

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 regulated
 - 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

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
- Deceased owner assets become property of surviving owners
- Not subject to probate if surviving owner exists
- May add TOD, will apply if no surviving owners left

Joint tenants in common (TIC)

- 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)