

Rules & Regulations Checklist

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
- Research Analyst = an associated person who is primarily responsible for preparing the substance of a research report or whose name appears on a research report
 - Research Analysts must be registered and pass a qualification exam
 - Research reports involve a detailed discussion of a particular stock and the analyst’s opinion of whether the stock should be purchased, held, or sold
- Registration is completed electronically through the Central Registration Depository “CRD” system maintained by FINRA.
- Any person who fails to pass any qualification exam is permitted to take the exam again after 30 calendar days, but after the third failing score is prohibited from re-taking the exam for 180 calendar days going forward

- Continuing Education requirements:
 - Regulatory Element: each registered person must complete the Regulatory Element on their second registration anniversary date and every three years thereafter. The Regulatory Element must be completed within 120 days after the person's registration anniversary date.
 - Failure to complete Regulatory Element leads to registration being declared inactive until the requirement is completed
 - Firm Element: member must maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skill, and professionalism. At a minimum, each member shall at least annually evaluate and prioritize its training needs and develop a written training plan.

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
 - Trading ahead of a customer market or limit order
 - stepping ahead of customer's order by buying or selling a security for firm's account at a price equal to or more favorable than what customer is willing to pay/accept
 - Front running: placing an order for the firm's or agent's own account that will then benefit from the placement of a large customer order immediately afterward
 - I.e., 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.
 - Market makers may not "back away" from firm quotes to buy and sell securities on the over-the-counter market.
 - Quotes that are not firm (subject, nominal) must be clearly identified as such.

- Firm quotes honored for a minimum of 100 shares of common stock or other normal trading unit for other securities
 - 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
 - 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**
 - 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 in writing by the customer
 - **Unauthorized Transactions**
 - Executing purchase 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**

- OTC Equity Securities = securities not listed on an exchange or NASDAQ
 - To recommend them, member must review issuer's financial statements and determine that the recommendation is suitable for the customer
 - If issuer is delinquent in filing financial information, member must inquire into reasons for delinquency
- Member firms must make reasonable effort to obtain a price that is as favorable as possible to the customer
- Member firms must not insert a third party between the member and the best available market price for a security (called "interpositioning") unless it reduces the costs of the transactions to the customer.
- 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).
- At least quarterly, member firm must send customers account statements showing securities values, cash amounts, purchases and sales since last statement, dividends and interest credited, margin interest charged
- Must provide non-institutional margin customers with a margin disclosure statement either when or before margin account is opened. Points disclosed:
 - You can lose more funds than you deposit in the margin account
 - The firm can force the sale of securities or other assets in your account
 - The firm can sell your securities or other assets without contacting you.
 - You are not entitled to choose which securities or other assets in your account(s) are liquidated or sold to meet a margin call.
 - The firm can increase its "house" maintenance margin requirements at any time and is not required to provide you advance written notice
 - You are not entitled to an extension of time on a margin call
- Must provide customers with information on SIPC and how to contact SIPC for more information by phone and through the website www.sipc.org.
- 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, including miscellaneous services such as collection of moneys due for principal, dividends, or interest; exchange or transfer of securities; appraisals, safe-keeping or custody of securities, and other services, must be reasonable (just) and not unfairly discriminatory (equitable) between customers
- Violation to enter into securities transactions with customers at prices not reasonably related to current market price for the security or to charge an unreasonable commission. The “5% Policy” is the guideline to be used to judge fairness of markups, commissions. The following factors determine the fairness of a markup:
 - Type of security involved: stocks involve higher markups than bonds. DPP's involve higher markups than stocks.

- Availability of security: inactive securities generally more costly
- Price of the security: markups and commissions are by definition a higher % when the security's price is low.
- Amount of \$ involved: a small transaction has a higher markup %
- Unusual commissions and markups must be disclosed to customer before the transaction. Disclosure does not in itself justify unreasonable markups, commissions
- 5% Policy not applicable to the sale of securities where a prospectus or offering circular is required to be delivered and the securities are sold at the specific public offering price
 - 5% markup is for secondary market
 - Primary offerings sold with a prospectus at one public offering price (POP) that includes compensation to the underwriters and selling brokers
- Before entering into a transaction with a non-institutional customer on a "net basis," firm must provide disclosure and get customer's written consent
 - Net basis means the firm buys security from a broker-dealer and sells it to the customer at a different price
- Discretion = choosing which securities are bought or sold or how many shares/units are purchased or sold without consulting the customer
 - 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
- Research analysts may not be subject to supervision or control of investment banking department and no personnel in investment banking can have any influence or control over research analysts' compensation. Compensation can not be based on investment banking done with the companies reported on.
 - Research reports may not be submitted to the subject company before publication except for factual accuracy
 - Favorable research reports can not be offered to subject companies in exchange for favors or negative reports used to threaten companies
 - Research analysts may not purchase or receive shares before the IPO of a company if the member covers that industry sector.
 - Research analysts may not purchase the subject company's stock from 30 days before the report and 5 days following the report
 - Research analysts must disclose in report and in public appearances whether they or any member of immediate family own stock in the subject company
 - Member must disclose if it seeks or has done business with the subject company on front cover of research report.
- 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
 - 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 the commencement of 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.
- Options position limits must be maintained
 - If 25,000 is maximum position limit, customer can have 25,000 "long" and 25,000 "short" positions. So, the customer could buy 25,000 calls and buy 25,000 puts. But, he could not buy 25,000 calls and *sell* 25,000 puts on that stock (long call, short put are both *bullish*).
- 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 procedures for reviewing and approving all transactions and for monitoring incoming and outgoing correspondence.
 - 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 \$)
 - Member firms must report to NASD/FINRA whenever the member or an associated person:
 - violates any securities law, any rule or standard of any government agency, self-regulatory organization, or financial business or professional organization
 - is the subject of any written customer complaint involving allegations of theft or misappropriation of funds or securities or of forgery

- is named as defendant or respondent in any proceeding by a regulatory or self-regulatory body alleging the violation of any provision of the Act,
- is denied registration or is expelled, enjoined, directed to cease & desist, suspended or otherwise disciplined by any securities, insurance, or commodities regulator
- is indicted, or convicted of, or pleads guilty to, or pleads no contest to, any felony; or any misdemeanor that involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds, or securities,
- is subject to a judgment in civil court or arbitration above a certain amount
- When an associated person is asked to sign a new or amended U-4, member firm must provide written disclosure that the associated person is bound by arbitration and the details of how arbitration process works
 - Arbitration generally allows no appeals
 - Discovery is more limited than in civil court (ability to obtain documents)
 - Arbitrators don't have to explain decisions
 - Sexual harassment claims do not have to be arbitrated (but may be)
- Each member shall make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy and with the Rules of this Association and as prescribed by SEC Rule 17a-3. The record keeping format, medium, and retention period shall comply with Rule 17a-4 under the Securities Exchange Act of 1934.
 - Marking of Customer Order Tickets: for non-exchange-listed securities, member must indicate that at least two price quotations were available or indicate which broker-dealers were contacted to determine the price
 - 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, either a separate file of all written complaints of customers and action taken by the member, if any, or a separate record of such complaints and a clear reference to the files

- containing the correspondence connected with such complaint as maintained in such office
- Complaint means “any written statement of a customer or any person acting on behalf 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 the disposition of securities 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 of Customer Mail: upon the written instructions of a customer, a member may hold mail for a customer who will not be at his or her usual address for the period of his or her absence, but (A) not to exceed two months if the member is advised that such customer will be on vacation or traveling or (B) not to exceed three months if the customer is going abroad.
 - Violation for a member to publish a transaction or a quote unless the firm has reasonable grounds to believe the transaction or quote are “bona fide,” meaning that this is not a fictitious price designed to manipulate the market
 - If nominal quotes are published, must be clearly indicated as such
 - Members can’t make an offer to buy from or sell to a customer any security at a stated price unless the member is prepared to purchase or sell at that price and under the conditions stated at the time of the offer to buy or sell.
 - Each member must create and maintain a written business continuity plan identifying procedures relating to an emergency or significant business disruption. Such procedures must be reasonably designed to enable the member to meet its existing obligations to customers.
 - 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