑
Fed. Lowers Interest Rates	↓

Series #7 Analysis 576

<u>EVENT</u>	<u>EFFECT ON U.S. DOLLAR</u>
More Foreigners Buy U.S. Securities	↑
More U.S. Citizens Buy Foreign Securities	↓
More U.S. Citizens Visit Foreign Countries	↓
More Foreigners Visit U.S.	↑

Series #7 Analysis 577

<u>EVENT</u>	<u>EFFECT ON U.S. STOCK PRICES</u>
Economic Output Rises	↑
Economic Output Falls	↓
Interest Rates Fall	↑
Interest Rates Rise	↓
Inflation Falls	↑
Inflation Rises	↓

Series #7 Analysis 578



Which of the following economic events would have a positive long term impact on common stock prices?

- I Rising interest rates
- II Rising capital gains tax rates
- III Rising employment rates
- IV Falling inflation rates

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

Series #7

Analysis

579