

# Brokerage Office Procedures

## INTRODUCTION

Guidelines for the practices that a brokerage firm uses to conduct the operation of its daily business are regulated by industry, state, and federal regulators. These guidelines are the foundation for the way that the firm handles all business, from hiring a new agent to executing a customer's order. All Series 24 candidates must have a full understanding of a brokerage firm's operations and procedures to successfully complete the exam.

## HIRING NEW EMPLOYEES

A registered principal of a firm will be the individual who interviews and screens potential new employees. The principal will be required to make a thorough investigation into the candidate's professional and personal backgrounds. With few exceptions, other than clerical personnel, all new employees will be required to become registered as an associated person with the firm. The new employee will begin the registration process by filling out and submitting a Uniform Application for Securities Industry Registration, also known as Form U4. Form U4 is used to collect the applicant's personal and professional history, including:

- 10-year employment history
- Five-year resident history

- Legal name and any aliases used
- Any legal or regulatory actions

The principal of the firm is required to verify the employment information for the last three years and must attest to the character of the applicant by signing Form U4 prior to its submission to FINRA. All U4 forms will be sent to the Central Registration Depository (CRD) along with a fingerprint card for processing and recording. Any applicant who has answered yes to any of the questions on the form regarding his or her background must give a detailed explanation in the DRP pages attached to the form. The applicant is not required to provide information regarding:

- Marital status
- Educational background
- Income or net worth

Information regarding the employee's finances is disclosed on Form U4 if the associated person has ever declared bankruptcy and if the employee has any unsatisfied judgements or liens. Any development that would cause an answer on the associated person's U4 to change requires that the member update the U4 within 30 days of when the member becomes informed of the event. In the case of an event that could cause the individual to become statutorily disqualified, such as a felony conviction or misdemeanor involving cash or securities, the member must update the associated person's U4 within 10 business days of learning of the event.

## RESIGNATION OF A REGISTERED REPRESENTATIVE

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If a registered representative voluntarily resigns or has his or her association with a member firm terminated for any reason, the member must fill out and submit a Uniform Termination Notice for Securities Industry Registration, which is known as Form U5. The member must submit the form to FINRA within 30 days of the termination. The member firm is also required to give a copy of the form to the representative upon termination. The member must also state the reason for the termination, either voluntary or for cause. Voluntary terminations cover all terminations that were not the result of the agent being fired for violations of industry or company regulations, such as staff reductions. An associated person's registration is nontransferable. A representative may not simply move his or her registration from one firm to another. The employing firm that the representative

is leaving must fill out and submit a Form U5 to FINRA, which terminates the representative's registration. The new employing firm must fill out and submit a new Form U4 to begin a new registration for the associated person with the new employer. The new employer is required to obtain a copy of the U5 form filed by the old employing member either from the employee or directly from FINRA within 60 days of submitting the new U4. The previous employer is not required to provide a copy to the new member firm. If the new employing member asks the associated person for a copy of the U5, the member has two business days to provide it. If the member requests a copy of the U5 from the agent who has not received a copy of his or her U5 from the old employer, the agent must promptly request it from the old employer and provide it to the new employer within two business days of receipt. Should an agent's previous employer discover facts that would alter the information on Form U5, the previous employer must file an amended Form U5 within 30 days and provide a copy to the former employee. A representative who leaves the industry for more than 24 months is required to requalify by exam. During a period of absence from the industry of two years or less, FINRA retains jurisdiction over the representative in cases involving customer complaints and violations.

**TAKENOTE!**

A firm may not allow an inactive agent to "park" his or her license with the firm and may not maintain an inactive agent's license on the books simply to ensure that the agent does not have to requalify by exam. The one exception to the rule is for agents in the military who are called to active duty. While on active duty, the agent's registration and continuing education requirements will be "tolled" until they return. While on active duty the agent may not conduct business but may receive commissions generated from his or her book of business. Once the agent returns from active duty they have 90 days to reenter the securities industry. If after 90 days the agent does not reenter the business, the 24 month window begins.

## REGISTRATION EXEMPTIONS

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The following individuals are exempt from registration:

- Clerical
- Nonsupervising officers and managers not dealing with customers

- Non-U.S. citizens working abroad
- Floor personnel

## PERSONS INELIGIBLE TO REGISTER

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Individuals applying for registration must meet the association's requirements in the following areas:

- Training
- Competence
- Experience
- Character

Anyone who fails to meet the association's requirements in any of the above listed areas may not become registered. An individual may also be disqualified by statute or through rules for any of the following:

- Expulsion, suspension, or disciplinary actions by the Securities and Exchange Commission (SEC) or any foreign or domestic self-regulatory organization (SRO).
- The individual caused the expulsion or suspension of a broker dealer or principal.
- The individual made false or misleading statements on the application for registration on Form U4 or Form B-D.
- Felony conviction or misdemeanor involving securities, bribery, falsification of reports, perjury, or any other felony within the last 10 years.
- Court injunction or order barring the individual.

A member firm may seek to maintain the employment of or to initially hire a person who has been statutorily disqualified by filing an appeal to FINRA's registration and disclosure (RAD) department. The appeal may be decided by the department or referred to the National Adjudicatory Counsel (NAC). A hearing may be held by the Statutory Disqualification Committee and appealed to the NAC. The position being applied for under the appeal may only be clerical in nature and may not entail duties of a registered agent.

## DISCIPLINARY ACTIONS AGAINST A REGISTERED REPRESENTATIVE

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If another industry regulator takes disciplinary action against a representative, the employing member firm must notify FINRA. Actions by any of the following should be immediately disclosed to the association:

- SEC
- An exchange or association
- State regulator
- Clearing firm
- Commodity regulatory body

All disclosures must include the type of action brought as well as the name of the party bringing the actions and the name of the representative involved. The firm will make the disclosure on Form U4. FINRA will submit disciplinary actions that are taken by FINRA on Form U6 and they will be recorded on the employee's record. All disciplinary actions, along with a record of the agent's registrations and employment history, are available through FINRA's BrokerCheck program. FINRA members are required to regulate the activities of its associated people and must disclose to the association any action that the member takes against a registered representative.

## TERMINATION FOR CAUSE

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A member may terminate a registered representative for cause if the representative has:

- Violated firm policy.
- Violated the rules of the New York Stock Exchange (NYSE), FINRA, the SEC, or any other industry regulator.
- Violated state or federal securities laws.

A firm may not terminate a representative who is the subject of investigation by any securities industry regulator until the investigation is completed.

## OUTSIDE EMPLOYMENT

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If a registered representative wants to obtain employment outside of his or her position with a member firm, the registered representative must first provide written notification to the employing member firm. The member firm may reject or limit the representative's outside employment. Exceptions to this rule are if the registered representative is a passive investor in a business or if the representative owns rental property. All other outside business activities must be disclosed to the member firm. If the member is a NYSE member, it must provide the representative with prior written approval before the representative engages in any outside activity.

## PRIVATE SECURITIES TRANSACTIONS

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A registered representative may not engage in any private securities transactions without first obtaining the broker dealer's prior written approval. The registered representative must provide the employing firm with all documentation regarding the investment and the proposed transaction. An example of a private securities transaction would be if a representative helped a startup business raise money through a private placement. If the representative is going to receive compensation, the employing member firm must supervise the transaction as if the firm itself executed the transaction. If a representative sells investment products that the employing member does not conduct business in without the member's knowledge, then the representative has committed a violation known as selling away. An exception to this is if the representative is helping an immediate family member raise money and the representative receives no compensation for his or her role in the private transaction. In this case, the notification and permission of the member is not required.

## GIFT RULE

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Broker dealers may not pay compensation to employees of other broker dealers. If a broker dealer wants to give a gift to an employee of another broker dealer, the gift must:

- Be valued at less than \$100 per person per year.
- Be given directly to the employing member firm for distribution to the employee.
- Have the employing member's prior approval for the gift.

The employing member must obtain a record of the gift, including the name of the giver, the name of the recipient, and the nature of the gift. These rules have been established to ensure that broker dealers do not try to influence the employees of other broker dealers. An exception to this rule would be in cases where an employee of one broker dealer performs services for another broker dealer under an employment contract. The following are also excluded from the \$100 limit:

- Occasional meals
- Occasional tickets to sporting events
- Business-related travel

Records of gifts and employment contracts must be retained for three years. Prior FINRA approval is not required for employment contracts between members. The gift rule also applies to gifts given to or received from customers of the firm or agent. In the case of a mutual fund holding a seminar, the mutual fund may pay for a registered representative's travel-related expenses and the seminar must be held at a "reasonable" location. Spouses of agents are allowed to attend; however, the mutual fund may only pay for the travel expenses of the agent. The agent's expenses may not be paid for by the fund in exchange for past sales or the promise of sales in the future.

 **TAKENOTE!**

Firms and agents also may not give a gift to influence any report or dissemination of information designed to influence the price of a security.

## SHARING IN A CUSTOMER'S ACCOUNT

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It is permissible for a representative to maintain a joint account with a customer as long as the firm approves it in advance. The representative may share in the profit and loss of the account only in direct relation to his or her contribution to the account. A registered representative is precluded from sharing in the profit and loss of an account without making any financial contribution to the account.

## BORROWING AND LENDING MONEY

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Borrowing and lending of money between registered persons and customers is strictly regulated. If the member firm allows borrowing and lending between representatives and customers the firm must have policies in place that will allow for the loans to be made. Loans may be made between an agent and a customer if the customer is a bank or other lending institution, where there is a personal or outside business relationship and that relationship is the basis for the loan, or between two agents registered with the same firm. The firm must provide the agent with written preapproval for the loan unless the loan is being made between the agent and an immediate family member or a bank. The approval documentation must be maintained for 3 years from the date when the loan was repaid or 3 years from the rep's termination from the firm.

## ORDER TICKETS

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Prior to executing a customer's order the representative must fill out the appropriate order ticket and present it to the trading department or wire room for execution. All order tickets will include:

- Buy or sell.
- Name of security.
- Number of shares or bonds.
- Account name and number.
- Account type (i.e., cash or margin).
- Price and time limits, if any.
- Solicited or unsolicited.
- Discretionary authority exercised or discretionary authority not exercised, if applicable.
- Time stamp when entered, executed, changed, or canceled.

## EXECUTING AN ORDER

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An important part of executing a customer's order lies in the operational procedures that route the order to the markets and handle trade input functions



for the order once it has been executed. The brokerage firm assigns specific departments to handle all of the important functions of trade execution and input. The departments are:

- Order room/wire room
- Purchase and sales department
- Margin department
- Cashiering department

### **ORDER ROOM/WIRE ROOM**

Once a representative has received an order from a client, the representative must present the order for execution to the order room. The order room will promptly route the order to the appropriate market for execution. Once the order has been executed, the order room will forward a confirmation of the execution to the registered representative and to the purchase and sales department.

### **PURCHASE AND SALES DEPARTMENT**

Once the order has been executed the purchase and sales department inputs the transaction to the customer's account. The purchase and sales department, sometimes called "P&S," is also responsible for mailing confirmations to the customer and for all billing.

### **MARGIN DEPARTMENT**

All transactions, regardless of the type of account, are sent through the margin department. The margin or credit department calculates the amount of money owed by the customer and the date when the money is due. The margin department will also calculate any amount due to a customer.

### **CASHIERING DEPARTMENT**

The cashiering department handles all receipts and distributions of cash and securities. All securities and payments delivered from clients to the firm are processed by the cashiering department. The cashiering department will also issue checks to customers and, at the request of the margin department, will forward certificates to the transfer agent.

## BECOMING A STOCKHOLDER

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Although some people purchase the shares directly from the corporation when the stock is offered to the public directly, most investors purchase the shares from other investors. These investor-to-investor transactions take place in the secondary market on the exchange or in the over-the-counter market. Although the transaction in many cases only takes seconds to execute, trades actually take several days to fully complete. Let us review the important dates regarding transactions for a “regular-way” settlement.

### TRADE DATE

The trade date is the day when the order is actually executed. Although an order has been placed with a broker, it may not be executed on the same day. Certain types of orders may take several days or even longer to execute. A market order, however, will be executed as soon as it is presented to the market, making the trade date the same day the order was entered.

### SETTLEMENT DATE

The buyer of a security actually becomes the owner of record on the settlement date. When an investor buys a security from another investor, the selling investor's name is removed from the security and the buyer's name recorded as the new owner. The settlement date is three business days after the trade date. This is known as T + 3 for all regular-way transactions in common stock, preferred stock, corporate bonds, and municipal bonds. Government bonds and options all settle the next business day following the trade date. Any trade done on a cash basis settles on the same day regardless of the security involved in the transaction. Settlement dates are set by the Uniform Practice Code.

### PAYMENT DATE

The payment date is the day when the buyer of the security has to have the money to the brokerage firm to pay for the purchase. The payment date for securities under the industry rules is five business days after the trade date, or T + 5. Payment dates are regulated by the Federal Reserve Board under Regulation T of the Securities Exchange Act of 1934. Although many brokerage firms require their customers to pay for their purchases sooner than the rules state, the customer has up to five business days to pay for the trade.

## **VIOLATION**

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If the customer fails to pay for the purchase within the five business days allowed, the customer is in violation of Regulation T. As a result, the brokerage firm will “sell out” and freeze the customer’s account. On the sixth business day following the trade date, the brokerage firm will sell out the securities that the customer failed to pay for. The customer is responsible for any loss that may occur as a result of the sell out and the brokerage firm may sell out shares of another security in the investor’s account in order to cover the loss. The brokerage firm will then freeze the customer’s account, which means that the customer must deposit money upfront for any purchases in the next 90 days. After the 90 days have expired, the customer is considered to have reestablished good credit and may then conduct business in the “regular way” and take up to five business days to pay for trades. A customer may get an additional five business days to pay for the trade by requesting an extension. An extension request must be submitted to the NYSE or FINRA before the expiration of the fifth business day. A broker dealer may ignore a call for cash of \$1,000 or less.

## **CLEARLY ERRONEOUS REPORTS**

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If a registered representative reports the execution of a trade to a customer and that report is clearly an error, then that report is not binding on the agent or the firm. The customer must accept the trade as it actually occurred, not as it was erroneously reported, so long as the transaction was in line with the terms of the order.

## **EXECUTION ERRORS**

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If a transaction is executed away from a customer’s limit price or is executed for too many shares of stock, the customer is not obligated to accept the transaction. A registered representative who is informed of an execution error should immediately inform the principal of the error.

If the firm has executed an order at the wrong price, size, or side of the market or in the wrong security, the trade should promptly be moved into the firm’s error account and off set as soon as possible. If the error involved a customer order, the order in line with the customer’s instructions should be executed for the customer’s account. The representative or trader may move the trade to the error account and must notify the supervisor promptly.

If a customer makes an error entering the terms of an order over an online trading platform, the customer is obligated to accept the execution in line with the terms entered, not as intended. The customer in this case should be advised to execute an order to reverse the trade over the online trading portal.

**EXAMPLE**

A customer who maintains an account with a broker dealer enjoys working with his agent when making investment decisions. Virtually all of the customer's orders are executed by his registered rep once a trading decision has been made. The customer has owned 500 shares ABC Microchips for some time and his rep is on vacation in the week just prior to ABC releasing its earnings. Concerned about how the report will be received, the customer logs on to his account to sell his 500 shares of ABC. Not being familiar with the online trading platform the customer enters the order to buy 500 shares of ABC instead of entering an order to sell 500 shares. The customer, who is now long 1,000 shares of ABC, should be advised to enter an offsetting order to sell 1,000 shares of ABC. Any losses as a result of the customer's error will be absorbed by the customer and are not the responsibility of the firm.

## CORPORATE AND MUNICIPAL SECURITIES SETTLEMENT OPTIONS

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Regular-way transactions in corporate stocks and bonds and municipal bonds settle on the third business day, or T + 3. However, occasionally either party to the transaction may request an alternative settlement. Other settlement options include:

- Cash
- Next day
- Seller's option
- Buyer's option
- RVP/DVP/COD

### CASH

A transaction done on a cash basis settles the same day. A cash trade requires that the buyer have the funds available for payment and the seller to have the securities available for delivery on the day the trade is executed. Cash trades executed prior to 2:00 p.m. EST settle by 2:30 p.m. EST. Trades executed after 2:00 p.m. EST settle within 30 minutes.

**NEXT DAY**

A transaction executed for a next day settlement requires that the buyer has the cash available for payment and the seller has the securities available for delivery on the next business day.

**SELLER'S OPTION**

A seller who wishes to lock in a sale price for the securities but who, for some reason, is not able to deliver the securities, may elect to specify a seller's option settlement. The seller may specify the date on which the securities will be delivered but may not deliver the securities any sooner than the fourth business day. If the seller wants to deliver the securities earlier than specified in the contract, the seller must give the buyer one day written notice of his or her intention to settle the trade early.

**BUYER'S OPTION**

Buyers may specify the date when they will make payment for the securities and accept delivery of the securities, much the same as a seller's option.

**RVP/DVP/COD**

Many trusts and other fiduciaries will not allow cash to be paid out until the securities they purchased are delivered. Alternatively, in the case of a sale, they will not allow the securities to be delivered until payment is received. A bona fide RVP/DVP account will allow the transaction to settle no sooner than the regular way of T + 3 but no later than 35 calendar days. The account is given up to 35 days to settle the transaction. In the case of a purchase, the securities have to be registered in the buyer's name by the transfer agent and delivered.

**WHEN-ISSUED SECURITIES**

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When a corporate issuer declares a stock split, the stock will trade in the marketplace on a when-issued basis, prior to the distribution of the new shares. Sellers of the stock during this time may sell the stock on a when-issued basis or may deliver the old securities with a due bill attached for the new shares. Corporate securities sold on a when-issued basis will normally settle three business days after the securities are issued. Municipal securities that are sold prior to the certificate being available for delivery

are sold on a when-issued basis. The purchaser will receive a when-issued confirmation and a final confirmation three days prior to the certificate's delivery.

## GOVERNMENT SECURITIES SETTLEMENT OPTIONS

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Regular-way transactions in government securities settle on the next business day, or  $T + 1$ . There are, however, times when either party to the transaction may request an alternative settlement. Other settlement options include:

- Cash
- Next day
- Seller's option
- Buyer's option
- RVP/DVP/COD

The settlement options available to investors in government securities are similar to those for corporate and municipal securities. However, government securities that are traded on a when-issued basis settle the day after the securities are available for delivery.

## ACCRUED INTEREST

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Most bonds pay interest semiannually based on their maturity date. An investor who wishes to sell a bond between the interest payment dates will be owed the interest that has become due or that has accrued during the holding period. Investors who purchase the bonds between interest payment dates will receive the full semiannual interest payment on the bond's next interest payment date. As a result, the purchaser of the bonds must pay the seller the portion of the earned interest, which is known as accrued interest. Most bonds trade with accrued interest, also known as "and interest." There are only two dates during the month that a bond may pay interest: the 1st and the 15th of the month. Interest on a new issue of bonds begins to accrue on the dated date. It is not unusual for an investor who purchases a new issue of debt securities to owe accrued interest to the issuer for bonds that are delivered

after the dated date. Semiannual interest payments may be made on the 1st or 15th of the following months:

January & July
February & August
March & September
April & October
May & November
June & December

### CALCULATING ACCRUED INTEREST

Interest on all bonds accrues from the last interest payment date up to, but not including, the settlement date. Accrued interest calculations for corporate and municipal securities use a 360-day year in which all months contain 30 days. To determine the amount of accrued interest due or owed for corporate and municipal issues, use the following formula:

**principal × rate × time**

**(principal × interest rate) × (number of days/360) = accrued interest**

To calculate the accrued interest for a government issue, use the actual number of calendar days in the month and a 365-day year.

### CLOSE OUTS

In the case where the selling broker dealer fails to deliver the securities to the buying broker dealer, the buying broker dealer may close out the trade by purchasing the securities in the open market. This is known as a buy in, and the selling broker dealer will be responsible for any loss as a result of the buy in. Notice of the buying broker dealer's intention to buy in the selling broker dealer may be done no sooner than three business days past the settlement or trade date plus six business days. The broker dealer executing the buy in must send notice to the contra party no later than 12 noon, two business days prior to buying the broker dealer in. If a selling broker dealer delivers securities in good form to the buying broker dealer and the securities are rejected, the selling broker dealer may sell out the securities immediately.

UPC Rule 11830 requires the mandatory close out of certain naked short positions. If a firm or a customer has a naked short position and fails to deliver the subject securities 10 business days after the settlement date, the position is subject to a mandatory buy in. A special notation next to their symbol on the Nasdaq workstation identifies securities subject to the mandatory buy in. UPC 11830 securities must have a net short position of at least 10,000 shares and the net short position must be at least 1/2% of the issuer's outstanding stock. A full list of all UPC 11830 subject securities is available online. The mandatory close out does not apply to short positions established as a result of bona fide market making, fully hedged, or arbitrage positions.

## CUSTOMER CONFIRMATIONS

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All customers must be sent a confirmation at or before the completion of the transaction. Industry rules consider the completion of the transaction to be the settlement date. For buyers of the security, it is the time when the payment is made. If the customer has the funds available in the account, it is the time when the funds are moved through a book-keeping entry. For the seller, it is the time when the security is delivered. If the security is delivered prior to its due date, completion will occur when the payment is credited into the account. It is unlawful to settle a transaction without having sent a confirmation of the transaction to the customer. All customer confirmations must include:

- Customer's name and account number.
- Description of the transaction, such as buy or sell.
- Trade date and settlement date.
- Number of shares, bonds, or units.
- Price.
- CUSIP number.
- Amount due or owed.
- Commission charged for agency transactions.
- Markup charged for riskless principal transactions.
- Markup charged for principal transactions in Nasdaq Global Market and third-market trades ("reported securities"), as required under SEC Rule 10b-10.
- Markup charged for Nasdaq Capital Market securities stocks under FINRA rules.



- Yield information for bonds.
- If bonds or preferred stock is callable.
- Whether the firm acted as an agent or principal.
- Whether the firm acted as agent for the other side of the transaction—known as “dual agency.”
- Amount of commission or markup or markdown.
- If the firm makes a market in the security.
- If there is a control relationship between the firm and the issuer of the security.
- Information regarding where the transaction was executed.
- If the firm received payment for executing the order with another firm.
- The time of execution or a statement that the time will be furnished upon request.

If the customer requests additional information within 30 days of the transaction, as detailed on the confirmation, the firm has five business days to provide it. If the customer's request is made after 30 days, the firm may take up to 15 days to provide the information. If the firm receives payment for executing orders with other firms (payment for order flow), the firm must disclose this at the time the customer opens the account and annually thereafter.

## **RULES FOR GOOD DELIVERY**

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All securities delivered by a customer or another broker dealer must be in good condition and must:

- Be signed by all owners, and all owners must be alive.
- Be in the correct denominations, such as number of shares or par value of bonds.
- Have all attachments.
- Be accompanied by a uniform delivery ticket.

The owner of a security must endorse the certificate at the time of sale to ensure its negotiability or sign a stock or bond power, also known as a power of substitution. The stock power, when attached to the certificate, will make

it negotiable and includes an irrevocable power of attorney. All signatures must be accepted by the transfer agent. To ensure that the transfer agent accepts the signatures on certificates delivered by NYSE member firms, the NYSE started the Medallion Signature Guarantee Program, which allows NYSE members to stamp the certificates with a medallion rather than sign them. This stamp ensures that the transfer agent will accept the certificates for transfer and provides indemnification insurance for fraud. The Medallion Program members pay to participate.

Examples of invalid signatures are:

- The signature of a minor.
- The signature of a deceased person.
- The signature of only one owner if jointly registered.
- A forged signature.

## REJECTION OF DELIVERY

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The buying firm may reject the delivery of securities from the selling member if:

- The certificates are mutilated.
- The certificates are not in the proper denominations.
- All attachments are not present.
- The signatures are invalid.
- The signatures have not been guaranteed.
- The securities are delivered prior to settlement.
- The wrong securities are delivered.
- If the specific bond being delivered has been called and was not identified as being called at the time of the trade.

## RECLAMATION

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A broker dealer may return or demand the return of securities previously accepted for delivery through a process known as reclamation. A broker dealer using the reclamation process must make the demand by submitting a Uniform Reclamation Form to the contra broker dealer. The reasons for rejecting delivery listed above are also valid reasons for instituting the reclamation process.

## MARKING TO THE MARKET

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A broker dealer who has an open contractual commitment to another broker dealer will monitor the market value of the securities involved relative to the contract or trade price. This process is known as marking to the market. A broker dealer who is partially unsecured can issue a call or demand for more collateral. If a firm sends a mark to the market demand to another broker dealer, the demand must be met promptly.

### EXAMPLE

If a broker dealer borrows \$20,000 worth of securities for a customer who is executing a short sale for \$20,000 worth of ABC, the borrowing broker dealer would have to deposit \$20,000 with the lending broker dealer as collateral for the securities. If the market value of ABC increases to \$25,000, the broker dealer who loaned the securities may demand that the borrowing broker dealer deposit an additional \$5,000 as collateral. Alternatively, if the market value of ABC had fallen to \$15,000, the borrowing broker dealer may demand a return of \$5,000.

## CUSTOMER ACCOUNT STATEMENTS

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A customer must receive a statement every month in which there is activity in the account. All customers must receive account statements at least quarterly when there has been no activity in the account. Examples of activity include:

- Purchases and sales,
- Dividend and interest received.
- Interest charged.
- Addition or withdrawal of cash or securities.

Customer account statements must show:

- All positions in the account.
- All activity since the last statement.
- All credit and debit balances.

Brokerage firms are required to disclose their financial condition to their clients by sending them a balance sheet every six months or on the request of a customer with cash or securities on deposit.

## CARRYING OF CUSTOMER ACCOUNTS

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Not all brokerage firms maintain the physical possession of the customers' cash and securities. A brokerage firm that maintains the account of its customers and holds their cash and securities is known as a carrying firm, or a self-clearing member. A broker dealer may find it easier to have another member provide the clearing and custodial functions for its customers' accounts. This type of broker dealer is known as an introducing broker dealer. Anytime a clearing agreement is executed or amended it must be sent to FINRA for review. The clearing member must notify the introducing member of the reports it offers clearing members to monitor customer accounts when it executes the agreement and at least annually no later than July 31. Additionally, the introducing member must notify the clearing member of the reports it needs to supervise customer accounts. The introducing member forwards all cash and securities to the carrying or clearing member for deposit into the customers' accounts. The clearing firm sends the customers' statements and confirmations to the introducing firm's customers. If a firm clears all of their transactions on a fully disclosed basis, all customers of the introducing firm must be notified of the fact in writing when the account is opened. If the introducing broker is also a market maker, the clearing firm must stand behind all of the introducing firm's trades. An introducing member may also choose to clear its trades through an omnibus account maintained at the clearing firm. In this case, all transactions are cleared through one account, and the clearing member does not know for whom the trade was executed. The introducing member is required to send customer confirmations if they clear through an omnibus account. Omnibus accounts are not allowed to purchase securities on margin for customers. All securities must be paid for in full.

## DIVIDEND DISTRIBUTION

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If a corporation decides to pay a dividend to its common stockholders, it may not discriminate as to who receives the dividend. The dividend must be paid to all common stockholders of record. Existing stockholders do not need to notify the company that they are entitled to receive the pending dividend—it will be sent to them automatically. However, new purchasers of the stock may or may not be entitled to receive the dividend, depending on when they purchased the stock relative to when the dividend is going to be distributed. Let's now examine the dividend distribution process.

**DECLARATION DATE**

The declaration date is the day that the board of directors decides to pay a dividend to common stockholders of record. The declaration date is the starting point for the entire dividend process. The company must notify the regulators at the exchange or FINRA, depending where the stock trades, at least 10 business days prior to the record date.

**EX DIVIDEND DATE**

The ex dividend date, or the ex date, is the first day when purchasers of the security are no longer entitled to receive the dividend that the company has declared for payment. Stated another way, the ex date is the first day when the stock trades without (ex) the dividend attached. The exchange or FINRA set the ex date for the stock based on the record date determined and announced by the corporation's board of directors. Because it takes three business days for a trade to settle, the ex date is always two business days prior to the record date.

**RECORD DATE**

The record date is the day when investors must have their name recorded on the stock certificate in order to be entitled to receive the dividend that was declared by the board of directors. Stockholders whose names are on the stock certificates (owners of record) will be entitled to receive the dividend. The investor must have purchased the stock before the ex dividend date in order to be an owner of record on the record date. The record date is determined by the corporation's board of directors and is used to determine which shareholders will receive the dividend.

**PAYMENT DATE**

This is the day when the corporation actually distributes the dividend to shareholders, which completes the dividend process. The payment date is controlled and set by the board of directors of the corporation and is usually four weeks following the record date.

**STOCK PRICE AND THE EX DIVIDEND DATE**

It is important to note that the value of the stock prior to the ex dividend date reflects the value of the stock with the dividend. On the ex dividend date, the stock is now trading without the dividend attached, and new purchasers

will not receive the dividend that had been declared for payment. As a result, the stock price will be adjusted down on the ex dividend date in an amount equal to the dividend.

**EXAMPLE**

TRY declares a \$.20 dividend payable to shareholders of record as of Thursday, August 22. The ex dividend date will be two business days prior to the record date. In this case, the ex date will be Tuesday, August 20. If TRY closed on Monday, August 19, at \$24 per share, the stock would open at \$23.80 on Tuesday.

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

**DIVIDEND DISBURSEMENT PROCESS**

The corporation's dividend disbursement agent is responsible for the distribution of dividends and will send the dividends to the shareholders of record on the record date. Most investors, for convenience, have their securities held in the name of the broker dealer, also known as the street name. As a result, the dividend disbursement agent will send the dividends directly to the broker dealer. The broker dealer's dividend department will collect the dividends and distribute them to the beneficial owners. The dividend department also handles:

- Stock dividends
- Stock splits
- Bond interest payments
- Rights distributions
- Warrant distributions

 **TAKENOTE!**

It is fair and reasonable for a brokerage firm to charge a fee for the collection of dividends and other services as long as the fee is not excessive and is in line with the fees charged by similar firms.

## **DUE BILLS**

Should the wrong party receive a dividend or any other type of distribution, the buying broker dealer whose customer is owed the dividend will send a due bill to the selling broker for the amount of the dividend owed. In most cases, this would happen when the buyer purchased the stock just prior to the ex date and the security was delivered late to the buyer.

## **PROXIES**

Common stockholders have the right to vote on major corporate issues. Most stockholders, however, do not have the time to attend the meetings and must therefore vote using an absentee ballot, known as a proxy. The Securities Exchange Act of 1934 requires that all corporations that distribute proxies solicit votes from their shareholders. The corporation will send proxies to the shareholders of record. Stockholders who have their securities held in street name will have the proxies forwarded to them by the brokerage firm. The brokerage firm will then cast the beneficial shareholder's votes as indicated on the proxy as the shareholder of record. Proxies that have been signed and returned without indicating how to vote must be voted in accordance with the issuer's management's recommendation. If a shareholder fails to return the proxy to the member at least 10 days prior to the annual meeting, the member may vote the shares as it sees fit, as long as the matter is not of major importance. If the vote concerns a major issue, such as a merger, the member may never cast the votes. Member firms are required to forward proxies and other corporate communications, such as annual and quarterly reports, to the beneficial owner and the issuer is required to reimburse the member for reasonable expenses.

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# Pretest

## BROKERAGE OFFICE PROCEDURES

1. When hiring a new employee, the principal is responsible for all of the following, EXCEPT:
  - a. confirming the agent's employment for the last three years.
  - b. obtaining a U5 directly from the employee.
  - c. attesting to the character of the employee.
  - d. signing the U4 form prior to submission.
  
2. As it relates to influencing the employees of member firms, which of the following are true?
  - I. The gift may be given to the employee.
  - II. A record of the gift must be maintained by the employing firm.
  - III. The gift must be given to the employer for distribution.
  - IV. A contractual relationship is excluded from the rule.
  - a. I and IV
  - b. II and III
  - c. II, III, and IV
  - d. I, II, and IV

3. All of the following personnel are exempt from the registration requirement, EXCEPT:
- a. a manager who acts as a liaison between the firm and the board of directors.
  - b. a clerical employee.
  - c. the firm's Web designer, who posts information about the market conditions on the firm's website.
  - d. a sales assistant who occasionally accepts a customer's order.
4. As it relates to securities held in street name, which of the following are true?
- I. The corporation will send proxies to the broker dealer.
  - II. The corporation will not reimburse the broker dealer for forwarding the proxies.
  - III. The broker dealer may vote blank proxies any way it wishes.
  - IV. A shareholder who attends the annual meeting will have his or her proxies voided.
- a. I and III
  - b. II and III
  - c. I and IV
  - d. II and IV
5. A broker dealer that does not carry customer accounts is required to do all of the following, EXCEPT:
- a. clear all trades on an omnibus basis.
  - b. forward all securities to the carrying firm.
  - c. forward all checks to the carrying firm.
  - d. in the case of market making, have the carrying firm stand behind all trades.
6. All of the following are reasons to reject delivery, EXCEPT:
- a. the signatures are not guaranteed.
  - b. the customer has determined that the investment is unsuitable.
  - c. the certificate is unclear.
  - d. a bond is missing a coupon.

7. A security has been delivered late to the buying member after the record date for a dividend distribution. Which of the following is true?
- I. The seller will keep the dividend.
  - II. The buyer will be owed the dividend.
  - III. The buying member will send a due bill.
  - IV. The selling member will receive the dividend.
- a. I and II
  - b. II and III
  - c. I only
  - d. II, III, and IV
8. A customer who purchased 1,000 shares of XYZ on margin two months ago and has not executed any order since:
- a. must receive a statement this month.
  - b. does not need to receive a statement this month.
  - c. must receive a statement for the last two months only.
  - d. should have received a statement for the last two months and must receive one this month as well.
9. A brokerage firm may charge a fee for which of the following?
- I. The safekeeping of securities
  - II. The collection of dividends
  - III. Lack of activity in the account
  - IV. The clipping of coupons
- a. I and II
  - b. II and III
  - c. I, II, and IV
  - d. I, II, III, and IV
10. A wealthy customer has just made a purchase in a margin account. The account has substantial assets. The brokerage firm, as a courtesy to the client, may ignore a call for cash for up to:
- a. \$1,000.
  - b. \$10,000.
  - c. \$5,000.
  - d. \$500.

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