

## Securities Act of 1933

- Primary market legislation
- Requires issuers make disclosures by prospectus
- Registration form filed, 20 day cooling off period
  - Allowed = indications of interest, tombstone, red herring
  - Prohibited = sales, recommendations, advertising
- Exempt securities
  - Government securities
  - Bank, savings & loan securities
  - Non-profit, religious securities
  - Commercial paper (270 days or fewer)
- Exempt transactions
  - Regulation D private placement (35 or fewer non-acc investors)
    - Accredited investors
      - \$1 million net worth (excl. residence)
      - \$200k (single) income / \$300k (joint) income
    - Financial institutions
    - Non-financial orgs w/ \$5 million+ in assets
    - Officers, directors, or partners of issuer
    - Series 7, 65, or 82 holders

## Securities Exchange Act of 1934

- Secondary market legislation
- Regulates securities markets and their participants
- Created the SEC
- All forms of fraud are illegal and prohibited
- Market manipulation is prohibited
  - Spreading false rumors
  - Pump and dump schemes
  - Painting the tape / matched orders
  - Marking the open or close

## Investment Advisers Act of 1940

- Defines and regulates federal covered advisers
- Covered advisers subject to SEC registration
- Must perform notice filing with state administrator
- Unique rules (as compared to USA)
  - Exempt - persons only giving advice on US Gov't securities
  - Exempt - intrastate advisers (no advice on listed securities)
  - Exempt - only giving advice to insurance companies
  - Registration effective 45 days after filing

## SEC Release IA-1092

- Re-affirmed investment adviser definition (ABC rule)
- Considers the following as investment advisers:
  - Athlete & celebrity advisers
  - Financial planners
  - Pension consultants

## Federal criminal penalties (5-10-5 rule)

- Penalties if willfully violating law:
  - 5 year statute of limitations
  - \$10,000 max fine
  - 5 year max jail sentence

## Insider Trading Act of 1988

- Trading prohibited on material, non-public information
- \$25 million max fine (firms)
- \$5 million max fine, 20 year max jail sentence (individuals)
- Treble civil penalties (3x profit made or loss avoided)

## Broker-dealer compensation

- Agency (broker) transactions = commission
- Principal (dealer) transactions = markups/downs
- Not included in fee disclosure template
  - Commissions
  - Markups/downs
  - Advisory fees if dual registered as IA

## Investment adviser compensation

- May collect from any client:
  - Fixed fees
  - Hourly fees
  - AUM fees
- Collect performance fees only from qualified clients
  - \$1.1 million invested w/ adviser
  - \$2.2 million net worth
- May only collect commissions only from affiliated B/D
- Wrap fee program compensation
  - Trading and management fees "wrapped up"
- Soft dollar compensation
  - Disclose if compensated for sending trades to B/D
  - Allowed:
    - Research, newsletters, trading programs, seminar fees
  - Prohibited:
    - Travel or hospitality expense, office equipment

## Unethical actions

- Excessive trading (churning)
- Making unsuitable recommendations
- Executing transactions without proper authority
- Failing to segregate client assets from firm assets
- Executing transactions at unfair prices
- Failing to deliver a prospectus during new issue offerings
- Charging unreasonable fees
- Offering a security with not intention of trading it (backing away)
- Engaging in any form of market manipulation
- Guaranteeing investors against loss
- Failing to disclose conflicts of interest
- Failure to respond to customer complaints
- Borrowing from or lending to clients
  - Exceptions
    - Client in business of lending money
    - Offering a loan through a margin account
    - Loans between firm associates
  - Sharing accounts with customers
    - Agents → may share if the following are in place:
      - Written B/D permission
      - Written agreement with client
      - All other persons are prohibited
  - Splitting commissions with associates of other firms
    - Agents may split commissions with reps of same firm
- Performing securities transactions outside of firm
  - Applies to agents and IARs
  - Considered "selling away"
  - May avoid selling away if:
    - Written disclosure to firm
    - Written approval from firm if being paid

## Other ethical considerations

- Testimonials
  - Broker-dealers and agents may use
    - Must disclose if compensated > \$100
  - Investment advisers and IARs
    - State rules: testimonials are prohibited
    - Federal rules: testimonials are prohibited
      - Proper disclosures made
      - Written agreement with promoter
- Must disclose all material facts
  - During offers, recommendations, presentations, etc.
  - Material fact = any fact that may influence an investment decision

## CUSTOMER ACCOUNTS

### Individual accounts

- Owned by one individual
- Subject to probate if not TOD

### Transfer on death (TOD)

- Transfers assets to listed beneficiaries upon death
- TOD accounts avoid probate

### Joint with rights of survivorship (WROS)

- Account owned by one or more persons
- Pre-determined ownership between owners
- Deceased owner assets pass to estate (subject to probate)

### Fiduciary accounts

- Accounts manager must put owner's interests before their own
- **Guardianship**
  - Court appointed guardian over minor / incapacitated
- **Custodial**
  - Minor's assets managed by adult custodian
  - Contributions are irrevocable gifts to minor
  - Must be turned over to minor at:
    - UGMA = age of majority (18 or 21 depending on state)
    - UTMA = state-defined age (up to age 25)
- **Discretionary**
  - Account managed for client by financial professional
  - Requires power of attorney (POA) / trading authority
    - Limited POA = trading only
    - Full POA = trading + withdrawals
    - Durable POA = survives incapacitation
    - Non-durable POA = ceases upon incapacitation
  - Considered discretionary trade if representative chooses:
    - Asset (what security)
    - Action (buy or sell)
    - Amount (how much)