

# Career Employer

## Series 63 Cheat Sheet

### REGULATION OF PERSONS

In each state, the **administrator** is responsible for administering the Uniform Securities Act (USA).

Individuals, corporations, partnerships, and governments are all included in the USA's definition of a person.

A **person** is described as someone who is not deceased, is not a minor, or has not been declared mentally incompetent.

When talking of institutional investors, the USA includes banks, savings institutions, trust companies, insurance companies, investment companies as per the Investment Company Act of 1940 definition, as well as Employee Benefit Plans with \$1 million or more in assets (such as profit-sharing trusts, or pension trusts).

From time to time, it is as retail clients that individuals can be referred to.

Anybody that issues a security or proposes to issue them, is termed an **issuer**.

An **offer to sell** or **offer** is all attempts to dispose of, or solicitation of an offer to buy that's related to a security, or interest in one for value.

Every sale or disposition of a security or interest in a security for value is considered a **sale**.

Any of the 50 states, or territories of the United States (for example, Puerto Rico) is referred to as a **state**.

When it comes to securities professionals, they are broken down into four categories: broker-dealers, agents, investment advisers, and investment adviser representatives.

Broker-dealers (BDs) buy and sell securities. This can be for their own account or for the

accounts of others, for example, their clients. Trust companies, issuers of securities, agents, banks, or savings institutions are not included in the definition of a BD.

Should they have an office in a state, it is with the administrator of that state that they will need to register. Should there be no place of business in a state, a person won't be seen as a BD. This applies also if it is with other BDs, institutions, or the issuer of securities that transactions take place.

Under the snowbird exemption, there are exceptions including a BD which is licensed under the specific state's securities act in which they maintain a place of business and the BD who sells and offers in the state to persons who are already their existing customers but who are not residents of the state.

An agent is any individual that represents an issuer or BD and effects or attempts to effect securities sales or purchases. An agent, however, can never be the BD.

As long as they don't take part in any sales-related activities, any administrative employees of a BD are not considered agents either.

For individuals that represent the issuer, if they are involved with exempt securities or an exempt transaction, they are not deemed to be agents.

They will be, however, if they deal with transactions that are related to the employees of the issuer for which a sale-related compensation is paid to them.

When it comes to splitting commissions, BDs don't have to tell their clients that this is happening, but it can only be carried out between agents that are affiliated to the BD.

An investment adviser (IA) is someone who receives compensation for advising others. This could be directly or through writing and

publication, for example. This advice deals with the value of securities, as well as advice on what to purchase or sell. It also covers the production of reports or analyses regarding securities.

**SEC Release IA-1092** states that financial planners, for example, pension consultants and sports representatives can also fall under the definition of an IA if, as part of their business, they provide investment advisory services to their clients.

The following are excluded from the definition: Engineers, teachers, lawyers, and accountants but only if they offer incidental advice linked to their profession for which they receive no compensation.

Federal covered IAs generally register with the SEC and are excluded from the USA's definition of an IA.

The **National Securities Markets Improvement Act of 1966 (NSMIA)** brought about the split between state and federal regulation of IAs.

The Dodd-Frank Act of 2010 modified this further.

- SEC registration is necessary for a federal covered advisor that controls AUM of \$110 million or higher
- State registration is necessary if AUM <\$100 million
- Advisor can choose registration method if AUM is between \$100 and \$110
- An advisor can remain with an AUM of at least \$90 million once they have registered with the SEC

An IA is federally covered if investment companies form part of their advisory clients.

An IA who has no office in a particular state but deals with other IAs, BDs, and institutions, or who meets the snowbird rules is exempt from registration under the USA.

When the IA doesn't have an office in a particular state and over a 12-month period deals with not more than five noninstitutional clients, the **De Minimis** rule applies.

Investment advisor representatives (IARs) are employed by an IA and are considered as such if they carry out any of the following:

- Render advice or make recommendations regarding securities
- Deal with the portfolios or accounts of clients
- Decide, with regards to securities, what recommendations can be given
- Either negotiate, offer, or solicit for the sale of advisory services regarding investments
- Act as a supervisor to anyone who carries out the tasks described above

When working for federally covered IAs with a place of business in the state they only need to be registered with the state.

Automatic agent or IAR registration of partners, officers, and directors occur through the registration of a BD or investment adviser.

This also accounts for other staff performing similar functions.

Under the USA, all professional registrations or withdrawals will take place on the 30th day (at noon) after their completed application is filed.

A professional that has passed their Series 6 or Series 7 cannot share in commissions until they have passed their Series 63.

Securities professionals must renew their registration annually. This starts with the first December 31 to occur following when they were first registered, with the necessary fees being paid.

Until renewal, a successor firm to BD or IA won't have to pay any fees.

All initial applications for securities professionals and issuers have to agree to a consent to service process but they won't have to provide fingerprints. This won't need an annual renewal.

Disclosure of a previous conviction might be required for a securities application to the administrator. These convictions relate to not only misdemeanors that are financially related but to any past felony.

Registration applications may also see the administrator asking for the proposed business method as well as details regarding the applicant's citizenship.

When the registration application shows a non-securities related misdemeanor conviction from another state which would be a felony in the state they are applying in, the conviction on record (misdemeanor) is the one that counts.

Both the agent as well as the BD must notify the administrator when an agent's association with a BD is **terminated**, and following that, a period of one year from the termination date sees the administrator retaining jurisdiction.

There are certain net worth requirements in place for IAs but when it comes to Bs, these are based on net capital. Note that there are no financial requirements pertaining to IARs and agents.

As for the net capital requirements for BDs, administrators can never request that it be any higher than those laid out by the SEC.

Should any changes be made to the registration of an IA or BD, prompt reporting of these changes is a necessity.

In some cases, the posting of a surety bond may be necessary for a BD that exercises discretion or maintains custody of a client's account, funds, or securities. This is usually a necessity if the administrator's requirements for net capital are not met.

A surety bond may also be necessary for agents exercising discretion. In some cases, a deposit of cash or securities can be used instead of a surety bond at the administrator's discretion.

Surety bonds must meet requirements as set out in the USA meaning that if a client can prove a violation, the bond can be collected against by that client.

The recordkeeping requirements of a securities professional's home state are sufficient for any other state they may be registered in. SEC requirements, however, will supersede that of the state should the BD or IA be federally registered.

In terms of **recordkeeping**, documents for BDs must be kept on hand for a period of three years, including any electronic mail.

A **blotter** is one of the methods of record keeping that's a requirement as set out in regulations.

All activity of a BD is recorded through blotters, for example, all money in and out, certificates in and out, and what is bought and sold. Cash receipts journals are another recordkeeping necessity. It's not necessary for copies of customer tax returns to be kept

While SIPC coverage won't protect against a decline in stock prices, it does provide protection to a client if a BD goes bankrupt.

## **REGULATIONS OF SECURITIES AND ISSUERS**

Simply put, securities are investment contracts.

Note the following, however, that are not classed as securities; retirement plans (both IRAs and Keoghs), nonvariable insurance contracts (such as fixed annuity, term, modified endowment, as well as whole life), commodities, collectibles, personal residence condominiums, and currencies.

When the proceeds of a sale go to the issuer, an **issuer transaction** has taken place. An example of this would be the sale of treasury stock or a primary offering.

When the issuer does not benefit from the proceeds of a sale, a **nonissuer transaction** has taken place. An example of this would be any transactions taking place on the secondary market.

### **Federal covered security**

- It's under the Investment Company Act of 1940 that all investment companies must register
- Regulated exchanges such as Nasdaq are where securities are listed
- Regulation D of the Securities Act of 1933 governs private placements
- It's important to note that there can still be risk attached to federally covered securities

### **Methods of registration of securities under the USA**

They are:

- **Notice filing:** This, although not registration from a technical perspective, is for federal covered securities issued by investment companies registered under the Investment Companies Act of 1940

- **Coordination:** These relate to interstate issues that are concurrently filed at the SEC. Unless the administrator has issued a stop order, or hasn't received documents at the stated time, this becomes effective simultaneously
- **Qualification:** For use by all registrants but usually for issues that are intrastate. The administrator will set the effective date.

From their effective date, registrations are in effect for a period of one year. If there are unsold shares with the issuer or underwriter, this can be longer as long as nothing changes in terms of compensation to the underwriter or the price per share.

Prior to sale (and not the offer), the offeree must receive a prospectus.

Note that when we talk about an exempt security, it is as a noun but an exempt transaction is a verb.

Bonds guaranteed or issued by foreign governments with diplomatic relations are exempt securities. Unless it receives a guarantee from its sovereign government, the foreign city's issue is not exempt and neither are foreign corporations.

Issues that are from educational or charitable organizations are only considered exempt if they are nonprofit.

Exempt transactions include:

- Isolated nonissuer transactions
- Unsolicited orders
- Transactions with institutions
- Transaction between underwriter and issuer
- Transactions by fiduciaries (does not include a minor's custodian, however)
- Private placements (10 or less offers within a 12 month period to non-institutional clients)
- Preorganization certificates with 10 or less subscribers

No matter if a transaction or issue is exempt, an agent dealing with it must be registered properly. An unsolicited order for a nonexempt security from a retail client can be accepted by an agent that is properly registered. The reason for this is that the transaction is considered exempt. The right to have the client acknowledge that the order was unsolicited remains that of the administrator.

Because it is an exempt transaction, a registered agent can offer nonexempt unregistered securities to an institutional client.

If the security is registered, exempt, or federal covered, under the Uniform Securities Act, a nonexempt transaction can take place in the state.

The claimant has the burden of proof when it comes to qualifying for an exemption.

The number of securities offered in the state as well as all the other states where the securities will be offered must be included in the registration statement.

These statements can be filed by several parties, including BDs, issuers, as well as selling stockholders, but never an agent or the administrator of the state.

Often, quarterly reports need to be filed as requested by the administrator.

### **ADMINISTRATIVE PROVISIONS AND REMEDIES**

According to the USA, any attempt to make a sale is an **offer**.

While nonaccessible stock is not seen as involving an offer or sale when assessable stock is given as a gift, this is considered to be.

When a bonus for a purchase of stock is given by a BD or anyone else from a member firm and that bonus is deemed to be a sale.

Each administrator has jurisdiction when it comes to buy or sell orders thanks to the power given to them by the USA. Multiple administrators can bring action against parties involved should a violation occur.

Not under the jurisdiction of the administrator are newspapers published in the state where  $\frac{2}{3}$  of the circulation is outside of it.

### **Powers of the administrator**

These allow the administrator to:

- Specific to the needs of the state, make rules and forms as well as those that apply to everyone
- Issue orders to persons. These orders include cease and desist orders
- While they cannot make arrests, administrators can seek court injunctions
- Cancel, deny, revoke and suspend both licenses and registrations
- Subpoena evidence as well as witnesses where deemed necessary

- As a nonpunitive form of termination, they can withdraw or cancel registrations

If they cannot reach an agent within a reasonable time frame, an administrator can cancel the agent's registration.

They will also cancel the registration of an agent that has died, or if they have been declared mentally incompetent.

Failure to follow the provisions of the act, however, is not a reason for them to cancel registration.

For all BDs that are registered in the state of the administrator, access to books and records at any time must be possible.

For the exam, you should also make sure that you know the difference between a stop order, summary action, and a cease and desist order.

### **Stop orders**

In general, this is linked to a securities registration. An appeal against a stop order is possible within a 60-day period of it having been received.

The administrator can modify or vacate a stop order regarding a securities registration when conditions that contributed to the issuance of the order have altered and if it is in the interest of the public.

### **Cease and desist order**

It is with or without a prior hearing that a cease and desist order can be issued by an administrator.

A court-imposed injunction can occur if this order is not adhered to.

### **Summary action**

As long as a hearing is held within a 15-day period after receipt of a written request, the administrator can summarily suspend the registration of both a security and a person.

Under the terms of the USA, civil suits need to be filed within three years of an alleged infraction.

This drops to two years after a violation's discovery and it depends on which of these comes first.

Under the terms of the USA, when suing, clients who receive money back with interest

paid are not allowed to be paid treble damages.

The offer to return money to a customer, along with a payment of interest, legal costs, and the investment's income when the sale has taken place in violation of the USA is termed **the right of rescission**.

Under the USA, the maximum fine that can be levied is \$5,000 while a prison sentence term is three years.

Administrators can also choose both punishments should they deem it necessary.

### **COMMUNICATING WITH PROSPECTS AND CUSTOMERS**

Disclosure is necessary for potential conflicts of interest and at all times, any potential BD fees must be disclosed.

Service offered by BDs, including appraisals, collection of dividends and interest, account transfers as well as keeping client assets can be charged for, but at all times, fees must be reasonable.

Neither the registration of a security nor the registered person is very allowed.

#### **Margin account**

- Mandatory – Credit and hypothecation forms
- Optional – loan consent forms
- After the first trade takes place, these must be returned as quickly as possible
- Prior to trading, a risk disclosure document must be completed

#### **Options account**

- Prior to first trade or approval of account – ODD
- After 15 days – Options agreement

#### **Discretionary account**

It's not the time or the price that's chosen by a registered person handling a discretionary account, but instead the asset, the amount, or the chosen action. No written authorization is required in this regard.

#### **Investor red flags**

The website of a BD is seen as part of their advertising. All records of the site and any changes made to it will need to be kept for a period of three years.

Any advertising used by investment advisors is not allowed to have testimonials as part of it. If charts are used, a disclaimer pertaining to difficulties of use and limitations thereof must be provided.

### **ETHICAL PRACTICES AND OBLIGATIONS**

The USA's anti-fraud provisions are always in effect. This means that they apply to securities and transactions that are deemed exempt, as well as individuals that aren't part of the securities business.

Unless the transaction is exempt, offering or sale of a nonexempt unregistered security is not allowed.

As a way to make an intelligent decision when it comes to investing, an investor should use **material facts**.

It's critical that these facts are never omitted or misstated in any way.

Also, when it comes to the prospectus, even as a way to point out critical information, it cannot be marked or highlighted.

The value of a security can be affected significantly by **material inside information** that the public is not privy to. Using insider information is only a crime, however, should a trade have taken place.

When there is excessive activity on a client's account as a way to generate income, this practice is known as **churning**.

When making recommendations, they must be suitable for the client. The same security, for example, cannot be recommended to all clients because it won't be suitable for all of them. This is termed a blanket recommendation.

Other practices that are prohibited include borrowing either securities or money from a client. If they are a BD, a financial institution that loans funds (but not a mortgage broker), or a BD or IA affiliate, then this isn't prohibited.

Unless the IA or BD takes part in the business of loaning money, for example, on margin accounts, or if the client is their affiliate, loaning money to a client is not allowed either.

Clients should be told, both in writing and orally, should the BD operate from the location of a financial institution, for example, a bank and if they do, their services should be distinct from those offered by the other institution.

Prominent postings relating to the fact that any investments don't receive FDIC

insurance are also necessary as well as that investments can drop in value.

Disclosures such as this aren't necessary for radio advertising of 30 seconds or less.

BDs may not alter a client's information, for example, showing a higher net worth or income so as to ensure that they are allowed to trade using a margin or options account.

Another prohibited practice is that of **front running**.

This is when orders from a BDs personal account or that of their firm are put ahead of a client's with the knowledge that this will benefit them.

When trading on margin accounts occurs, once the initial trade is made, a signed margin agreement must be received from the client. This does not occur before the trade.

Written complaints received from customers (including emails) must be dealt with as soon as possible by showing the complaint to the relevant supervisor.

Note that when an agent has acted in an irresponsible manner, officers can be held liable for their actions.

When the sale of certain securities would violate state law, it is not permitted to get a written statement from a client saying that they won't sue the agent should the practice fall under scrutiny. Waivers or agreements in such a manner are never valid.

If there is written permission from the client and BD, agents can share the profits and losses on an account. This doesn't apply to BDs, IAs, or IARs, however.

A fund that has a front-end load, 12-b1 charges higher than .25%, or any CDSC can never be referred to as no-load.

Breakpoints are being discussed when an agent mentions possible discounts for mutual fund shares.

Order tickets should include the following information: customer number (but never their name or where they live), time of order entry, execution price, time execution or cancellation took place, as well as the terms and conditions of the order.

Don't confuse not being allowed to guarantee results with a guaranteed security. The latter will have a third party that will provide the

guarantee on interest, principal, or dividends. This guarantee won't ever be on capital gains, however.

When it comes to unethical or prohibited practices, **arbitrage** is not one of them, and should conditions mean that the inventory held by a BD appreciates, that's fine.

Another practice to be aware of is **selling away**. This is when transactions are effected on the books of a BD, without gaining written consent from the employing BD beforehand.

A receipt must always be provided to customers when they deposit securities with a BD, while if a client wants delivery of securities or money, this can not be delayed as it's considered to be unethical.

When a BD places an ad offering various free services, this must be free of any obligations on the part of people who enquire about those services.

Unless responding to an IRS order or that of the court, the personal information of the client of an IA is confidential. If it is a joint account, information can be passed onto the spouse of the account holder who is part of that joint account.

Unless clients are given full written disclosure regarding the capacity in which the adviser will act and the client gives consent before the settlement of the said transaction, an IA may not effect transactions as a principal or as an agent.

If an advisor has an undisclosed interest in certain securities, it's deemed unethical to encourage a client to trade in them, especially if, as a result of said trade, their value goes up and the adviser benefits.

As stated by the USA, when paid a fee for their service, a solicitor for an IA must be registered as an IAR.

Unless they are authorized to keep custody thereof, a stock certificate mailed to an IA by the executing BD in error must be returned in three business days.

If custody is not prohibited in state rules and the administrator has been notified, the USA allows IAs to maintain custody of the securities or cash of a client.

Custody will not include the following:

- Receipt of checks that the client has drawn which were payable to third parties not related in any way but these must be forwarded to that third party

within three days of them having been received

- Investment discretion when it comes to a client account

Funds and/or securities under the custody of an investment advisor must be segregated. Clients must also receive statements regarding these funds and/or securities each quarter. If a change in location occurs, that must be sent as soon as possible.

### Cybersecurity and data protection

At all times, both customer and firm data must be securely protected and potential theft red flags identified. All software should be updated on a regular basis while all breaches or attempts at breaches must be reported. In the fight against cybercrime, agents are one of the first lines of defense.