



# Registered Options Principal Qualification Examination (Test Series 4)

## Study Outline

**Registered Options Principal  
Qualification Examination  
Series 4  
Study Outline**

**Introduction**

The Registered Options Principal (ROP) Qualification Examination is designed to test a candidate's knowledge of the rules and statutory provisions applicable to the supervisory management of a firm's options personnel and options accounts. This study outline, the examination question bank and question allocation have been developed by a committee of securities industry professionals with experience in the management of the broker-dealer's day-to-day options activities. This outline has been prepared to assist member firms in preparing candidates to sit for the examination. The outline is designed for use by course developers in the preparation of training material, for training directors in the development of lecture notes and seminar programs, and for use by the candidates themselves, both to structure their study and as a final review check list prior to sitting for the examination.

A passing score will satisfy the qualification requirements of the Chicago Board Options Exchange, FINRA , NASDAQ OMX PHLX, NYSE Amex, and NYSE ARCA (jointly referred to as SROs) for a candidate who will function as a Registered Options Principal. The Registered Options Principal Qualification Examination and this study outline are composed of three general areas of supervision. These areas are specified below, accompanied by the number of questions that have been assigned to each section.

<b>Section</b>	<b>General Area</b>	<b>Number of Questions</b>
1	Options Investment Strategies	34
2	Supervision of Sales Activities and Trading Practices	75
3	Supervision of Employees, Business Conduct, and Recordkeeping and Reporting Requirements	16
<b>Total</b>		125

**Structure of the Examination**

The examination is composed of 125 multiple-choice questions covering all of the materials in the following outline in accordance with the subject-matter distribution shown above. Candidates will be allowed 3 hours to complete the examination. A

candidate must correctly answer 70 percent of the questions to receive a passing grade. At the completion of the examination, each candidate will receive an informational breakdown of their performance on each section and their overall score. The examination is a closed-book test and candidates will not be permitted to use any reference material during their testing session. Scratch paper and a basic electronic calculator will be provided by the test center administrator. Severe penalties are imposed on candidates who cheat on securities industry qualification examinations. Examination questions are updated regularly to reflect the most current interpretations of the rules and regulations. Questions on new rules will be added to the pool of questions for this examination within a reasonable period of their effective dates.

Unless a question is specifically asking about conventional OTC options, all questions should be read and answered as they apply to exchange listed standardized options. Also, unless a question is specifically worded to the contrary, all questions involving calculations exclude commissions and other transactions cost considerations.

Information about qualifications examinations may be found at [www.finra.org/Industry/Compliance/Registration/QualificationsExams/RegisteredReps/Qualifications/index.htm](http://www.finra.org/Industry/Compliance/Registration/QualificationsExams/RegisteredReps/Qualifications/index.htm)

There are also sample Series 4 test questions written in the various formats. They do not mirror the difficulty level of the actual test questions or the subject matter distribution of the test itself. Their use is merely to familiarize the candidate with the styles of multiple-choice questions used in the Series 4 Examination.

The following reference materials may be used in preparing for the examination.

Please Note: Candidates are responsible for keeping abreast of changes made to the applicable rules and regulations, as the examination is updated when new rules are introduced and/or amended.

## Reference Materials

**While options rules are to a large extent uniform throughout the industry, trading floor procedures and operations requirements for conducting an options business vary slightly from exchange to exchange. Rule manuals and often options educational material may be obtained by contacting the following organizations:**

### **NYSE Amex**

#### ***Rules***

20 Broad Street  
New York, NY 10005  
www.nyse.com

### **NYSE ARCA**

#### ***Constitution and Rules***

115 Sansome Street  
San Francisco, CA 94104  
www.pacificex.com

### **Securities Act Handbook**

Aspen Publishers  
111 Eighth Avenue  
New York, NY 10011  
www.aspenpublishers.com

### **NASDAQ OMX PHLX *Manual***

1900 Market Street  
Philadelphia, PA 19103  
Phone: (215) 496-5214  
www.phlx.com

### **Chicago Board Options Exchange**

#### ***Constitution and Rules***

LaSalle at Van Buren  
Chicago, IL 60605  
www.cboe.com

### **The Stock Market**

7th Edition  
R.J. Teweles and E.S. Bradley  
John Wiley & Sons, Inc.  
605 Third Avenue  
New York, NY 10158

### **Code of Federal Regulations**

#### **Title 17 — Commodity and Securities Exchanges**

Superintendent of Documents  
U.S. Government Printing Office  
Washington, DC 20402

### **Other publications available through:**

[www.finra.org](http://www.finra.org)

FINRA/NASD Rules

FINRA Notices

NASD Guide to Rule Interpretations

NASD Sanctions Guidelines

### **Dictionary of Finance and Investment Terms**

Barron's Educational Series, Inc.  
250 Wireless Boulevard  
Hauppauge, NY 11788  
[www.barronsedu.com](http://www.barronsedu.com)

### **Options, Futures, and Other Derivative Securities**

J.C. Hull  
Prentice Hall  
Englewood Cliffs, NJ 07632

## 1.0 Options Investment Strategies

### 1.1 Listed Options

- Understand terms and definitions of options products, investment strategies, and the inherent risks
- Apply knowledge of terms and definitions in supervising options transactions

#### 1.1.1 Equity Options

- Underlying securities
- Selection /withdrawal process
- Exercise settlement
  - American
  - European
- Expiration cycles
  - Cycles vary
- Long-term equity anticipation securities (LEAPs)
- Strike price intervals
  - Dependent upon the price of the stock
- Adjustment to option terms
  - Cash dividends
  - Stock dividends
  - Stock splits
  - Spin-offs
- Premiums
  - Premium increments
  - Factors affecting option premiums
- Expiration date
  
- CBOE Rules
  - Rule 1.1—Definitions
- FINRA Rule
  - Rule 2360(a) Definitions
  - Rule 4210 – Margin Requirements (Definitions)
- NASDAQ OMX PHLX Rules
  - Rule 1000—Applicability, definitions and references
  - Rule 1010—Withdrawal of approval of underlying securities
  - Rule 1012.05(a)—Series of options open for trading
- NYSE Rule
  - Rule 700—Applicability, Definitions and References
  - Rule 701—Option Contracts to Be Traded
  - Rule 703—Series of Options Open for Trading
  - Rule 716—Withdrawal of Approval of Underlying Stocks and Groups
- NYSE Amex Rules
  - Rule 900—Applicability, definitions and references
  - Flexible exchange options
  - Rule 900G – Applicability and definitions
  - Rule 903G – Terms of flex options
  - Rule 904G – Flex trading procedures and principles
- NYSE ARCA Rule

## Rule 6.1(a)—Options trading, definitions

### 1.1.2 Index Options

- Broad-based index
- Narrow-based index
- Exchange traded funds (ETFs)
- Industry-based index
- Exercise style
  - By cash payment on the next business day
  - Settlement amount is the difference between strike price and index closing value
- Expiration cycles
  - Cycles vary
  - LEAPs
  - Flexible Exchange options (FLEX)
- Strike price intervals
- Premium increments
- Expiration date
- Exercise assignment
  - European
  - American
  
- CBOE Rules
  - Chapter XXIV—Index options
- NASDAQ OMX PHLX Rules
  - Rule 1006—Order restrictions on exchange option transactions and exercises
  - Rule 1101A(a) and (ii)—Terms of option contracts
- NYSE Rules
  - Rule 700(b)(2A)—American-Style Index Options
  - Rule 700(b)(19)—European-Style Index Options
  - Rule 703(c)—Expiration Months—Index Options
- NYSE Amex Rules
  - Rule 900C—Stock index options
- NYSE ARCA Rules
  - Rule 5.10—Index options

### 1.1.3 Foreign Currency Options

- Contract sizes
- Expiration cycles
- Expiration date
- Settlement style
  - American style
  - European style
- Trading hours
- Strike price intervals
- Premium increments
  - NASDAQ OMX PHLX Rules
    - Rule 1000(b)(13)—Definitions – foreign currency
    - Rule 1012(a)(ii)—Foreign currency options series
    - Rule 1016—Block transactions in foreign currency options

## 1.2 Strategy Investment Posture for Various Market Scenarios and Their Tax Implications

- Assist Registered representatives in formulating investment strategy for customers
- Identify uneconomic trades
- Understand investment strategies

### 1.2.1 Strategies for Using Puts or Calls

Call buying strategies  
Alternative to buying the underlying security  
To lock-in a purchase price  
To hedge a short sale  
Put buying strategies  
To hedge a long position  
Alternative to short sale  
Covered call writing concepts  
Increase yield  
Hedge a position  
Put writing concepts  
Increase income  
Acquire stocks below current prices  
Types of Spread  
Bull spread  
Bear spread  
Time spread  
Diagonal spread  
Variable spread  
Butterfly spread  
Straddle

### 1.2.2 Strategies Based on Market Outlook

Neutral  
Covered call writing (at market)  
Straddle writing  
Combination writing  
Bullish  
Covered call writing (above market)  
Uncovered put writing  
Call purchasing  
Long stock/long put  
Bull spreading  
Bearish  
Uncovered call writing  
Put purchasing  
Bear spreading

### 1.2.3 Other Strategy Considerations

Synthetic positions  
Long stock/short call = short put  
Short stock/long call = long put  
Short stock/short put = short call  
Long call/short put = long stock  
Long stock/long put = long call

Short call/long put = short stock

### 1.3 Calculation of Profit, Loss and Break-even

- Know how to calculate profit, loss and breakeven points of various strategies

#### 1.3.1 Ability to calculate profit, loss and breakeven limits and amounts at expiration of aggregate positions relative to movements in the underlying security - percentage return (loss)

Limits will fluctuate from time of recommendation to time of close-out or expiration

### 1.4 Taxation

- Understand tax implications of options transactions
- Understand wash sales and their impact on customer accounts

#### 1.4.1 General Concepts

Identification of securities  
Holding periods of securities  
Wash Sale rules  
Tax treatment of short options  
Determination of cost basis  
Determination of taxable event  
Cabinet trading

#### 1.4.2 Tax Treatment of Options

- 1.4.2.1 Options purchased by investors
- Subsequent sale of options
  - Expired options
  - Exercised call options
  - Exercised put options
- 1.4.2.2 Options written by investors
- Short-term gain or loss
  - Expired options
  - Exercised put options
  - Exercised call option
  - Subsequent purchase of options
- 1.4.2.3 Tax treatment of long straddles and combinations



## 2.0

### Supervision of Sales Activities and Trading Practices

#### 2.1 Supervision of Account Activities

- **Supervise RR and customer activities relating to options**
- **Ensure that Registered Options Principal designated by the member firm's written supervisory procedures (WSP) reviews the acceptance of each options discretionary account**
- **Ensure that Registered Options Principal designated by the member firm's WSP provides frequent appropriate supervisory review**
- **Ensure that discretionary option orders are approved and initialed on the day entered**
- **Ensure that options programs are in writing**
- **Establish written supervisory procedures**
- **Ensure that branch office manager reviews all correspondence**

#### 2.1.1 Supervisory Procedures

Written policies and procedures

Supervisory reviews

Account approvals

Training

Transactions with issuers

Members may not accept transaction for sale (writing) of call options for issuer of underlying security

Determination that necessary appropriate documentation is on file

Level of trading

Must specify the delineation of supervisory responsibilities within the firm for specific tasks

Must establish separate review procedures to insure that delegated authority is being properly exercised

CBOE Rules

Rule 9.8(a)—Supervision of accounts; Interpretation .01

FINRA Rules

Rule 2360(b)(20)—Supervision of Accounts

Rule 3130 – Annual Certification of Compliance and Supervisory Processes

Rule 3160— Networking Arrangements Between Members and Financial Institutions

NASD Rules

Rule 3010—Supervision

Rule 3012—Supervisory Control System

NASDAQ OMX PHLX Rules

Rule 748—Supervision

Rule 761—Supervisory procedures

Rule 1025—Supervision of accounts

NYSE Rules

Rule 342(a) and (d)(3)—Offices – Approval, Supervision and Control

Rule 343—Offices – Branch Office Space-Sharing Arrangements and Main Office Business Hours

Rule 722—Supervision of Accounts

- NYSE Amex Rules
  - Rule 320—Offices—approval, supervision and control
  - Rule 921(g)—Written procedures
  - Rule 922(a)—Duty to supervise, designation of supervisory personnel
  - Rule 922—Commentary .01—Supervision of accounts
  - Rule 991—Communications to customers
- NYSE ARCA Rules
  - Rule 9.1(c)—Office Supervision
  - Rule 11.18—Supervision

## **2.1.2 Account-Related Communications With Customers**

- 2.1.2.1 Confirmations to customers
  - CBOE Rules
    - Rule 9.11—Confirmation to customers
  - FINRA Rules
    - Rule 2360(b)(12)—Confirmations
  - NASDAQ OMX PHLX Rules
    - Rule 1028—Confirmations
  - NYSE Rules
    - Rule 725—Confirmations
  - NYSE Amex Rules
    - Rule 925—Confirmations
  - Securities Exchange Act of 1934
    - Rule 10b-10—Confirmation of transactions
  
- 2.1.2.2 Statements of accounts to customers
  - CBOE Rules
    - Rule 9.12—Statements of accounts to customers
  - FINRA Rule
    - Rule 2360(b)(15)—Statements of account
  - NASD Rule
    - Rule 2340—Customer Account Statement
  - NASDAQ OMX PHLX Rules
    - Rule 1032—Statements of Accounts
  - NYSE Rules
    - Rule 409—Statement of Accounts to Customers
    - Rule 730—Statement of Accounts
  - NYSE Amex Rules
    - Rule 930—Statement of accounts
  - NYSE ARCA Rules
    - Rule 9.15—Statements of accounts to customers
  - Securities Exchange Act of 1934
    - Rule 17a-5(c)—Customer statements
  
- 2.1.2.3 Statements of financial condition to customers
  - CBOE Rules
    - Rule 9.13—Statement of financial condition to customers
  - FINRA Rules
    - Rule 2261—Disclosure of Financial Condition
  - NYSE Amex Rules
    - Rule 442—Disclosure of financial condition to customers

- 2.1.2.4 Anti-money laundering compliance program
  - CBOE Rules
    - Rule 4.20—Anti-money laundering compliance program
  - FINRA Rules
    - Rule 3310—Anti-Money Laundering Compliance Program
  - NASDAQ OMX PHLX Rules
    - Rule 757—Anti-money laundering compliance program
  - NYSE Amex Rules
    - Rule 432—Anti-money laundering compliance program
  
- 2.1.2.5 Offer and sale of new issue securities—indications of interest
  - FINRA Rules
    - Rule 5130—Restrictions on the Purchase and Sale of Initial Equity Public Offerings

## 2.2 Supervising Options Sales Practices

- **Supervise sales practice activities of registered representatives as they assist their customers in buying and writing options**
- **Conduct suitability review to ensure use of options is consistent with client profile**
- **Understand written supervisory procedures, application and adherence thereto**
- **Understand documentation requirements for options accounts**
- **Ensure compliance with firm's written supervisory procedures for trading of options**
- **Ensure that complaints are segregated and forwarded to main office within prescribed time**
- **Review account documentation for completion**
- **Review to ensure customer verification within 15 days of ROP approval and receipt of signed options agreement**
- **Ensure options disclosure document is delivered at or prior to account approval**
- **Provide special statement for uncovered writers**
- **Ensure that accounts approved for uncovered options transactions meet the firm's internal standards for approval**
- **Understand minimum net equity requirements for approval and maintenance of uncovered transactions**
- **Ensure that any exceptions are approved and evidenced by a Registered Options Principal designated by the firm's written supervisory procedures**

### 2.2.1 Client Account Documentation

- 2.2.1.1 Types of customer accounts
  - Individual customer
  - Joint customer
  - Corporate customers
  - Partnership accounts
  - Fiduciaries
    - Trust accounts
    - Qualified retirement accounts
  - Investment advisory accounts
    - Institutional discretionary accounts

- 2.2.1.2 Options new account form
  - Limited authorization
    - Full authorization
    - Discretionary
      - Client profile
      - Terms of approval
  - Account approval based on evaluation of client profile
  - Approval required not later than the time an initial option order is accepted for the account
  - Branch office manager approval
  - Options accounts must be approved for only certain strategies
  - Copy of background and financial data must be sent to customer for verification within 15 days after approval
  - New account form must be retained at both the branch office and the principal supervisory office
  - Account approval for foreign currency options
- CBOE Rules
  - Rule 9.7(b)—Diligence in opening account
  - Rule 9.10(a)—Authorization and approval required
  - Rule 9.10(e)—Options programs
  - Rule 9.14—Addressing of communications to customers
- FINRA Rules
  - Rule 2360(b)(16)(B)— Diligence in opening accounts
- NASDAQ OMX PHLX Rule
  - Rule 1024—Diligence in opening accounts
  - Rule 1024(b)(iii)—Verification of customer background and financial information
  - Rule 1049—Communications to customers
- NYSE Rules
  - Rule 405—Diligence as to Accounts
  - Rule 721—Opening of Accounts
  - Rule 726—Delivery of Options Disclosure Document and Prospectus
- NYSE Amex Rules
  - Rule 421—Discretion as to customer’s accounts
  - Rule 921(c)—Diligence in openings
  - Rule 922—Supervision of accounts
- NYSE ARCA Rules
  - Rule 9.2(a)—Diligence as to accounts
  - Rule 9.2(b)—Account supervision
  - Rule 9.2(c)—Customer records
  - Rule 9.18—Doing public business in options
- 2.2.1.3 Other supplementary account documentation and customer verification
  - Hypothecation and loan consent agreement
  - Margin agreement
  - Credit terms disclosure
  - Third party trading authorization
  - Signed option account agreement
  - Risk disclosure document
  - Account guarantee acknowledgment
  - Information required for institutional customers engaging in foreign currency options

Escrow receipts, bank letters of guarantee, depository trust receipts or other special collateral arrangements

Requirements regarding accounts of deceased/incompetent persons

Transfer on Death (TOD) Account

Outstanding orders

Cancellation

Freeze on assets in account

Fiduciary treatment of positions

Death of a joint tenant

Death of tenant-in-common

Death of a partner

Death of a principal on a power of attorney

CBOE Rules

Rule 9.7(d)—Agreements to be obtained

Rule 9.15—Delivery of current options disclosure documents

Rule 9.16—Restrictions on pledge and lending of customers' securities

Rule 12.8—Guaranteed accounts

FINRA Rules

Rule 2360(b)(16)(C)— Verifications of customer background and financial information

Rule 4210—Margin Requirements

NASDAQ OMX PHLX Rules

Rule 256—Option risk disclosure

Rule 724—Guaranteed accounts

Rule 1024(b)(iii)—Verification of customer background and financial information

Rule 1024(b)—Opening accounts

Rule 1024(b)(iv)—Agreements to be obtained

NYSE Rules

Rule 721(c)—Verifications of Customer Background and Financial Information

Rule 721(d)—Agreements to Be Obtained

NYSE Amex Rules

Rule 411—Duty to know and approve customers

Rule 413—Agreement does not warrant delivery of customer's securities for firm or corporation account

Rule 462(d)(2)(K)(4)—Guaranteed accounts

Rule 921(d) and Commentary .03—Verifications of customer background and financial information

Rule 921(e)—Agreements to be obtained

Securities Exchange Act of 1934

Rule 10b-16—Disclosure of credit terms in margin transactions

Regulation S-P — Privacy of consumer financial information

2.2.1.4

Discretionary accounts authorization and approval

Records to be maintained

Excessive transactions prohibited

Discretion as to time or price excepted

Options programs

Supervision

- CBOE Rules
    - Rule 9.10— Discretionary accounts
  - FINRA Rules
    - Rule 2360(b)(18)—Discretionary accounts
  - NASDAQ OMX PHLX Rules
    - Rule 1027—Discretionary accounts
  - NYSE Rules
    - Rule 408—Discretionary Power in Customers’ Accounts
    - Rule 724—Discretionary Accounts
  - NYSE Amex Rules
    - Rule 924—Discretionary accounts
  - Securities Exchange Act of 1934
    - Rule 15c1-7—Discretionary accounts
- 2.2.1.5 Options programs
- CBOE Rules
    - Rule 9.10(e)—Options programs
  - FINRA Rules
    - Rule 2360(b)(18)(C)—Options Programs
  - NASDAQ OMX PHLX Rule
    - Rule 1027(b)—Options programs
  - NYSE Rules
    - Rule 724(b)—Options Programs
  - NYSE Amex Rules
    - Rule 924(b)—Options programs
- 2.2.1.6 Minimum net equity requirements
- CBOE Rules
    - Rule 9.7(f)(4)—Opening of accounts
  - FINRA Rules
    - Rule 4210—Margin Requirements
  - NYSE Rules
    - Rule 721(e)4—Uncovered Short Option Account
  - NYSE Amex Rules
    - Rule 921(g)(4)—Minimum net equity requirements
- 2.2.1.7 Special statement for uncovered writers
- CBOE Rules
    - Rule 9.7(f)(5)—Opening of accounts
    - Rule 9.15(c)—Delivery of current options disclosure documents and prospectus
  - FINRA Rules
    - Rule 2360(b)(16)(E)—Uncovered short option contracts
  - NASDAQ OMX PHLX Rules
    - Rule 1029—Delivery of options disclosure documents and prospectus
  - NYSE Rules
    - Rule 721(e)5—Uncovered Short Option Accounts
    - Rule 726(c)—Uncovered Short Options Risk Disclosure
  - NYSE Amex Rules
    - Rule 921(g)(5)—Special written description of the risks

- 2.2.1.8 Uncovered options transactions
- NYSE Amex Rules
    - Rule 921(g) and Commentary .04—Written procedures
  - CBOE Rules
    - Rule 9.7(f)—Opening of accounts
    - Rule 9.8(a)—Duty to supervise
  - FINRA Rules
    - Rule 2360(b)(7)—Limit on uncovered short positions
  - NASDAQ OMX PHLX Rules
    - Rule 1024(c)—Uncovered options supervision
  - NYSE Rules
    - Rule 721(e)—Uncovered Short Option Accounts
  - NYSE ARCA Rules
    - Rule 6.18—Limits on uncovered short options

## 2.2.2 Suitability

- **Assist registered representatives in helping customers formulate investment objectives and to set financial goals**
- **Review trading and suitability of trade activity, *e.g.*, use of margin, day trading or concentrated positions and/or excessive transactions**
- **Review for initial and ongoing suitability of various investment portfolios and objectives**
- **Review managed accounts to ensure that the investment styles of the advisers and managers are consistent with the objectives of the customer**
- **Ensure that registered representatives have necessary product knowledge**
- **Ensure suitability of recommending options strategies**
- **Ensure that registered representatives understand suitability requirements**

### 2.2.2.1 Suitability of recommendations

- Clear understanding of customer's investment objectives
- Need for customer understanding of strategies
- Customer's understanding of and ability to assume financial risk/loss
- Potential for excessive transaction costs
- Consequences of exercise
  - Tax implications
  - Margin implications
    - Investment risks relative to customer's total portfolio
- Substitution problems
- Restrictions on profit sharing
- Prohibition on assuming losses
  
- CBOE Rules
  - Rule 9.9—Suitability of recommendations
- FINRA Rules
  - Rule 2360(b)(19)—Suitability
- NASD Rules
  - Rule 2310—Recommendations to Customers
- NASDAQ OMX PHLX Rules
  - Rule 1026—Suitability

NYSE Rules  
Rule 721(e)—Uncovered short options accounts  
Rule 723—Suitability  
NYSE Amex Rules  
Rule 923—Suitability

## 2.3 Communications with the Public

- **Supervise registered representatives' use of options advertisements, sales literature and educational material**
- **Ensure that all advertisements, educational material and sales literature are approved in advance by the Registered Options Principal designated by the firm's written supervisory procedures**
- **Review and approve options sales literature and educational material**
- **Ensure compliance with recordkeeping and record retention requirements**
- **Ensure that options materials comply with SRO requirements**
- **Review and approve public seminars and presentations**
- **Monitor the use of 'internal use only' sales material**
- **Monitor telemarketing procedures, e.g., maintain 'do not call' list**
- **Maintain a log of public seminars and presentations given by registered representatives**

### 2.3.1 Definitions

Advertisement  
Educational material  
Sales literature  
Market letters  
Research reports  
Internal communications  
Exchange-produced materials  
Seminar texts  
Worksheets  
Telemarketing scripts  
Correspondence  
Institutional sales material

#### CBOE Rules

Rules 9.21 (e)(i), (ii), (iii)—Definitions

#### FINRA Rules

Rule 2220(a)—Definitions

#### NASD Rules

Rule 2211(a)—Definitions

Rule 2711(a)—Definitions

#### NASDAQ OMX PHLX Rules

Rule 605—Advertisements, market letters, research reports and sales literature

Rule 1049(e)—Communications to customers

#### NYSE Rules

Rule 472—Communications With The Public

Rule 791(e)—Communications to Customers, Definitions

#### NYSE Amex Rules

Rules 991 (e)(i), (e)(ii), (iii)—Definitions



## 2.3.2 Required Approval

### 2.3.2.1 Approval by designated ROP

#### CBOE Rules

Rule 9.21(b)—Approval by Registered Options Principal

#### FINRA Rules

Rule 2220(b)—Approval by a Registered Options Principal and Recordkeeping

#### NASD Rules

Rule 2711(i)—Supervisory Procedures

#### NASDAQ OMX PHLX Rules

Rule 1049(b)—Approval by a CROP

#### NYSE Rules

Rule 791(b)—Approval by Compliance Registered Options Principal

#### NYSE Amex Rules

Rule 991(b)—Required approval by a CROP

### 2.3.2.2 SRO approval requirements

#### CBOE Rules

Rule 9.21(c)—Exchange approval required for options advertisements and educational material

#### FINRA Rules

Rule 2220(c)—FINRA Approval Requirements and Review Procedures

#### NASDAQ OMX PHLX Rules

Rule 1049(c)—Exchange approval required for options advertisements and educational material

#### NYSE Rules

Rule 791(c)—Exchange Approval Required for Options Advertisements and Educational Material

#### NYSE Amex Rules

Rule 991(c)—Exchange approval required for options advertisements and educational material

### 2.3.2.3 Guidelines and standards of approval

In the case of "option programs" the cumulative history or unproven nature and underlying assumptions must be disclosed

Worksheets must conform to sales literature requirements

Such communications must be kept in an easily accessible place for a period of three years

Prohibitions against:

Untrue statements and material omissions

Promises of specific results or exaggerated claims

Hedge clauses

Disclaimers

Failure to meet general standards of good taste and truthfulness

Communications that would constitute a prospectus

#### CBOE Rules

Rule 9.21—Communications to customers

Rule 9.21.01—Special risks

Rule 9.21.02—Advertisements

Rule 9.21.03—Educational Material

Rule 9.21.04—Sales Literature

- FINRA Rules
  - Rule 2220(d)—Standards Applicable to Communications
- NASDAQ OMX PHLX Rules
  - Rule 1049(a)—Communications to customers
- NYSE Rules
  - Rule 791(a)—Communications to Customers, General Rule
- NYSE Amex Rules
  - Rule 991(a)—Communications to customers, general rules
- NYSE ARCA Rules
  - Rule 9.28—Advertisements, market letters and sales literature relating to option

### **2.3.3 Options Disclosure Documents**

- 2.3.3.1 Delivery requirements
  - Must be offered in advertisements and educational material
  - Must precede or accompany sales literature
- CBOE Rules
  - Rule 9.7(e)—Options disclosure documents to be furnished
  - Rule 9.21(d)—Communications to customers
- FINRA Rules
  - Rule 2360(b)(11)—Delivery of current disclosure document
- NASDAQ OMX PHLX Rules
  - Rule 1029—Delivery of options disclosure document and prospectus
  - Rule 1049(d)—Communications to customers
- NYSE Rules
  - Rule 791(d)—Options Disclosure Document Required
- NYSE Amex Rules
  - Rule 921 (f) – options disclosure document to be furnished
  - Rule 926 – Delivery of options disclosure document and prospectus
  - Rule 991(d)—Delivery of disclosure documents

### **2.3.4 Telemarketing Requirements**

- CBOE Rules
  - Rule 9.24—Telephone solicitation
- NASD Rules
  - Rule 2212—Telemarketing
- NASDAQ OMX PHLX Rules
  - Rule 762—Telemarketing
- NYSE Rules
  - Rule 440A—Telephone Solicitation
- NYSE Amex Rules
  - Rule 428—Telephone solicitation--recordkeeping
  - Rule 429—Telemarketing

## **2.4 Federal Regulations Pertaining to Sales Practices**

### **2.4.1 Securities Act of 1933**

- 2.4.1.1 Section 2—Definitions under the Act
  - Rule 134—Communications not deemed a prospectus
  - Interpretations as applied to options of the OCC

Rule 144—Persons deemed not to be engaged in a distribution and therefore not underwriters  
Rule 145—Reclassification of securities, mergers, consolidations and acquisitions of assets

- 2.4.1.2 Section 5 – Prohibitions Relating to Interstate Commerce and the Mails
  - Rule 135—Notice of certain proposed offerings
  - Rule 135A—Generic advertising
    - Use of "worksheets", "substantially identical" letters, "prospecting" letters
  - Rule 153(b)—Definition of “preceded by a prospectus”, as used in Section 5(b)(2), in connection with certain transactions in standardized options

## **2.4.2 Securities Exchange Act of 1934**

- 2.4.2.1 Section 3 – Certain definitions under the Act
  - Exchange
  - Member
  - Broker
  - Dealer
  - Issuer
  - Security
  - Equity security
  - Buy-Purchase
  - Sale-sell
  - Clearing agency
- 2.4.2.2 Section 9 – Prohibition Against Manipulation of Security Prices
  - Section 9(a)(1)—Misleading appearance of active trading
  - Section 9(a)(2)—Inducing purchase or sale by others
  - Section 9(a)(3)—Dissemination of information as to rise or fall of securities prices
  - Section 9(a)(4)—Making false or misleading statements
  - Section 9(a)(5)—Dissemination of information for consideration
  - Section 9(a)(6)—Pegging, fixing or stabilizing prices
  - Section 9(b)—Options disclosure document
  - Section 9(e)—Liability for unlawful acts or transactions
- 2.4.2.3 Section 10(b)—Use or Employment of Deceptive Devices
  - Rule 10b-3—Employment of manipulative and deceptive devices by brokers or dealers
  - Rule 10b-18—Purchases of certain equity securities by the issuer and others
- 2.4.2.4 Regulation 14E—Tender offers
  - Rule 14e-4—Prohibited transactions in connection with partial tender offers
- 2.4.2.5 Regulation M—Antimanipulation Rules Concerning Securities Offerings
  - Rule 101—Activities by distribution participants
  - Rule 102—Activities by issuers and selling security holders during a distribution
  - Rule 103—NASDAQ passive market making
  - Rule 104—Stabilizing and other activities in connection with an offering
  - Rule 105—Short selling in connection with a public offering

- 2.4.2.6 Regulation FD—Fair disclosure  
Requirement that when an issuer discloses material nonpublic information to certain persons (such as, securities market professionals and holders of the issuer's securities who may well trade on the basis of the information), it must make public disclosure of that information  
Enhancement of existing prohibitions against insider trading

### 2.4.3 Insider Trading

- Insider Trading and Securities Fraud Enforcement Act of 1988  
Section 3—Civil penalties of controlling persons for illegal insider trading by controlled persons  
CBOE Rules  
Rule 4.18—Prevention of misuse of material, nonpublic information  
NASDAQ OMX PHLX Rules  
Rule 761—Supervisory procedures relating to Insider Trading and Securities Fraud Enforcement Act of 1988  
NYSE Rules  
Rule 342.21—Trade Review and Investigation  
Rule 351(e) — Reporting Requirements  
NYSE ARCA Rules  
Rule 11.3—Prevention of misuse of material, nonpublic information  
Securities Exchange Act of 1934  
Section 15(f)—Registration and regulation of brokers and dealers – written policies and procedures relating to misuse of material, non-public information  
Rule 10b-5—Employment of manipulative or deceptive devices  
Rule 10b5-1—Trading on the basis of material nonpublic information in insider trading cases  
Rule 10b5-2—Duties of trust or confidence in misappropriation insider trading cases

## 2.5 Extensions of Credit in the Securities Industry

- **Understand margin implications associated with various strategies**
- **Understand minimum margin requirements set by regulation for initial/maintenance requirements**
- **Recognize that firms and/or exchanges may set higher requirements**
- **Obtain documentation related to margin agreement**
- **Understand margin calculations**
- **Know how to calculate initial/maintenance/variation call**
- **Understand mark to market to calculate amount of call**
- **Know what is required to meet margin call daily**
- **Know the acceptable collateral deposits**
- **Understand margin strategy offsets under FINRA Rule 4210**
- **Review customer accounts/transactions to ensure compliance with short sale and buy-in rules**

### 2.5.1 General Margin Requirements

- 2.5.1.1 Long accounts  
Regulation T

- 2.5.1.2 Spread
  - Any options position having both long options and short options of the same type on the same underlying instrument; for a spread to qualify for margin, the long must expire prior to the short position
- 2.5.1.3 Uniform options margin requirements:
  - Initial requirement
  - Maintenance call
- 2.5.1.4 Short accounts
  - Federal initial requirements for short sales
  - Maintenance margin requirements for short sales
- 2.5.1.5 Margin substitutions
  - Same day substitutions
  - Adjusted debit balance
- 2.5.1.6 Withdrawal of dividend and interest credit
  - CBOE Rules
    - Chapter XII—Margins
  - FINRA Rules
    - Rule 4210 – Margin Requirements
    - Rule 4210 (f)(2)—Puts, Calls and Other Options
  - NASDAQ OMX PHLX Rules
    - Rule 721—Proper and adequate margin
    - Rule 722—Margin accounts
  - NYSE Rules
    - Rule 700(b)(14)—Covered - Short Positions
    - Rule 772—Option Contracts of Suspended Members
  - NYSE Amex Rules
    - Rule 462—Minimum margins
  - Securities Exchange Act of 1934
    - Regulation T
      - Section 7—Margin requirements
      - Section 8—Restrictions on borrowing by members, brokers and dealers

## **2.5.2 Other Provisions of Regulation T**

- General rule
- Prompt payment
- Extensions of time
- Cash accounts
- Escrow Agreements
- Letters of guarantee
- Depository trust receipts

## **2.5.3 Short Sales and Mandatory Buy-ins**

- NASD Rules
  - Rule 11810—Buying-In
- NASDAQ OMX PHLX Rules
  - Rule 455—Short sales

## NYSE Rules

Rule 440B—Short Sales

Rule 440C – Short Sale Borrowing and Delivery Requirements

## NYSE Amex Rules

Rule 7—Short sales

Rule 784—Mandatory closing of fails

## Securities Exchange Act of 1934

### Regulation SHO—Short sales

Rule 200—Definition of “short sale”

Rule 201—Price test and marking requirements

Rule 203—Borrowing and delivery requirements

Rule 15c3-3(h)—Customer Protection – reserves and custody of securities

## 2.6 Trading Practices

- **Understand when and why a trading rotation and fast markets will be utilized**
- **Understand the roles and responsibilities of market participants**
- **Comply with relevant position/exercise limits**
- **Ensure appropriate aggregation of accounts for reporting position limits, exercise limits, and large positions**
- **Understand contract adjustment due to such events as splits, mergers, dividends**
- **Review orders to ensure they are eligible for electronic order routing/execution**
- **Review orders to ensure that orders are not "unbundled"**

### 2.6.1 Terms and Definitions

#### CBOE Rules

Rule 6.45—Priority of bids and offers—allocation of trades

Rule 6.70—Floor broker defined

Rule 8.1—Market maker defined

Rule 8.80—DPM defined

#### NYSE Amex Rules

Rule 900.1NY—Applicability, definitions and references

Rule 950(d)—Precedence of bids and offers

#### NYSE ARCA Rules

Rule 6.52—Obligations for orders

### 2.6.2 Trading Rotation

Opening

Closing

Business day prior to expiration

Intra-day

Re-open after halt

#### CBOE Rules

Rule 6.2—Trading rotations

Rule 6.2A—Rapid opening system

Rule 6.2B—Hybrid opening system

#### NASDAQ OMX PHLX Rules

Rule 1047—Trading rotations, halts and suspensions

#### NYSE Rules

Rule 717 (a)—Trading Rotations

- NYSE Amex Rules
  - Rule 1 Commentary .02 Hours of business (Trading rotation)
  - Rule 918 (a) – Trading rotations
  - Rule 918 – Commentary .01, .02, .03 and .04
  - Rule 918C(a)—Supervision of trading
  - Rule 918C – Commentary .03, .04, .05 and .06 (Trading rotations)
- NYSE ARCA Rules
  - Rule 6.64—Trading rotations

### **2.6.3 Fast Markets and Trading Halts**

- CBOE Rules
  - Rule 6.3—Trading halts
- FINRA Rules
  - Rule 5260 – Prohibition on Transactions, Publication of Quotations, or Publication of Indications of Interest During Trading Halts
  - Rule 6120—Trading Halts
- NASDAQ OMX PHLX Rules
  - Rule 1047—Trading Rotations, Halts and Suspensions
- NYSE Rules
  - Rule 717 (b)—Trading Halts or Suspensions
- NYSE Amex Rules
  - Rule 918 – Trading halts
  - Rule 918(b) – Trading halts
  - Rule 918 – Commentary .05 – Delayed openings
  - Rule 918(c) – Supervision of trading
  - Rule 958A(d) – Application of the firm quote rule – use of unusual market exception
- NYSE ARCA Rules
  - Rule 6.65—Trading halts and suspensions

### **2.6.4 Position and Exercise Limits**

- CBOE Rules:
  - Rule 4.11—Position limits
  - Rule 4.12—Exercise limits
  - Rule 24.4—Position limits for broad-based index options
  - Rule 24.4A—Position limits for industry index options
  - Rule 24.5—Exercise limits
  - Rule 24.18—Exercise of American style index options
- FINRA Rules
  - Rule 2360(b)(23)(A)—Exercise of options contracts
  - Rule 2360(b)(4)—Exercise limits
  - Supplementary Material .01 Position limit examples
- NASDAQ OMX PHLX Rules
  - Rule 1001—Position limits
  - Rule 1001A—Position limits—options on indices
  - Rule 1002—Exercise limits
- NYSE Rules
  - Rule 704—Position Limits
  - Rule 705—Exercise Limits
- NYSE Amex Rules
  - Rule 904—Position limits
  - Rule 904C – Position limits – stock index options
  - Rule 904D – Position limits – T-Bill options

- Rule 904D – Exercise limits – T- Bill options
- Rule 905—Exercise limits
- Rule 905C – Exercise limits – stock index options
- Rule 906G – Position Limits – Flexible exchange options
- Rule 907G – Exercise Limits – Flexible exchange options
- Rule 980—Exercise of options contracts
- NYSE ARCA Rules
  - Rule 6.8(a)—Options Trading, Position limits
  - Rule 6.9—Options trading, exercise limits
  - Rule 6.11—Exercise of options contracts

**2.6.5 Contract Adjustments**

- CBOE Rules
  - Rule 5.7—Adjustments
- NYSE Rules
  - Rule 703(g)—Contract Adjustments

**2.6.6 Exchange Order Routing Systems**

- CBOE Rules
  - Rule 6.8 – RAES Operations
- NYSE Amex Rules
  - Rule 60 – Responsibility for PER and AMOS orders, subparagraph (a)

**2.6.7 Types of orders**

- Market orders
- Limit orders
- Stipulation
  - Day
  - GTC
- Market not held
- Stop limit
- Spread
- Straddle
- Combination
- Contingency
- Immediate-or-cancel
- At the close
  - CBOE Rules
    - Rule 6.53 – Certain types of orders defined
  - NASDAQ OMX PHLX Rules
    - Rule 1066—Certain types of orders defined
  - NYSE Rules
    - Rule 123A—Miscellaneous Requirements
  - NYSE Amex Rules
    - Rule 131—Types of orders
    - Rule 131A—Market on the close policy and expiration procedures
    - Rule 950(e)—Types of orders



## 2.7 Exercise/Assignment of Options

- Understand the mechanics and ramifications of the tendering of exercise notices for options; exercise by exception and same day exercise
- Understand the effect of exercise prior to ex-dividend date
- Understand applicable time limitations
- Understand the mechanics and effects of assignment, particularly on ex-dividend date
- Understand OCC assignment procedure and firm/market maker/customer assignment
- Understand firm procedures for allocating customer assignments (FIFO, random)
- Ensure customer notification of allocation method
- Ensure compliance with requirement for delivery and payment/settlement
- Understand priority offered orders
- Understand time priority
- Understand off-floor accommodations and the necessary reporting obligations

### 2.7.1 Tender of Exercise Notices

Equity options

Effect of exercise prior to ex-dividend date

Time limitations

Same day exercise

Exercise by exception

Index options

Foreign currency options

CBOE Rules

Rule 11.1—Exercise of option contracts

FINRA Rules

Rule 2360(b)(23)—Tendering procedures for exercise of options

NASDAQ OMX PHLX Rules

Rule 1042—Exercise of equity option contracts

Rule 1042A—Exercise of option contracts – options on indices

NYSE Amex Rules

Rule 980—Exercise of options contracts

### 2.7.2 Assignment of Exercise Notices

Effect of assignment on ex-dividend date of equities

OCC assignment procedure

Firm/market maker/customer assignment

Acceptable procedures for allocating customer assignments

Allocation methods

Delivery and payment /settlement date

Workpapers and documentary materials regarding assignment notices

CBOE Rules

Rule 11.2—Allocation of exercise notices

Rule 11.3—Delivery and payment

FINRA Rules

Rule 2360(b)(23)(C)—Allocation of exercise assignment notices

NASDAQ OMX PHLX Rules

Rule 1043—Allocation of exercise notices

- NYSE Rules
  - Rule 781—Allocation of Exercise Assignment Notices
- NYSE Amex Rules
  - Rule 981—Allocation of exercise notices
  - Rule 982—Delivery and payment
- NYSE ARCA Rules
  - Rule 6.25—Allocation of exercise assignment

### **2.7.3 Obligations of Floor Personnel**

- Specialists
- Order Book Official (OBO)
- Market makers/ Registered Option Traders (ROT's)
- Limited Trading Permits (LTP's – for indices only)
- Designated Primary Market Maker (DPM)
- Lead Market Maker
- Agency capacity
- Principal capacity
- Cabinet trading
  - Supervision of specialist/OBO
  - .01 per lot
  - Time priority
  - Not reported to vendors
  - Off-floor accommodations
  
- CBOE Rules
  - Rule 6.54 – Accommodation liquidations
  - Rule 6.73 – Responsibilities of floor brokers
  - Rule 8.4 – Remote market makers
  - Rule 8.8 – Restriction on acting as market maker and floor broker
  - Rule 8.85—DPM obligations
- FINRA Rules
  - Rule 2360(b)(24) – Options transactions and reports by market makers in listed securities
- NASDAQ OMX PHLX Rules
  - Rule 1059—Accommodation transactions
- NYSE Rules
  - Rule 756 – Transaction off the Exchange
  - Rule 759 – Accommodation Transactions
- NYSE Amex Rules
  - Rule 950(f)—Orders left with specialist
  - Rule 950(g) —Representation of orders
  - Rule 950(n) —Registration and functions of specialists
  - Rule 958—Options transactions of registered traders
  - Rules 959—Accommodation transactions
- NYSE ARCA Rules
  - Rule 6.37 – Obligations of market makers
  - Rule 6.46 – Responsibilities of floor brokers

### **2.8 Clearance, Transaction Review and Settlement Procedures**

- **Ensure registered representatives understand and are able to explain to customers the settlement procedures, e.g., prompt receipt and delivery, affirmative determination, denominations of delivery, assignments, ex-dividend transactions, etc.**
- **Ensure proper documentation is obtained for settlement**
- **Ensure proper handling of customer requests to transfer accounts**
- **Review erroneous transactions for proper resolution**

## **2.8.1 OCC Clearance Procedures**

- 2.8.1.1 Daily Position Report  
 Trades compared from previous business day  
 Net premium balance due to or from OCC for all settled transactions  
 All exercises and assignments  
 All daily activity
- 2.8.1.2 Daily Margin Report  
 Amount of margin on deposit, amount of margin required, margin excess or deficit, acceptable forms of margin  
 Underlying stock  
 Un-segregated long positions (spread margin)  
 Cash or equivalent, T-bills, Letter of Credit
- 2.8.1.3 Depository Record
- 2.8.1.4 Advisory In-the-Money Report

## **2.8.2 Transaction Review**

- 2.8.2.1 Position adjustments  
 Trade adjustments form  
 Unmatched adjustment report  
 Types of errors  
 Account type errors (firm/customer)  
 Trade type error (open/close)
- CBOE Rules  
 Rule 6.52—Price binding despite erroneous report
- FINRA Rules  
 Rule 11890—Clearly Erroneous Transactions
- NYSE Amex Rules  
 Rule 152—Taking or supplying stock to fill customer’s order  
 Rule 731—Resolution of uncomparing transactions  
 Rule 958NY—Price Binding Despite Erroneous Report  
 Rule 970—Comparison of option transactions excluded from clearance
- NYSE ARCA Rules  
 Rule 6.70—Price binding despite erroneous report

## **2.8.3 Settlement Practices**

- 2.8.3.1 Settlement and delivery requirements  
 NASD Rules

Rule 11550—Assignments and powers of substitutions; Delivery of registered securities

Rule 11574—Certificate in name of deceased person, trustee, etc.

Rule 11860 – COD Orders

NASDAQ OMX PHLX Rules

Rule 1044—Delivery and payment

NYSE Rules

Rule 198—Signatures

Rule 199—Corporate Assignments

Rule 200—Assignments - By Member Organizations

Rule 201—Assignments - By Persons Since Deceased, Trustees, Guardians, etc.

Rule 207—Two or More Names

National Medallion Signature Guarantee Program

NYSE Amex Rules

Rule 752 – Failure to deliver

Rule 753—Payment on delivery

Rule 982 – Delivery and payment

2.8.3.2 Account transfer requirements

CBOE Rules

Rule 9.20—Transfer of accounts

FINRA Rules

Rule 2140—Interfering with the Transfer of Customer Accounts in the Context of Employment Disputes

NASD Rules

Rule 11870—Customer Account Transfer Contracts

NYSE Rules

Rule 412—Customer account transfer contracts

## 3.0 Supervision of Employees, Business Conduct, and Recordkeeping and Reporting Requirements

### 3.1 Hiring, Qualifications and Continuing Education

- Ensure that registered representatives' Form U4s are current
- Ensure that state registration requirements for agents and investment advisers are met
- Ensure that registered representatives are adequately trained with respect to options
- Initiate pre-hire investigations
- Review new employees' previous registration and work history
- Supervise registered representatives' compliance with Continuing Education requirements

#### 3.1.1 Qualification and Registration Requirements

##### 3.1.1.1 Registered Representative (RR)

Persons required to be registered  
Terminations

##### 3.1.1.2 General Securities Sales Supervisor (BM or SU)

Persons required to be registered  
Limitations on principal supervisory function

##### 3.1.1.3 Registered Options Principal (ROP)

Persons required to be registered  
Terminations

##### CBOE Rules

Rule 9.2—Registration of Options Principals  
Rule 9.3—Registration and termination of representatives  
Rule 9.6(b)—Branch offices of member organizations  
Rule 9.8—Supervision of accounts

##### FINRA By-Laws

Article III, Section 3—Ineligibility of certain persons for membership or association  
Article V, Section 1—Qualification requirements

##### NASD Rules

Rule 1022(f)—Limited Principal - Registered Options and Security Futures  
Rule 1032(d)—Limited Representative - Options and Security Futures

##### NASDAQ OMX PHLX Rules

Rule 604—Registration and termination of registered persons  
Rule 1024(a)(i)—Registration of options principals  
Rule 1024(a)(iii)—Foreign currency options—qualified customer personnel

##### NYSE Rules

Rule 345—Employees—Registration, Approval, Records  
Rule 347—Controversies as to Employment or Termination of Employment

- Rule 351—Reporting Requirements
- Rule 720—Registration of Options Principals
- Rule 722(a)—Supervision of Accounts, Duty to Supervise: SROP
- Rule 722(b)—Compliance Registered Options Principal
- NYSE Amex Rules
  - Rule 920—Registration and examination of options personnel - Options principal
- NYSE ARCA Rules
  - Rule 9.26—Registration of Options Principals
  - Rule 9.18—Doing public business in options
  - Rule 9.27 (a)—Registration of Representatives

### **3.1.2 Special Registration Review for Disciplinary History**

#### **3.1.2.1 Statutory Disqualification**

- CBOE Rules
  - Rule 3.18—Members and associated persons who are or become subject to a statutory disqualification
- FINRA By-Laws
  - Article 3 Sec.4—Definition of disqualification
- NYSE Rules
  - Rule 345.11—Investigation and Records
- NYSE Amex Rules
  - Rule 310(d) – Formation of or admission to member organization or membership owner
  - Rule 341B – Independent contractors
  - Rule 342(e) – Association of members, member organizations, and persons associated with member organizations
  - Rule 353 – Amex Trading Permit Requirements
  - Rule 356 – Member organizations
- Securities Exchange Act of 1934
  - Sec. 3(a)(39)—Definition of “statutory disqualification”

### **3.1.3 Continuing Education for Registered Persons**

#### **3.1.3.1 Regulatory element**

- CBOE Rules
  - Rule 9.3A(a) and (b)—Regulatory element
- NASD Rules
  - Rule 1120(a)—Regulatory element
- NYSE Rules
  - Rule 345A(a)—Regulatory Element
- NASDAQ OMX PHLX Rules
  - Rule 640(a)—Regulatory element
- NYSE Amex Rules
  - Rule 341A(a)—Regulatory element
- NYSE ARCA Rules
  - Rule 9.27(c)—Regulatory element

#### **3.1.3.2 Firm element**

- CBOE Rules
  - Rule 9.3A(c)—Firm element

NASD Rules  
Rule 1120 (b)—Firm element  
NASDAQ OMX PHLX Rules  
Rule 640(b)—Firm element  
NYSE Rules  
Rule 345A(b)—Firm Element  
NYSE Amex Rules  
Rule 341A(b)—Firm element

### **3.2 General Supervision—Conduct of Associated Persons**

- **Ensure compliance with firm written supervisory procedures and systems**
- **Monitor registered representatives’ activities regarding gifts and gratuities**
- **Review possible outside business activities of registered representatives – obtain necessary approvals**
- **Review for possible private securities transactions by registered representatives (selling away)**
- **Review registered representatives’ accounts and employee-related accounts held at other firms – ensure necessary approvals are obtained, review confirmations and statements**
- **Monitor trading activities for possible selling away**
- **Review customer accounts to determine that registered representatives are properly handling customer securities or funds**
- **Prevent improper use of customer assets**
- **Monitor and document third party transfer of securities or funds**
- **Monitor entry and allocation of block orders**
- **Ensure correct entry and handling of orders**
- **Review employee related accounts for any irregularities**
- **Review customer accounts to ensure that investments are consistent with stated objectives and risk tolerance**
- **Ensure that proper disclosures are made regarding nature of securities sold to a customer**

#### **3.2.1 Business Conduct**

CBOE Rules  
Rule 4.1—Just and equitable principles of trade  
FINRA Rules  
Rule 2010—Standards of Commercial Honor and Principles of Trade  
NASD Rules  
Rule 2420—Dealing with non-members  
NASDAQ OMX PHLX Rules  
Rule 707—Just and equitable principles of trade  
NYSE Rules  
Rule 401—Business Conduct  
Rule 435(1)—Miscellaneous Prohibitions  
NYSE Amex Rules  
Rule 16 – Business conduct  
Article V, Section 4(h) – Violation of constitution, rules or resolution- inequitable conduct

#### **3.2.2 Gifts and Gratuities**

CBOE Rules  
Rule 4.4—Gratuities

- FINRA Rules
  - Rule 3220—Influencing or Rewarding Employees of Others
- NYSE Amex Rules
  - Rule 347—Gratuities to employees of financial concerns

### **3.2.3 Outside Business Activities**

- CBOE Rules
  - Rule 9.4—Other affiliations of registered associated persons
- FINRA Rules
  - Rule 3270—Outside Business Activities of Registered Persons
- NASD Rules
  - Rule 3040—Private Securities Transactions of an Associated Person
- NYSE Amex Rules
  - Rule 342 – Association of members, member organizations and persons associated with member organizations

### **3.2.4 Non-cash Compensation**

- FINRA Rules
  - Rule 5110(e)—Valuation of non-cash compensation
  - Rule 5110(i)—Non-cash compensation

### **3.2.5 Sharing in Customer Accounts**

- CBOE Rules
  - Rule 9.18—Guarantees and profit sharing
  - Rule 9.19—Assuming losses
- FINRA Rules
  - Rule 2150 – Improper Use of Customers’ Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts
- NYSE Rules
  - Rule 352 – Guarantees, Sharing in Accounts, and Loan Arrangements
- NYSE Amex Rules
  - Rule 390—Assumption of loss prohibited

### **3.2.6 Transactions with Customers**

- CBOE Rules
  - Rule 9.25—Borrowing from or lending to customers
- FINRA Rules
  - Rule 3240— Borrowing From or Lending to Customers

### **3.2.7 Transactions with Other Professionals**

- CBOE Rules
  - Rule 9.17—Transactions of certain customers
- NASD Rules
  - Rule 3050—Transactions For or By Associated Persons
- NASDAQ OMX Rules
  - Rule 751—Accounts of employees of members of participating organizations
- NYSE Rules
  - Rule 407—Transactions of Employees of Members, Member Organizations and the Exchange
  - Rule 407A—Disclosure of All Member Accounts
- NYSE Amex Rules
  - Rule 415—Member’s transactions with another member organization



### **3.3 Customer Complaints**

- **Review and investigate customer complaints (oral and written)**
- **Document and keep records of customer complaints**
- **Ensure that complaints are forwarded to main office within prescribed time frames**
- **Comply with firm and SRO reporting requirements**
- **Ensure that options related complaints are segregated and forwarded to main office within prescribed time**

#### **3.3.1 Handling Customer Complaints and Reporting Requirements**

Complaints must be kept in a central file/log

Branch offices must forward complaint to the central file no later than 30 days after receipt

Copies of complaints must be maintained at the branch office

##### CBOE Rules

Rule 4.9—Disciplinary action by other organizations

Rule 9.3(b)—Termination – reporting of U-5s

Rule 9.3(c)—Termination – filing of amended U-5s

Rule 9.23—Customer complaints

##### FINRA Rules

Rule 4513— Records of Written Customer Complaints

Rule 4530—Reporting Requirements

##### NASDAQ OMX PHLX Rules

Rule 1070—Customer complaints

##### NYSE Rules

Rule 401A—Customer Complaints

Rule 732—Customer Complaints

##### NYSE Amex Rules

Rule 341 Commentary .09—Termination of employment – Form

U5 Filing

Rule 932—Customer complaints

### **3.4 Disciplinary Proceedings and Arbitration/Mediation**

- **Ensure that registered representatives understand the consequences of failure to comply with industry regulations**
- **Disclose to associated persons the effect of signing a pre-dispute arbitration clause**
- **Understand matters subject to arbitration**
- **Understand the difference between arbitration and mediation processes**
- **Ensure compliance with rules pertaining to suspended associated persons**

#### **3.4.1 Investigations, Sanctions and Disciplinary Proceedings**

##### CBOE Rules

Rule 17.1—Disciplinary jurisdiction

Rule 17.2—Complaint and investigation

Rule 17.3—Expedited proceeding

Rule 17.4—Charges

Rule 17.7—Summary proceedings

Rule 17.8—Offers of settlement

Rule 17.11—Judgment and sanction

FINRA Rules

Rule 8000—Investigations and Sanctions

Rule 8210—Provisions of Information and Testimony and Inspection and Copying of Books

Rule 8310—Sanction for Violation of the Rules

Rule 8320—Payment of Fines, Other Monetary Sanctions, or Costs; Summary Action for Failure to Pay

Rule 9200 Series—Disciplinary Proceedings

Rule 9300 Series—Review of Disciplinary Proceeding by National Adjudicatory Council and FINRA Board; Application for SEC Review

Rule 9800—Temporary Cease and Desist Orders

NASDAQ OMX PHLX Rules

Rule 960—Disciplinary Rules

NYSE Rules

Rule 475—Prohibition or Limitation

Rule 476—Disciplinary Proceedings

Rule 476A—Imposition of Fines for Minor Violation(s) of Rules

Rule 477—Retention of Jurisdiction—Failure to Cooperate

NYSE Amex Rules

Article V of AMEX Constitution

Sec.1—Assistance of counsel permitted

Sec.2—Delegation of disciplinary power

Sec.4—Suspension or expulsion

Sec.6—Retention of jurisdiction over former members

Rules of Procedure in Disciplinary Matters Rules 1 through 12

American Stock Exchange Sanction Guidelines Overview, et. seq.

NYSE ARCA Rules

Rule 10—Disciplinary proceedings and appeals

**3.4.2 Arbitration and Mediation Procedures**

CBOE Rules

Chapter XVIII—Arbitration

FINRA Rules

Rule 2263—Arbitration Disclosure to Associated Persons When Signing or Acknowledging Form U4

Rule 10100—Administrative provisions

Rule 10200—Industry and clearing controversies

Rule 10300—Uniform code of arbitration

Rule 10400—Mediation rules

NASDAQ OMX PHLX Rules

Rule 950—Arbitration

NYSE Rules

Rule 347(a)—Controversies as to Employment or Termination of Employment

Rule 600—Arbitration

Rule 636—Requirements When Using Pre-Dispute Arbitration Agreements With Customers

Rule 638—Mediation

NYSE Amex Rules

Rule 600—Arbitration

### **3.5 Recordkeeping and Reporting Requirements**

- **Comply with firm and regulatory requirements regarding review of correspondence, complaints and records**
- **Comply with all document retention requirements, including any action taken**
- **Ensure compliance with SRO filing requirements; such as, reports related to position limits; uncovered short positions; market maker accounts; activity in market maker accounts; etc.**

#### **3.5.1 Books and Records**

##### CBOE Rules

Rule 15.1—Maintenance, retention and furnishing of books, records and other information

##### FINRA Rules

Rule 2268 – Requirements When Using Predispute Arbitration Agreements for Customer Accounts

Rule 2360(b)(17)—Maintenance of Records

Rule 4510 Series—Books and Records Requirements

Rule 5340—Pre-Time Stamping

Rule 7440 (a)(4) – Order Audit Trail System (OATS) - Recording of Order Information

##### NASD Rules

Rule 3110(b)—Marking of Customer Order Tickets

Rule 3110 (i) —Holding of Customer Mail

##### NASDAQ OMX PHLX Rules

Rule 760—Maintenance, retention and furnishing of books records and other information

##### NYSE Amex Rules

Amex Constitution Article XI Section 3 – Keeping of books

Rule 31—Requests for books, papers, records or testimony

Rule 153 – Record of orders

Rule 302 – Provisions with respect to books of account

Rule 324 – Books and records

Rule 922(b)—Maintenance of customer records

##### Securities Exchange Act of 1934

Rule 17a-3—Records to be made by certain exchange members, brokers and dealers

Rule 17a-4—Records to be preserved by certain exchange members, brokers, and dealers

Rule 17a-5—Reports to be made by certain brokers and dealers

Rule 17a-8—Financial record keeping and reporting of currency and foreign transactions

Rule 17f-1—Requirements for reporting and inquiry with respect to missing, lost, counterfeit or stolen securities

### **3.6 Securities Investor Protection Act and SIPC Rules**

- **Know coverage limits for various types of accounts**
- **Know advertising requirements by members of SIPC**

#### **3.6.1 Securities Investor Protection Act and SIPC Rules Thereunder**

## Sample Questions

The questions that appear on the following pages are similar in format and content to questions on the examination. These sample questions, however, are not intended to exactly parallel either the level of difficulty or the subject coverage of the actual examination. Their purpose here is to acquaint candidates and training personnel with the types of multiple-choice questions that will appear on the examination.

### Answers

1. (B)
2. (B)
3. (C)
4. (C)

### Questions

1. Which two of the following are TRUE regarding a firm's minimum net equity requirements, both initial and maintenance, for uncovered options transactions?

- I. They may exceed regulatory requirements.
- II. They are determined by the level of customer activity in the account.
- III. They must be maintained as part of the written policies of the member firm.
- IV. They must match regulatory requirements.

- (A) I and II
- (B) I and III
- (C) II and IV
- (D) III and IV

2. A customer with no other cash or securities in the account sells one XYZ Jul 100 call for 10 and buys 100 shares of XYZ at \$105 per share. What is the market price per share of XYZ stock at which the customer breaks even?

- (A) \$ 90
- (B) \$ 95
- (C) \$110
- (D) \$115

3. How long must advertisements, market letters and sales literature issued by a member organization pertaining to listed options be retained and readily available for inspection?

- (A) 6 months
- (B) 1 year
- (C) 3 years
- (D) 5 years

4. A customer buys 1 XYZ Oct 50 put at a premium of \$7 and subsequently exercises the put with stock purchased at \$40 per share. For Federal income tax purposes, the sale proceeds upon exercise of the put are equal to

- (A) \$3,300
- (B) \$4,000
- (C) \$4,300
- (D) \$5,000