



## Series 6 Condensed Study

### Sheet

#### ***Investment Companies***

- Three types of Investment Companies: Face-Amount Certificate Company, Unit Investment Trust, Management Company
  - Face-amount certificate
    - Issued at a discount
    - Redeemed at higher face amount on some future date
  - UIT (unit investment trust) is a portfolio of income producing securities (usually bonds or preferred stock) that is not managed
    - Securities are selected and held (buy and hold)
    - No management fees charged
    - No board of directors
    - When all bonds mature, the trust expires
  - Open- and Closed-End funds are management companies
- Open-End mutual funds do NOT trade on secondary market among investors
  - Bought from issuer, redeemed by issuer on primary market
  - Priced by NAV plus any sales charges
  - *Redemption or Redeemable* = Open-End fund
- Closed-End funds trade among investors, not redeemed
  - Fixed number of shares
  - Priced by supply & demand for the shares
- If POP is below NAV, it's a "closed-end fund"
  - Closed-End Funds also may trade at a premium to NAV
  - Open-End Funds never purchased for less than NAV

#### ***Open-End Funds***

- A-shares charge front-end load but lower annual operating expenses
  - Suitable for long-term investments and larger amounts of money
- B-shares charge back-end load (deducted when investor sells) and higher operating expenses
  - Suitable for smaller investments and long-term
  - Convert to A-shares usually after 7 years
- C-shares charge high annual operating expenses
  - Suitable for short-term investments only
  - Do not convert to A shares
- If POP is the same as NAV, it's a "no-load fund"
  - Still has operating expenses
  - All funds have operating expenses
- Sales charges and redemption fees are NOT operating expenses

This is a Condensed Study Sheet only covering essential exam points.

- Deducted from a particular investor's check, not fund assets
- Operating expenses include management fee, 12b-1 fee, custodial and transfer agent, legal & accounting, board of directors
  - Deducted from fund assets on an ongoing basis
- A "diversified fund" follows the 75/5/10 rule.
  - 75% of portfolio has no > 5% of assets invested in a particular stock and owns no > 10% of a company's outstanding shares
  - No requirement to be "diversified fund"
- A "no-load fund" can still charge a 12b-1 fee up to .25% of average net assets
- Conduit treatment means fund distributes 90%+ of net income to shareholders
  - Fund pays tax on remainder only
  - Investors pay tax on dividends and capital gains received, as indicated in 1099
- Investors reinvest dividends and capital gains without paying a sales charge
  - Taxed whether reinvesting or cashing the check
  - Raise their cost basis by amount of reinvestment
- Investors have voting rights on:
  - Board of Directors
  - Approve investment adviser's contract
  - 12b-1 fees
  - Changes to investment objective and policies
- The mutual fund prospectus discloses material information
  - Does not have all securities in the portfolio or all shareholders
  - No other sales literature is required to sell a mutual fund, unless requested by client
  - Deliver prospectus at or before solicitation
- Open-end funds priced by formula
  - NAV plus any sales charges
  - NAV figured at end of trading day, called "forward pricing"
- Sales charge as a percentage =  $\text{POP} - \text{NAV} \text{ divided by POP}$
- To find POP given NAV and sales charge use  $\text{NAV} \text{ divided by } (100\% - \text{sales charge})$
- If more investors buy than redeem, or if more redeem than buy, this has NO EFFECT on the price of the fund
  - The fund calculates NAV before executing purchase and redemption orders
  - Based on value of securities in the portfolio, not supply and demand for shares

### ***Variable Annuities***

- Number of accumulation units and their value vary
  - Not tied to AIR, just to positive returns
- Number of annuity units fixed
  - Their value varies, separate account versus AIR
  - Not this month vs. last month
- Earnings/growth subject to ordinary income
  - Subject to 10% early withdrawal penalty
- Random withdrawals use LIFO accounting
  - All withdrawals first treated as taxable earnings

This is a Condensed Study Sheet only covering essential exam points.

- Annuity payments part tax-free return of cost basis and part taxable as ordinary income
  - Exclusion ratio determines how much is taxable
- No limits on income or contributions
  - Contributions made “after-tax,” no current deduction
- VA’s charge “mortality & expense” risk fees to protect insurance company from people living longer than expected
- VA’s offer death benefit during accumulation period
  - Beneficiary gets greater of contract value or amount contributed
  - Any amount received above contributions taxable as ordinary income to beneficiary
- 1035 contract exchange = tax-free exchange from one annuity to another
  - Can’t turn an annuity into a life insurance policy
  - Within a VA, individual can move among sub-accounts without tax implications
- VA’s charge more fees than mutual funds
- Deferred annuities have surrender charges in first years of contract
  - Long-term investment only
  - Investor has no need for liquidity on this \$
  - Not suitable inside tax-deferred account

## **Taxation**

- “Marginal tax rate” is the tax owed on the next dollar of income earned
- Only earned income can be used for IRA and other retirement plans
  - Not portfolio income (interest, dividends, capital gains)
  - Not passive income (from partnerships, rental income, etc.)
- Until tax filing deadline (April 15<sup>th</sup>) individual can contribute to last year’s IRA
  - For example, can contribute for 2009 until April 15<sup>th</sup>, 2010
  - Indicate on IRA deposit slip for which year a contribution is being made
- Bond interest is taxable at ordinary income rates
  - Treasuries pay interest subject only to federal income tax
  - Municipal bonds pay interest exempt from federal income tax
  - Corporate bond interest taxable at federal, state, and local level
- Dividends are taxable at dividend tax rates
- Capital gains are taxable for the year realized
  - Capital gains on municipal bonds or municipal bond mutual funds taxable just like any other capital gain
    - Only the *interest* received on a municipal bond is tax-exempt!
- Variable Annuities grow tax deferred during accumulation period
- Withdrawals on the “excess over cost basis” taxable as ordinary income
  - Not capital gains rates!
- Withdrawals use LIFO (not FIFO) accounting
  - Treated as the taxable earnings first, then the return of cost basis
- Annuity payments = part taxable income, part return of cost basis
  - Called “exclusion ratio”

This is a Condensed Study Sheet only covering essential exam points.

- Mutual funds do not offer tax deferral
  - Dividends, capital gains taxable for the year received
- Mutual funds using “conduit theory” distribute 90% or more of net income to shareholders
  - Shareholders taxed according to 1099 received from fund
  - Dividends and capital gains distributions reinvested in a mutual fund are taxable to the investor
  - Raise the investor’s cost basis by the amount reinvested
  - Investor avoids sales charges on reinvestments (no effect on taxation)
- INSURANCE: Partial surrenders of cash value taxed differently from variable annuities
  - Use FIFO (treated as the cost basis first)
    - Amount up to net premiums paid not taxable
    - Only excess above that
- Death benefit paid on life insurance not taxable to beneficiary
  - Included in value of insured’s “estate” at death

**Monetary & Fiscal Policy**

<b>MONETARY</b> Federal Reserve Board	<b>RESERVE REQUIREMENT</b>	<b>DISCOUNT RATE</b>	<b>OPEN Market Operations</b>
Fight Inflation	Increase	Increase	Sell Treasuries
Stimulate	Decrease	Decrease	Buy Treasuries
<b>FISCAL</b> Congress & President	<b>TAXATION</b>	<b>GOVERNMENT SPENDING</b>	
Fight Inflation	Increase	Decrease	
Stimulate	Decrease	Increase	

## **NASD/FINRA Rules & Regulations**

Note: the SRO is called “FINRA,” but there are still NASD Rules

### **Membership, Registration, and Qualification**

- Filing incomplete, incorrect, or misleading information is a violation
  - i.e. failing to disclose disciplinary or criminal matters on U-4
- Branch offices of a member firm must be registered, and an OSJ (Office of Supervisory Jurisdiction) must be designated to oversee them
- Failure to register those subject to registration is a violation
- Principals = individuals managing the member's investment banking or securities business, including supervision, solicitation (selling), conduct of business or the training of persons for any of these functions
  - Principals must be registered
  - Firms (except sole proprietorships) must have at least two registered principals, one a “financial and operations” or “FINOPS” principal
  - Principals approve and file sales literature and advertising and monitor correspondence
  - Principals handle customer complaints and maintain files
  - Principals approve accounts and all transactions in securities
- Registered representatives = individuals engaged in the investment banking or securities business of a member
  - Registered representatives must be registered
  - If out of industry 2+ years, or if registration is revoked, must re-qualify by examinations (Series 7, i.e.)
  - Series 7 is “general securities representative” selling stocks, bonds, municipal bonds, government securities, options, investment company shares, direct participation programs
  - Series 6 is “Investment Company Products/Variable Contracts Representative” selling investment company products only. Can sell closed-end funds during primary offering only, not when trading among investors on secondary market
- Form U-4 used to register representatives plus fingerprint card
- Form U-5 used to terminate/disassociate with representative
- Registration is completed electronically through the Central Registration Depository “CRD” system maintained by FINRA.

## Conduct Rules

- A member must observe high standards of commercial honor and just and equitable principles of trade
- Examples of violating the above code:
  - Filing misleading information concerning membership or registration of agents, principals
  - Failure to register personnel required to be registered
  - Front running: placing an order for the firm's or agent's account that will benefit from the placement of a large customer order afterward
    - For example, buy the stock for agent's account, then place large customer order in such a way as to move the price up for a quick profit
  - Charging excessive markups when acting as a principal on a transaction
    - Excessively marking up the price charged to a customer or marking down the price paid to a customer in a securities trade where the firm is on the other side of the transaction
  - Breakpoint selling: selling investment company shares just below the next dollar value that would give the customer a lower sales charge
  - Publishing transactions that did not actually occur or publishing fictitious prices in order to manipulate securities prices
    - I.e. buy stock for the firm's account and then fraudulently drive the price up by reporting a series of bogus transactions that make it appear the price is rising.
  - Failure to pay an arbitration award.
  - Refusal to abide by rulings of the disciplinary committee
- Communications with the public must not be misleading, must represent fair dealing with customers. Communications with the public may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast.
  - For example, "Cash in when the Dow triples next month!" or, "This stock will rise at least 1,000% by next Friday—don't miss out!"
- Communications must be approved by principal and maintained on file by the member firm for three years following an item's last use
  - Correspondence must be monitored by compliance principal(s)
    - Correspondence = any written letter or electronic mail message distributed by a member to: (A) one or more of its existing retail customers; and (B) fewer than 25 prospective retail customers within any 30 calendar-day period
    - A communication to 25+ prospects = sales literature, subject to pre-approval.
  - Sales literature, advertising, public appearances must be pre-approved by compliance principal

This is a Condensed Study Sheet only covering essential exam points.

- Sales literature = communications sent to a selected audience, i.e. research report, market letter, cold calling script, seminar invitations, computer slide shows
- Advertising = mass media, i.e. billboard, newspaper, radio, television, magazine, kiosk or other electronic display
- Public appearance = participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public appearance or public speaking activity.
- Telemarketing rules: firm must maintain a firm-specific do-not-call list and must check national do-not-call list to avoid calling anyone on either list.
  - Don't call the residence of any person before 8 AM or after 9 PM in their time zone
  - Exceptions = member has an established business relationship with the person, has received the person's prior written permission, the person is a broker-dealer
- Broker-dealers must deliver trade confirmations to customers no later than settlement of the transaction
  - Disclose whether acting as a broker or dealer
  - Source and amount of any commission
- Broker-dealers must disclose if they are controlled by, or under common control with, the issuer of the securities involved in a transaction
  - If the broker-dealer is owned by GE, they must disclose this when recommending GE stock to their customers
- Broker-dealers must forward proxy voting materials and annual reports to customers delivered by the issuer
  - Issuer bears the cost, i.e. GE or MSFT
- Broker-dealers must provide disclosure of their financial condition upon customer request by providing their most recent balance sheet
- Suitability – Recommendations to Customers: must have reasonable grounds to believe recommendations to customers are suitable based on information disclosed by customer regarding his other security holdings and as to his financial situation and needs
  - Before recommending anything other than a money market mutual fund to a non-institutional customer, broker-dealer must make reasonable effort to obtain the following information:
    - Customer's financial status
    - Customer's tax status
    - Customer's investment objectives
- Fair Dealing: sales efforts must be undertaken within the ethical standards of the Association's Rules, with particular emphasis on the requirement to deal fairly with the public. Sales efforts must be judged on the basis of whether they can be reasonably said to represent fair treatment, rather than on the argument that they result in profits to customers
  - Violations of fair dealing requirement include:
    - **Recommending Speculative Low-Priced Securities**



This is a Condensed Study Sheet only covering essential exam points.

- **Member has responsibility to know that speculative trading is appropriate for investor and that it is not appropriate for most investors**
- **Excessive Trading Activity**
  - **Called “churning” or “overtrading”**
  - **Trading more frequently than character of the account justifies to benefit the member at the expense of the customer**
- **Trading (frequent selling of) Mutual Fund Shares**
  - **Mutual funds not appropriate for frequent trading**
  - **Front- and back-end sales charges, redemption fees make frequent trades cost prohibitive for the customer**
- **Fraudulent Activity including:**
  - **Fictitious Accounts**
    - **Trading like crazy in an account opened in the name of a dead person**
  - **Discretionary Accounts**
    - **Using discretion when it’s not granted by the customer**
  - **Unauthorized Transactions**
    - **Executing purchases and sales in customer accounts without customer’s knowledge or consent**
  - **Misuse of Customers' Funds or Securities**
    - **Unauthorized borrowing of customer funds and securities**
- **Recommending Purchases Beyond Customer Capability**
  - **Pressuring customers to purchase securities beyond their financial means, risk tolerance, objectives, etc.**
- **Derivative Products or New Financial Products**
  - **When recommending new and/or sophisticated financial products, member must be sure customer understands risks and characteristics of the investment and that the investment is suitable**
  - **CMO’s, options, limited partnerships, and other complex investments not suitable for many investors**
- **No member or person associated with a member shall make improper use of a customer's securities or funds**
  - **Violation to lend customer’s securities to the firm or other party unless the firm has obtained from the customer a written authorization permitting the lending of securities, i.e. “properly executed lien.”**
  - **Firm must segregate the customer’s fully paid securities from the securities pledged as collateral for margin loans and from the firm’s own securities. Segregation and identification of who owns which securities.**
  - **No member or person associated with a member shall guarantee a customer against loss**
  - **No sharing in profits and losses with customer account unless the customer gives written consent, the firm gives written consent, and the associated person shares in proportion to his investment in the account (except for immediate family members and persons associated with the member firm).**
- **Must provide customers with information on SIPC and how to contact SIPC for more information by phone and through the website [www.sipc.org](http://www.sipc.org).**



This is a Condensed Study Sheet only covering essential exam points.

- Member firms operating on the premises of a bank must take precautions to make clear the difference between the broker-dealer and banking operations.
  - To the extent practical, conduct the securities business in a separate physical space from where retail deposits are taken
  - Identify the broker-dealer services as being separate from the banking services
  - Disclose orally and in writing that securities investments are:
    - Not FDIC insured
    - Not deposits of or insured by the bank
    - Subject to investment risks including loss of principal
- Borrowing from or lending to customers is a violation unless certain procedures are followed.
  - Member must have written procedures governing the practice of borrowing and lending with customers
  - If customer is a bank or other lending institution, associated persons and the firm may borrow money. If the customer is a broker-dealer, securities may be borrowed
  - If customer is an immediate family member or business partner, member firm may allow (or disallow) borrowing/lending activities
- No member shall deal with any non-member broker or dealer except at the same prices, for the same commissions or fees, and on the same terms and conditions as are accorded to the general public. Broker-dealers whose registrations are suspended, expelled, or revoked must be treated as non-members.
  - Payment of continuing commissions in connection with the sale of securities is okay as long as the person receiving the commissions remains a registered representative of a member of the Association.
  - However, payment of compensation to registered representatives after they cease to be employed by a member of the Association — or payment to their widows or other beneficiaries — will not be deemed in violation of Association Rules, provided bona fide contracts call for such payment.
  - Also, a dealer-member may enter into a bona fide contract with another dealer-member to take over and service his accounts and, after he ceases to be a member, to pay to him or to his widow or other beneficiary continuing commissions generated on such accounts
  - Can't pay someone who is ineligible for membership due to disqualification such as revocation, suspension, expulsion.
- Charges for services performed must be reasonable and not unfairly discriminatory between customers (just and equitable)
  - Violation to enter into securities transactions with customers at prices not reasonably related to current market price for the security
- Unusual commissions and markups must be disclosed to customer before transaction.
- Discretion = choosing which securities are bought or sold or how many shares/units are purchased or sold without consulting the customer

This is a Condensed Study Sheet only covering essential exam points.

- Must have discretionary authorization granted by customer in writing prior to executing first trade and account must be accepted by member in writing.
- Discretionary orders and accounts must be reviewed frequently
- Discretion as to time and price to enter the order does not require written authorization
- Members may not sell a new issue to an account in which a “restricted person” has a beneficial interest. Restricted persons include:
  - Any officer, director, general partner, associated person, or employee of a member or any other broker/dealer
  - Any agent of a member or any other broker/dealer that is engaged in the investment banking or securities business
  - An immediate family member of a person above if the person specified in subparagraph:
    - materially supports, or receives material support from, the immediate family member;
    - is employed by or associated with the member, or an affiliate of the member, selling the new issue to the immediate family member; or
    - has an ability to control the allocation of the new issue.
  - A finder or any person acting in a fiduciary capacity to the managing underwriter, including attorneys, accountants and financial consultants
    - And their immediate family
  - Any person who has authority to buy or sell securities for a bank, savings and loan institution, insurance company, investment company, investment advisor, or collective investment account.
    - And immediate family
  - “Immediate family member” means a person's parents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children, and any other individual to whom the person provides material support.
  - “Material support” means directly or indirectly providing more than 25% of a person's income in the prior calendar year. Members of the immediate family living in the same household are deemed to be providing each other with material support.
- To sell variable contracts of an insurance company member must have written sales agreement and must sell only through member firms; must forward payment by customers promptly to the insurance company
  - Can not accept payment from “offeror” in form of securities
  - Member must keep records on any cash or non-cash compensation paid to member or associated person by offeror of the variable contracts
  - Gifts from offeror may not exceed current annual limit
    - Occasional meals, entertainment ticks ok as long as not pre-conditioned on meeting a sales target
  - Seminar/meeting attendance of member or associated person can't be preconditioned on meeting sales targets

This is a Condensed Study Sheet only covering essential exam points.

- Attendees must get prior approval from member, who must keep records
- Location of meeting must be appropriate (Maui looks suspicious)
- Expenses of guest can not be covered
- Must make special efforts to determine suitability when selling deferred variable annuities (deferred = surrender period, charges in early years of contract)
  - customer must be informed, in general terms, of various features of deferred variable annuities, such as the potential surrender period and surrender charge; potential tax penalty if customers sell or redeem deferred variable annuities before reaching the age of 59½; mortality and expense fees; investment advisory fees; potential charges for and features of riders; the insurance and investment components of deferred variable annuities; and market risk
  - the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit
  - in general, the recommendation is suitable taking all relevant facts into consideration
- When completing a surrender/exchange of a deferred variable annuity, member must take into consideration whether:
  - the customer would incur a surrender charge, be subject to a new surrender period, lose existing benefits (such as death, living, or other contractual benefits), or be subject to increased fees or charges (such as mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements);
  - the customer would benefit from product enhancements and improvements; and
  - the customer's account has had another deferred variable annuity exchange within the preceding 36 months
- Member firms may not sell investment company securities (mutual funds) if sales charges are excessive and may only sell through member firms. Member firms only buy shares to fill customer orders or orders for firm's account—not in anticipation of future orders. 8.5% is maximum sales charge and only if no 12b-1 or "asset-based sales charge."
  - Breakpoint selling a violation: not giving customer appropriate sales charge or failing to inform of breakpoints, LOI, rights of accumulation
  - Selling dividends is a violation: implying that customer should buy shares in order to receive the next dividend
  - If the shares have a CDSC or "back-end sales charge," firm must disclose on confirmation, "On selling your shares, you may pay a sales charge. For the charge and other fees, see the prospectus." The legend shall appear on the front of a confirmation and in, at least, 8-point type.
  - Member firms may not enter agreements to push a fund to customers based on trading business the fund does through the firm.
  - Members and associated persons may not accept gifts from mutual fund sponsor that exceeds annual limit or suggest impropriety. Meeting and

- seminar attendance may not be preconditioned on meeting sales targets and only the attendee's (not guest's) expenses may be reimbursed.
- Each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules. Firms must designate principals and Offices of Supervisory Jurisdiction (OSJ) responsible for supervision.
  - Each member must establish and implement a written anti-money laundering program to comply with the Bank Secrecy Act
    - Currency Transaction Reports filed for cash transactions > \$10,000
    - Suspicious Activity Reports filed for any suspicious activity
  - Associated persons must notify member firm of *all* outside activities for compensation
    - Member can refuse to allow registered person to engage in outside activity
    - Passive investments not considered "outside employment"
    - Investing in a limited partnership = passive investment
  - No person associated with a member may participate in a private securities transaction unless the firm is notified and approves
    - Rep can't sell securities outside the firm or sell securities his firm doesn't want him to sell
    - Otherwise, a violation called "selling away"
    - If firm approves, must supervise and record transactions on regular books and records
  - Before executing any transaction for an associated person or his immediate family, a member firm must notify the employing member of their intention of opening the account, notify the associated person of their intent to notify the employer, and, upon request, provide the employing member with duplicate trade confirmations or other information requested
    - Associated person must notify employer of intention to open account and notify the executing member firm that he is associated with a member firm
    - If account established before employment, associated person must notify employer of its existence and notify the firm holding the account that he is now associated with a member firm
    - Investment company shares (variables, UIT's, open-end funds) exempt from this requirement
  - Violation to give or permit to be given anything of value, in excess of \$100 per individual per year to any person, principal, proprietor, employee, agent or representative of another person where the payment is related to the business of the employer of the recipient. A gift of any kind is considered a gratuity.
    - Occasional meals or tickets to entertainment/sporting events okay
    - Reminder advertising okay (as long as it isn't worth a lot of \$)
  - Each member shall make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy

- Customer Account Information: for each account, each member shall maintain the following information:
  - customer's name and residence
  - whether customer is of legal age
  - signature of the registered representative introducing the account and signature of the member or partner, officer, or manager who accepts the account
  - if the customer is a corporation, partnership, or other legal entity, the names of any persons authorized to transact business on behalf of the entity
- For non-institutional accounts in which securities will be recommended (most accounts), the member must obtain:
  - customer's tax identification or Social Security number
  - occupation of customer and name and address of employer
  - whether customer is an associated person of another member
- Record of Written Complaints: each member shall keep and preserve in each office of supervisory jurisdiction records of customer written complaints
  - Complaint means “any written statement of a customer alleging a grievance involving the activities of those persons under the control of the member in connection with the solicitation or execution of any transaction or funds of that customer.”
- Requirements When Using Pre-dispute Arbitration Agreements for Customers Accounts: any pre-dispute arbitration clause shall be highlighted and make clear what arbitration involves
  - Arbitrators don't have to explain decisions
  - Generally no appeals (all decisions final)
  - Some arbitration panelists come from securities industry
- Holding Customer Mail: a member may hold mail for a customer who will not be at the usual address for the period of his absence, but not to exceed 2 months if the member is advised the customer will be on vacation or traveling or not to exceed 3 months if the customer is going abroad.
- Violations of Member Conduct Rules handled under Code of Procedure
  - Sanctions include monetary fines, suspension, expulsion, bar
  - No maximum penalty
  - Failure to provide written response or cooperate taken as admission
  - Respondents may appeal to National Adjudicatory Council, SEC, federal courts
- Disputes handled under Code of Arbitration
  - Members, associated persons, transfer agent, others in the industry must use arbitration (not civil court) for disputes
  - Customer must use arbitration after signing pre-dispute arbitration agreement
  - Arbitration decisions are binding on all parties
  - Failure to abide by decision is a violation of conduct rules

## **Federal Securities Acts**

### Securities Act of 1933

- Investors provided with full and fair disclosure on primary market (new issues of securities)
- Securities registered unless exemption can be claimed
- SEC and other regulators neither approve nor disapprove
  - o No judgment passed on merits
  - o Issuers, underwriters unconditionally liable

### Securities Act of 1934

- Creates Securities and Exchange Commission (SEC)
- Requires broker-dealers, associated persons to register
- Requires exchanges, SRO's to register
- Gives FRB power to regulate margin
- Anti-fraud, manipulation rules
- Public company reports to SEC
- Insider/Control Person regulation
  - o Officers, directors, 10% owners register
  - o Can't sell short
  - o No "short swing" profits
  - o Anyone with material, non-public information = insider
    - o Can not share or use inside information
    - o Civil penalties, Criminal prosecution

### Investment Company Act of 1940

- Requires investment companies to register
- Classifies investment companies
  - o Face-Amount Certificate
  - o Unit Investment Trust (UIT)
  - o Management Company
    - o Managed by advisor for a fee
    - o Usually % of assets
    - o Open-End - redeemable
    - o Closed-End – traded on secondary market