Career Employer

Securities Industry Essentials (SIE) Exam Cheat Sheet

Knowledge of Capital Markets

Capital market types

- **Primary markets** are where capital is raised by issuers of securities selling them
- **Secondary markets** involve transactions among investors

Types of offering

- **Public securities offering:** Publicly traded securities
- **Private securities offering**: Securities traded to private investors
- Primary offering: The issuer receives the proceeds thereof
- **Initial public offering (IPO):** This is the issuer's first release of securities to the public. They will receive the proceeds thereof
- **Additional primary offering (APO):** Following an IPO, an additional distribution of securities can be made available to the public to which the issuer will receive the proceeds
- **Split or combo offering:** Here, both the issuer and existing shareholders will receive proceeds
- **Secondary offering**: Here, the existing stockholders get the proceeds

Market centers (Transactions on the secondary market)

- **Exchanges:** Takes place in an auction market with designated market makers trading listed securities in a physical location
- **Over-the-counter (OTC):** Here market makers (dealers) trade in a decentralized manner
- **Third market:** OTC trading of exchange-listed securities
- **Fourth market:** Here, securities are traded over electronic communications networks (ECNs) between institutions

Broker-dealer types

- **Carrying (clearing) firm:** These BDs carry the accounts of their customers. Both funds and securities are accepted
- **Introducing (fully disclosed) firm:** Brings the clearing firm to the customer and introduces them
- **Prime BD:** This type of BD holds custody of securities and carries out other services but execution services are carried out by other BDs.

Four stages of the business cycle

These are peak, contraction, trough, and expansion

Economic policy

- **Monetary:** The Federal Reserve Board enacts policies to direct the money supply
- **Fiscal:** Congress and the president enact policies that will influence the need for services and goods
- **Supply-side:** Here market forces determine prices as good sellers price their products so as to remain profitable by meeting demands

Products

Equity

- **Common stock:** This is used to raise capital by a company and it offers investors growth
- **Preferred stock:** Also used to raise capital but offers investors income. There are several types of preferred shares including:
- Straight (noncumulative): If dividends are missed, they don't have to be paid
- **Cumulative:** If dividends are in arrears they, along with current preferred dividends will be paid out before common stock investors receive theirs
- **Callable:** At a specified price and after a specified date, the issuer can buy back shares
- **Participating:** Dividends may be paid in excess of the stated amount by the issuer
- **Adjustable rate**: Here the dividend is bound to another rate
- **Rights and warrants:**
  - Rights: Short-term, with an exercise price lower than CMV. Existing shareholders are eligible. Existing stockholders have the opportunity to keep their percentage of ownership
  - Warrants: Sold as units and bundled with other securities, for example, a bond with an attached warrant. These are long-term. Warrants can be exercised above CMV when issued
- **Real estate investment trusts (REITs)**
  - Traded OTC on or exchanges
  - A form of liquidity for investors in real estate

Debt securities (Bonds)

Bond maturities:

- **Term:** It is on one date that the entire issue matures
- **Serial:** It's over a period of years that the issue matures
- **Balloon:** A period of years for a payment schedule with the final maturity date having the largest number of bonds maturing

Bond features:

- **Callable:**

- Prior to maturity, on a specified date and at a specified price bonds can be bought back by the issuer
- In anticipation of interest rates dropping, issuers will call bonds
- It allows issuers to borrow at a lower cost

- **Puttable:**
  - Prior to maturity, on a specified date and at a specified price investors can put bonds to the issuer
  - In anticipation of interest rates rising, investors will put bonds
  - Reinvestment at higher current rates is therefore possible for investors

- **Convertible**
  - This means that a debt instrument can be converted to stock (equity) by an investor

Par value and bond yields:

- **Par value:** Unless stated differently, this is always assumed to be $1,000
- **Bond yields:**
  - These are coupon, nominal, or stated (annual interest / par value, so if a bond pays $30 annual interest, $30 / $1,000 = 3% coupon yield)
  - Current yield: Annual interest / current market value (if a bond trading at $1,200 pays $30 annual interest, $30 / $1,200 = 2.5% current yield)
  - Yield to maturity: If the bond is held to maturity, this is the annualized return
  - Yield to call: This is the return showing early redemption and discount gain acceleration or premium loss

Corporate debt securities

- **Secured:**
  - Mortgage bond: This is a bond that has real estate backing
  - Collateral trust bond: This is a bond that is backed by other issuer-owned securities (for example, government debt)
  - Equipment trust certificate: This receives backing from equipment used by the issuer

- **Unsecured:**
  - Debenture: This receives the issuer's full faith and credit backing
  - Subordinated debenture: When an issuer defaults, this is the last of all debt to be paid
  - Guaranteed bond: A third party provides guarantees for this bond (for example, the debt of a subsidiary is guaranteed by a parent company)
  - Income bond (adjustment bond): Only earned interest is payable. This is not a great investment choice for those targeting to earn income

Liquidation priority in corporate debts

- Secured bonds
- General creditors and debentures
- Subordinated debentures
- Preferred stock
- Common stock

Zero coupon bonds

- **Treasury receipts** are BD issued and backed and will mature at par
- **Treasury STRIPS** are U.S. Treasury-issued and will mature at par

Government debt securities - Treasury bills, notes, and bonds

- **T-bill:** Matures at 1 year or less. Quoted at annualized % discount from par. Is not callable
- **T-note**: Matures in 2 to 10 years. Quoted at a % of par in 32nds. Is not callable
- **T-bond**: Matures in 10 years or more. Quoted at % of par in 32nds. Is callable

Municipal debt securities

- **General obligation bonds:** Are backed by issuing municipality through taxes but voter approval is required. These bonds are susceptible to statutory debt limits while analysis thereof is based on their overall tolerance to taxes, debt ratios, and debt statements
- **Revenue bonds:** These are self-supporting through user fees and don't require voter approval. Additional bond tests may occur while analysis thereof is based on debt service coverage ratio as well as feasibility studies

Options

- **Standard contracts:**
  - Equity option contract where 1 contract = 100 shares
  - Premiums where 1 point = $100. For example, 1 ABC company 35 Call @ 3 premium = 3 (100 shares) = $300
  - Intrinsic value: This is the difference between the strike price and the stock's current market value
  - Time value: Is premium - intrinsic value. The formula to calculate premium is IV + TV = premium

- **Calls - In, at, and out-of-the-money:**

It's by the amount of its intrinsic value that an option is in-the-money by

Here's an example: A 40 call, stock @42 has an intrinsic value of 2 points. It is in-the-money at 2 points

A 40 call, stock @40 has an intrinsic value of 0 points (stock = strike price). It is at-the-money

A 40 call, stock @38 has an intrinsic value of 0 points. It is out-of-the-money

- **Puts - In, at, and out-of-the-money:**

Here are some examples

A 40 put, stock @37 has an intrinsic value of 3 points. It is in-the-money at 3 points

A 40 put, stock @40 has an intrinsic value of 0 points (stock = strike price). It is at-the-money

A 40 put, stock @44 has an intrinsic value of 0 points. It is out-of-the-money

- **Basic options positions**

  - Position: Long call (buy). Premium: Pay out. If exercised: Right to buy stock at the strike price
  - Position: Short call (write or sell. Premium: Receive. If exercised: Obligation to sell stock at the strike price
  - Position: Long put (buy). Premium: Pay out. If exercised: Right to sell stock at the strike price
  - Position: Short put (write or sell). Premium: Receive: If exercised: Right to buy stock at the strike price

- **Calculating maximum loss, gain and breakeven**

  - If holding a long call position, an investor holds a bullish attitude. Their maximum loss is the premium paid, while maximum gain is unlimited. Breakeven is the strike (exercise price) or XP + premium
  - If holding a short call position, an investor holds a bearish attitude: Their maximum loss is unlimited, while maximum gain is the premium received. Breakeven is XP +premium
  - If holding a long put position, an investor holds a bearish attitude: Their maximum loss is the premium paid, while maximum gain is breakeven to zero. Breakeven is XP - premium
  - If holding a short put position, an investor holds a bullish attitude: Their maximum loss is breakeven to zero, while maximum gain is premium received. Breakeven is XP - premium

For example, Long 1 ABC June 30 Call @ 3 maximum loss - premium paid = 3 (100 shares) = $300 while maximum gain = unlimited BE = XP + premium = 30 + 3 = 33.

- **Option transaction settlements:** Settled next business day (T+1) and applies to all options transactions including equity, index, debt, and currency.

- **Option exercise settlements:** When an options contract is exercised, a settlement is made. As with the underlying security, this will be the same. For example, T+2 is how equity securities settle, so when an equity option is exercised, it's T+2 that the resulting stock transaction will settle. T+1, however, is how index or currency option exercises settle

Money market securities

- **General characteristics include:**
  - High liquidity
  - High quality more often than not
  - A year or less till they mature

- **Money market security types:**
  - **Treasury bills:** U.S. government direct obligations
  - **Repurchase agreements:** Capital raised by securities sales that will be repurchased at a higher price in the future
  - **Banker's acceptance (BA):** Issued by a bank these are short-term time draft
  - **Commercial paper:** Also known as promissory notes, these debts are issued by corporations in the short term to raise finance for urgent needs
  - **Negotiable certificates of deposits:** Also known as CDs, these are essentially a version of promissory notes for banks that are traded on the secondary market

Direct participation programs (DPPs):

- **General characteristics** include:
  - While not taxed as a business entity, the business structure of a DPP does report to the IRS
  - It is to the partners that all tax consequences flow
  - Any income must be reported
  - Deductible expenses

- **Program types - real estate, leasing, oil and gas**
  - Limited partnerships
  - Both limited and general partners
  - General partner: Deals with partnership management, can decide that others be appointed to manage assets, have unlimited liability (so stand to lose more than their investment), can be sued as they have fiduciary responsibility to partners, are prohibited from competing with the partnership
  - Limited partner: No responsibilities when it comes to management, invest passively, have limited liability and can never lose more than invested, have no fiduciary responsibility, when it comes to other investments there are no limitations

Investment company products

- **Management companies**: These have a specific objective to which they are managed towards. Objectives could include income, growth, or specialized

- **Mutual fund (open-end) vs. management (closed-end) companies:**
  - Mutual fund (open-end): Every share is an IPO because they offer a continuous primary offering. A prospectus is necessary while they can only issue common shares which the company must redeem. These shares won't be traded on the secondary market. A formula is used to price the shares: NAVE + $SC = POP (net asset value + $ sales charge = public offering price). Sales charges can be 8.5% maximum
  - Management (close-end) company: Offer a fixed number of shares, while after the IPO a prospectus is not necessary. Can issue debt instruments, common and preferred shares but no shares are redeemable. Following the IPO, shares will trade on the secondary market both OTC and on exchanges with price determined by supply and demand and commissions paid

- **Exchange-traded funds (ETFs):**
  - Throughout the trading day, ETFs are priced by supply and demand
  - Marginable
  - They offer low expenses and operating costs
  - Tax is not applied until the point that shares are sold

Insurance company products

- Fixed annuity: Here a stated rate of return is promised with risk assumed by the insurance company
- Variable annuity: Here it is on investments that return is based with risk assumed by the annuitant

Investment risks

- Systematic
  - This risk sees individual investments impacted by changes in the economy
  - Systematic risks include market, interest rate, reinvestment, and inflation (purchasing power) risk

- Nonsystematic
  - It's to certain issuers, investment types, or industries that these risks are unique but they can be reduced through diversification
  - Nonsystematic risks include capital, financial, business, currency, call, regulatory,

liquidity, legislative and political risk

Trading, customer accounts, and prohibited activities

Order types

- **Day order:** If there is any unexecuted portion, it will be canceled at the end of the day
- **Good till cancel order (GTC):** Unless renewed, any portion of these orders that is unexecuted will remain in working till the last trading day in April or October
- **Fill or kill (FOK):** The entire order is canceled unless it is executed immediately and in its entirety
- **Immediate or cancel (IOC):** Any potion that is available can be executed immediately with any balance remaining then canceled
- **All or none (AON):** if available, this order is executed. When no execution of the entire order is possible, it is held as a GTC
- **Market at open:** At or near the opening of the day, this order will be executed but the exact opening price is not guaranteed
- **Market on close:** At or near the close of the day, this order will be executed but the exact closing price is not guaranteed
- **Market, limit, and stop orders:**
  - Market (buy and sell): Entered at the market. At the next available price the order is executed
  - Buy limit: Entered below CMV. It's at the limit price or better that this is bought. No guaranteed execution
  - Sell limit: Entered above CMV. It's at the limit price or better that this is sold. No guaranteed execution
  - Buy stop: Entered above CMV. It is at or above the stop price that it will be triggered. Execution is immediate at the next available price
  - Buy stop limit: Entered above CMV. It is at or above the stop price that it will be triggered. Execution (not guaranteed) is at the limit price or better
  - Sell stop: Entered below CMV. It is at or below the stop price that this is triggered. Execution is immediate at the next available price
  - Sell stop limit: Entered below CMV. It is at or below the stop price this is triggered. Execution (not guaranteed) is at limit price or better

Adjustment for corporate actions

- **Stock dividend:**
  - Stock price adjusts down for dividend
  - Additional shares are received from investors
  - Aggregate value doesn't change
  - When shares are sold tax applies
  - As an example, 100 shares @ $55 = $5,500. Following a 10% dividend, the position becomes 110 shares $50, $5,500. Note that 100 shares x 10@ = 10 additional shares

- **Stock split:**
  - Stock price adjusts down for a split
  - Additional shares passed on to investors
  - Aggregate value doesn't change
  - When shares are sold tax applies
  - As an example of an even split: 100 shares @ $30 = $3,000. Following a 2-for-1 even split, position is now 200 shares @ $15 = $3,000. For an uneven split: 100 shares @ $30 = $3,000. Following a 3-for-2 uneven split, position is now 150 shares @ $20 = $3,000

- **Reverse stock split adjustments**
  - For reverse splits, stock price adjusts up
  - Fewer shares for investors
  - Aggregate value does not change

Types of settlements

- **Regular way:** For both corporate and municipal bonds - T+2 (trade day + 2 business days)
- **Regular way:** For government bonds - T+1 (trade day + 1 business day)
- **Cash:** While BD approval is required, cash settlements are same day settlements

Account types

- **Cash:** Payment is made in full
- **Margin**: Up to 50% is borrowed. Regulation T (set by the Federal Reserve Board) sees a 50% initial margin

Account registrations

- **Individual:** There is only one beneficial owner
- **Joint:** There are two (or more) beneficial owners
- This includes tenants in common (TIC) where the interest of a deceased tenant are retained by their estate and joint tenants with rights of survivorship (JTWROS) where the surviving tenants receive a deceased tenant's interests
- **Corporate:** Here both corporate charter and resolution are necessary
- **Partnership:** Here both a partnership agreement and resolution of the partners is necessary
- **Fiduciary:** It's for the benefit of the account owner that investments are made with the account managed by a fiduciary
- **Custodial (UGMA and UTMA):** It's for the benefit of a minor that investments are made with the account managed by a custodian
- **Retirement:** Here plans can be both qualified and nonqualified.
  - In a qualified plan (which cannot discriminate), approval is required from the IRS while any contributions are deemed tax deductible. Any tax on accumulation will be deferred but withdrawals are taxed. Qualified plans are set up with a trustee.
  - In a nonqualified plan (which may only allow participation from certain employees), IRS approval is not necessary while any contributions are not deemed to be tax deductible. Any tax on accumulation may be deferred while at the time of withdrawal, only excess over cost basis will be taxed. Nonqualified plans don't require a plan trustee
  - Types of qualified plans include Individual retirement accounts (traditional and Roth IRAs), Simplified employee pension plans (SEPs), tax-sheltered annuities (TSAs) including 403 (b), and 501 (c), savings incentive match plans for employees (SIMPLEs), 401 (k) both Roth and traditional, defined benefit plans
  - Types of nonqualified plans include payroll deductions, deferred compensation, and 457 plans

Prohibited activities

- **Manipulation of the market**
  - Rumors regarding the market
  - Pump and dump
  - Churning (excessive trading)
  - Freeriding
  - Front running

- **Other prohibited activities**
  - Breakpoint sales on mutual funds
  - Guarantees of profit
  - Guarantees against loss
  - Using customer securities or funds in an improper manner
  - Paying an unregistered person commission
  - Withholding documents
  - Falsifying documents
  - Misleading or withholding certain information when advertising

Record retention

- **Lifetime:** Records of incorporation or partnership as well as original books
- **Six years:**
  - Blotters
  - General ledgers
  - Customer account records
  - Customer statements (ledgers)
  - Stock records
- **Four years:**
  - Complaints from customers
  - Quarterly filings
- **Three years:**
  - Advertising
  - Customer confirmations
  - Trial balances
  - Order tickets
  - Forms U4 and U5
  - Procedure and compliance manuals

Regulator framework

Regulatory acts

- **Securities Act of 1933:**
  - Prospectus and paper act
  - New issues are regulated through this act and it requires that securities are registered

- **Securities and Exchange Act of 1933:**
  - This act governs people and places
  - BDs are regulated through it as well as associated persons. Registration is required
  - It defines inside information and has antifraud provisions

- **Investment Company Act of 1940:**
  - ICs classified into three types (face amount certificate, unit investment trust, management company)
  - ICs regulated through the act

- **Securities Investor Protection Act of 1970:**
  - Through this act, investors are protected when BDs fail and go insolvent up to maximum limits for securities and cash
  - Securities Investor Protection Corporation (SIPC) was created through this act

- **Insider Trading and Securities Fraud Enforcement Act of 1988:**
  - Provides insider trading penalties

- **Telephone Consumer Protection Act 1991:**
  - The Federal Communication Commission (FCC) administers this act
  - Provides consumers with protection from unwanted telephone solicitations
  - Defines unsolicited calls and the requirements and limitations placed on them

- **Bank Secrecy Act:**
  - This defines the U.S. Treasury as the main agency in the development of programs that target money laundering
  - Currency transactions reports (CTRs) for amounts greater than $10,000 must be filed as a requirement of the act

- **Uniform Securities Act:**
  - Provides a framework for state registration and applies to BDs, RR or agents, IAs and IA reps

Know these percentages for the SIE exam

- No-load funds maximum 12b-1 fee = 0.25%
- Maximum 12b-1 fee-loaded funds = 1%
- Maximum sales charge for mutual fund (open-end company) = 10%
- Regulation T and insufficient IRA distribution after 72 years of age penalty = 50%

Know these days and calendar days

- **Same day business:** This is cash transactions' settlement date
- **1 business day:** U.S government securities and options regular way settlement
- **2 business days:** Corporate and municipal securities regular way settlement
- **15 calendar days:** This is the maximum time period that a customer can place an options order before the requirement of a signed option agreement
- **20 calendar days:** This is the minimum time between the filing date and registration and is known as the cooling off period
- **30 calendar days:** IRS wash-sale time period before and after a trade has taken place
- **60 calendar days:** There is no penalty applied if a roll over holding from one qualified plan to another is carried out in 60 days