Trading Securities I

Role of Persons

SEC
The Securities and Exchange Commission is made up of five Commissioners that are appointed by the President and confirmed by the Senate. The Securities and Exchange Commission oversees all of the securities industry in the United States including SROs such as FINRA, the CBOE, and the MSRB.

SROs
Self-regulatory organizations (SROs) are non-governmental organizations that are tasked with establishing rules for their industry and overseeing their members. FINRA, the CBOE, and the MSRB are all SROs.

MSRB
The Municipal Securities Rulemaking Board (MSRB) is the self-regulatory organization for the municipal securities industry. The MSRB makes rules for the municipal industry but does not have enforcement authority. FINRA enforces MSRB rules.

FINRA
FINRA is an SRO (self-regulatory organization). FINRA handles arbitration disputes, registration of registered representatives, and written complaints. FINRA enforces FINRA's rulebook.

Securities Exchange Act of 1934
The Securities Exchange Act of 1934 governs the secondary market including broker/dealers, transfer agents, stock exchanges, and the OTC market (People Act).

NYSE
The NYSE is a secondary market in the United States. A secondary market is where outstanding securities trade hands, shareholder to shareholder. The NYSE has a physical trading floor. The NYSE historically has been an auction-based marketplace with specialists on the floor. Today, the NYSE functions as a hybrid marketplace, maintaining a physical floor but also with some trading occurring electronically.

Specialist
It is the job of the specialist to maintain a fair and orderly market on the floor of the exchange. They are a dealer that works on the floor of the exchange, matching buyers and sellers for one or more company's stocks, but also ready and able to buy and sell out of their own account ensuring liquidity in the market. Floor brokers represent client orders only on the floor of the exchange. Today, we call the specialists designated market makers.

NASDAQ
The NASDAQ (OTC) market is a secondary market in the United States. It is a negotiated market, with the trading occurring electronically. The NASDAQ has market makers, these market makers primarily trade with each other.

CBOE
The CBOE is the Chicago Board Options Exchange, it is where listed options trade. Today it is part of Cboe Exchange, a publicly-traded company that operates multiple securities exchanges in the U.S. The Cboe Exchanges are overseen by the SEC. The CBOE is also a self-regulatory organization with its own rules and regulations.

OCC
In 1975 the Cboe Clearing Corporation became The Options Clearing Corporation. By acting as guarantor, the Options Clearing Corporation ensures that the obligations of the options contracts it clears are fulfilled. The OCC operates under the jurisdiction of both the SEC and the CFTC, offering clearing and settlement services for transactions in options, security futures, OTC options, and options on futures. The OCC is the world's largest equity derivatives clearing organization.

Underwriter
The underwriter is the investment banking firm that takes a company public or is involved in selling additional shares to the public. Underwriters are also used in getting debt issues to market. The underwriter does not take an inventory position in the company it is representing.

Broker/Dealer
In a principal transaction, the broker/dealer is acting for the firm, the dealer side. When a broker/dealer is trading for their own account we say they are acting as a dealer, or as a market maker. It is the market maker (dealer or principal) that buys or sells securities to/from clients out of their own account. The broker/dealer must disclose their capacity on the trade confirmation.

When the broker/dealer acts like a broker they are simply buying and selling securities for their clients and charging a commission for those transactions. Broker/dealers acting for their clients charge a commission. This commission is charged by the broker side of broker/dealer. When the broker/dealer buys and sells securities for the clients they are acting as an agent, in an agency capacity.

Market Maker
The market maker is the dealer who takes an inventory position in a security, in a principal transaction. It is the dealer side of broker/dealer. When a market maker buys or sells from the firm's account with a public customer, they charge a markup or markdown. Market makers make the NASDAQ market. Being a market maker is risky.

Investment Advisers
Investment advisers charge a fee to manage clients' assets. It does not matter whether the fee comes in the form of commissions or a percentage of assets under management.

FDIC
The FDIC (Federal Deposit Insurance Corporation) protects customers of insolvent banks. The protection provided is $250,000 per separate customer, per bank.

SIPC
All broker/dealers must be members of the Securities Investor Protection Corporation (SIPC). SIPC protects clients if their broker/dealer goes broke. Coverage is $500,000 per separate customer, of which up to $250,000 may be in cash. SIPC coverage does not apply to mutual fund accounts or issuer insolvency. SIPC never guarantees performance.

DTCC
The Depository Trust and Clearing Corporation (DTCC) processes almost 100 million financial transactions each day. The DTCC serves as a centralized clearinghouse for more than 50 exchanges. The Depository Trust Company (DTC) is one of the many subsidiaries of the DTCC. The DTC provides clearing and settlement efficiencies to the securities industry.

Blue Sky Laws
State securities regulators, also called Administrators, are responsible for enforcing state securities laws, including the Uniform Securities Act. Securities to be sold in a state must be registered in that state. Blue Sky laws refer to state securities laws and regulations. State laws are passed by the state legislature as statutes. State regulations consist of a body of rules passed by the state securities Administrator over a period of time.

Administrator
A new public issue of stock must be registered with the SEC and every state securities Administrator where sales will take place. To "blue sky" an issue means to register it with the state securities Administrator.

NASAA
The Administrator is a member of NASAA, North American Securities Administrators Association.

Accredited Investor
The definition of accredited investor is found under Regulation D, Rule 251. There are a few ways an individual can meet the definition of accredited investor: adjusted gross income, net worth, or by holding specific securities licenses. The AGI requirement, if single, is an adjusted gross income of greater than $200,000 in the previous two years, and reasonably expected to be so this year, or greater than $300,000 if married filing jointly. Alternatively, an accredited investor can qualify based on a net worth of greater than $1,000,000, excluding the value of their primary residence and any related debt. The net worth calculation includes the financial assets of the client and their spouse or spousal equivalent. A person can also meet the definition of an accredited investor if they hold in good standing a Series 7, Series 65, or Series 82 license.

Retail investors are individual investors who are not financial professionals. Institutional investors include persons and organizations that trade large quantities of securities. Institutional investors include insurance companies, mutual fund companies, hedge funds, private funds, and broker-dealers.

The term accredited investor may also include banks, savings and loans, investment companies, employee benefit plans, private development companies, limited liability companies, SEC- and state-registered investment advisers, rural business investment companies (RBIC), and any organization that was not formed primarily for the purpose of buying securities that have total assets in excess of $5 million. Entities, including Indian tribes, governmental bodies, funds, and entities organized under the laws of foreign countries, that own investments in excess of $5 million that was not formed for the specific purpose of buying securities. Family offices with at least $5 million in assets under management and their family clients also qualify as accredited investors.

Treasury Department
The U.S. Department of the Treasury's mission is to maintain a strong economy and create economic and job opportunities in the United States. The Department of the Treasury is also responsible for strengthening national security by combating threats and protecting the integrity of the U.S.'s financial system. FinCEN, the Financial Crimes Enforcement Network, is a bureau located within the Department of the Treasury. The Department of the Treasury manages the U.S. Government's finances and resources,

including the collection of taxes through the Internal Revenue Services, the largest bureau within the Treasury.

FinCEN

The Financial Crimes Enforcement Network (FinCEN) supports law enforcement investigative efforts against domestic and international financial crimes. FinCEN is one of the Treasury Department's primary agencies to oversee and implement policies to prevent and detect money laundering.

IRS

The IRS (Internal Revenue Service) is responsible for determining, assessing, and collecting internal revenue in the United States.

Federal Reserve

The Federal Reserve System is the central bank of the United States. It was established to serve the public interest. The Federal Reserve has five general functions designed to promote the effective operation of the U.S. economy:

- Conduct the nation's monetary policy
- Promote the stability of the financial system
- Promote the safety and soundness of the individual financial institutions
- Foster payment and settlement system safety and efficiency, and
- Promote consumer protection through the administration of consumer laws and regulations.

Introducing Firm

Introducing broker-dealers accept client orders to buy and sell securities, but do not have custody of client assets. Introducing firms have arrangements with carrying firms to maintain custody of client assets.

Clearing firm (carrying firm)

Clearing firms are also known as carrying broker-dealers. They carry clients' assets and clear trades for introducing broker-dealers.

Prime Brokers

Prime brokers are investment banking firms that offer hedge funds a bundle of services. Services offered by prime brokers include securities lending and margin financing. The prime broker is the intermediary between the hedge fund and those institutions with securities to lend (pension funds, mutual funds, insurance companies), allowing the hedge fund to short shares. The prime broker is also the middleman between the hedge fund and the commercial bank that has money to lend, allowing the hedge fund to buy securities on margin.

Municipal Advisors

Municipal advisors specialize in providing advice on bond sales and other financial products used by state and local governments, agencies, and obligated persons. The Securities Exchange Act defines the term municipal advisor to mean a person that provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters or undertakes a solicitation of a municipal entity. An obligated person generally means any person, including an issuer of municipal securities, committed to supporting the payments on the municipal securities to be sold in an offering.

Custodian

A custodian is responsible for the safekeeping of securities. The Investment Company Act of 1940 requires all investment companies to have a custodian to safeguard the assets of the investment companies. Commercial banks often provide custodial duties. Federally registered investment advisers who have custody as part of their contract must use a qualified custodian to safeguard their client assets.

Trustee

The trustee is the person responsible for managing the assets of a trust. The trustee may be anyone of legal age and sound mind. The trustee must manage the assets for the benefit of the beneficiary or beneficiaries. The trustee must follow the investment policy statement when making investment decisions. The trustee is also required to follow the Uniform Prudent Investor Act when managing trust assets.

Transfer Agent

The transfer agent keeps track of who owns shares of a publicly-traded company. Transfer agents work for the security issuer. They record changes of ownership, maintain the issuer's security holder records, cancel and issue certificates, and distribute dividends.

It is the duty of the mutual fund transfer agent to issue and redeem open-end mutual fund shares. The transfer agent also distributes capital gains and dividends to the mutual fund shareholders and sends out the annual 1099.

Transfer agents are often trust companies or banks. Transfer agents are required to be registered with the SEC, or if the transfer agent is a bank, with a bank regulatory agency.

Primary Market

When an issuer has an initial public offering it enlists the help of brokerage firms, commonly called investment bankers or underwriters. The very first time shares of stock are sold in an initial public offering they trade in the primary market. Primary market transactions are also called issuer transactions. Shares trade one time in the primary market. After the new shares trade in the primary market, they next trade in the secondary market. Primary market transactions must be sold with a prospectus. When new shares of stock are sold, they are sold at a set price.

Secondary Market

Non-issuer transactions are shareholder to shareholder. Non-issuer transactions take place in the secondary market. When shares trade in the secondary market they are traded at the going market price. The NYSE and the NASDAQ are examples of the secondary market.

Third Market

In the third market, exchange-listed securities are traded over-the-counter between broker-dealers and large institutional investors.

Fourth Market

The fourth market is a private over-the-counter network where institutions trade securities off the market. There are no broker-dealers in the fourth market. Dark pools are fourth markets. They are private exchanges that trade exclusively between institutional clients with little transparency to the public market.