

# Chapter One

## Definition of Terms

### Introduction

In order to successfully complete the Series 66 exam, it is important to have an in-depth understanding of the terms used within the securities industry—specifically within the framework of the Uniform Securities Act. The terms used by the USA, also known as The Act, may have broader meanings than we are accustomed to in everyday usage.

### Security

A security is anything that can be exchanged for value that involves a risk to the holder. A security also represents an investment in an entity managed by a third party. The Howey Test was used by the Supreme Court to determine a security, and states that a security must meet the following four characteristics. It must:

- ✓ Be an investment of money
- ✓ Involve a common enterprise
- ✓ Give the investor an expectation of a profit
- ✓ Entail the management of a third party

The following are examples of securities:

- ✓ Stocks
- ✓ Bonds
- ✓ Notes
- ✓ Debentures
- ✓ Evidence of indebtedness
- ✓ Transferable shares
- ✓ Warrants, rights, or options for securities

Most times when you see the term “certificate,” you have a security that is a:

- ✓ Certificate of interest in profit sharing or a partnership agreement
- ✓ Preorganization certificate
- ✓ Collateral trust certificate
- ✓ Voting trust certificate
- ✓ Certificate of interest in oil or a gas mining title
- ✓ Certificate of deposit for a security such as an American depository receipt (ADR) or an American depository share (ADS)

The term “variable” will also identify a security, as in:

- ✓ Variable annuity
- ✓ Variable life insurance
- ✓ Variable contract

The phrase “interest in” is another key to identifying a security on the Series 66 exam. All of the following are securities:

Interest in:

- ✓ Farmland and animals
- ✓ Whiskey warehouse receipts
- ✓ Commodity options (not futures)
- ✓ Insurance company separate accounts
- ✓ Real estate condominiums or cooperatives
- ✓ Merchandise marketing programs, franchises, or schemes
- ✓ Multilevel distributorships such as Amway

The term “option” is also a good way to identify a security, such as:

- ✓ Stock option
- ✓ Index option
- ✓ Futures option
- ✓ Commodity futures option

The following are not considered securities:

- ✓ Real estate
- ✓ Retirement plans (IRAs and 401(k)s)
- ✓ Bank accounts
- ✓ Collectibles
- ✓ Precious metals
- ✓ Fixed annuities/fixed contracts
- ✓ Whole and term life policies
- ✓ Antiques
- ✓ Futures contracts (commodities)
- ✓ Trade confirmations
- ✓ Prospectuses

The term “future” as it appears alone is an indication that a security is not involved. If the question is asking about a commodity future option, however, then a security is involved. Also the term “fixed” is a good indication that a security is not involved.

## **Person**

The term “person” as it is used in the USA, refers to any entity that may enter into a legally binding contract. Any entity that can enter into a legally binding contract may transact business in the securities markets. Agreeing to buy or sell a security represents a legally binding contract. For the Series 66, a person is any of the following:

- ✓ Natural person
- ✓ Corporation
- ✓ Trust
- ✓ Government organization
- ✓ Partnership
- ✓ Joint stock company
- ✓ Sole proprietor
- ✓ Association
- ✓ Unincorporated organization

A non-person is an individual or entity that may not enter into a legally binding contract and therefore may not transact business in the securities market. A non-person is:

- ✓ A minor
- ✓ Someone deemed to be legally incompetent
- ✓ A deceased individual

## **Broker Dealer**

A broker dealer is a person or a firm that maintains a place of business and affects transactions in the securities markets for its own account or for the account of others. A broker dealer must be registered in its home state as well as in the states of its “individual” clients.

A broker dealer is not:

- ✓ An agent
- ✓ A bank
- ✓ A savings and loan
- ✓ A person with no place of business in the state, who deals exclusively with financial institutions or issuers
- ✓ A person who conducts business with existing clients who do not reside in the state and are in state for less than 30 days

## **Agent**

An agent or Registered Representative may only be an individual who represents the issuer or a broker dealer in the purchase and sale or the attempted purchase and sale of securities with the public. Agents are required to register in their home state, their state of employment, and the state of residence of their customers.

An agent is not required to register if:

- ✓ They represent the issuer or a broker dealer in an underwriting transaction
- ✓ They represent a bank or a savings and loan in the issuance of securities

Agents who represent exempt issuers are not required to register. Examples of exempt issuers are:

- ✓ U.S. Government
- ✓ State and municipal governments
- ✓ Canadian federal and municipal governments
- ✓ Commercial paper with maturities of less than 270 days, sold in denominations exceeding \$50,000
- ✓ Investment contracts associated with employee pension plans, profit sharing, stock purchase, or savings plans
- ✓ Foreign national governments recognized by the United States

## **Issuer**

An issuer is any person that issues or simply proposes to issue a security. Issuers include:

- ✓ Corporations
- ✓ U.S. government and agencies
- ✓ State and local governments

In an issuer or primary transaction, the issuer receives the proceeds from the sale.

## **Non-Issuer**

A non-issuer is anyone who does not issue or propose to issue a security. All secondary market transactions that take place on an exchange or in the over-the-counter (OTC) market are non-issuer transactions, and the selling security holder receives the proceeds from the sale.

## **Investment Adviser**

An investment adviser is any person who is actively involved in and receives a fee for any of the following:

- ✓ Issuing research reports or analysis
- ✓ Publishing a market letter based on market developments or conditions
- ✓ Advising clients as to the advisability of the purchase or sale of a security
- ✓ Providing investment advisory services as a complement to their services and claiming to provide such services for a fee
- ✓ Presenting themselves as investment advisers, also known as the Shingle Rule
- ✓ Individuals who provide advice about selecting portfolio managers or asset allocation.
- ✓ Nationally recognized statistical ratings organizations such as Moody's

An investment adviser is not:

- ✓ A bank or savings and loan
- ✓ A broker dealer
- ✓ An agent
- ✓ A lawyer, accountant, teacher, engineer (LATE) whose services are incidental to their business and who do not receive a specific fee for such services
- ✓ Any person exempted by the administrator or SEC
- ✓ Individuals who only provide advise relating to government securities
- ✓ Publishers of newspapers and magazines
- ✓ Securities information processors

## **Investment Adviser Representative**

An investment adviser representative is a person who is under the control of the investment adviser and includes:

- ✓ Officers and directors
- ✓ Partners
- ✓ Solicitors
- ✓ Supervisors

Clerical employees are not considered investment advisory representatives and are not required to register.

### **Institutional Investor**

An institutional investor is a person or firm that trades securities for his or her own account or for the account of others. Institutional investors are generally limited to large financial companies. Because of their size and sophistication, fewer protective laws cover institutional investors. It is important to note that there is no minimum size for an institutional account. Institutional investors include:

- ✓ Broker dealers
- ✓ Investment advisers
- ✓ Investment companies
- ✓ Insurance companies
- ✓ Banks
- ✓ Trusts
- ✓ Savings and loans
- ✓ Government agencies
- ✓ Employment benefit plans with more than \$1,000,000 in assets

### **Accredited Investor**

An accredited investor is an individual who meets one or more of the following criteria:

- ✓ Has a net worth of \$1,000,000
  - *or*
- ✓ Earns \$200,000 per year or more for the last two years and has the expectation of earning the same in the current year
  - *or*
- ✓ Is part of a couple earning \$300,000 per year or more

### **Qualified Purchaser**

A qualified purchaser must meet strict minimum financial requirements. Securities sold to qualified purchasers are not required to register in the state where the qualified purchaser resides. A qualified purchaser is:

- ✓ An individual with at least \$5,000,000 in investments
- ✓ A family owned business with at least \$5,000,000 in investments
- ✓ A trust sponsored by qualified purchasers

### **Private Investment Company**

A private investment company is an unregistered investment company or hedge fund that raises funds through the sale of securities to qualified purchasers for any business purposes.

### **Offer/Offer to Sell/Offer to Buy**

An offer is any attempt to solicit the purchase or sale of a security for value. An offer is considered to have been made in the state where the offer originated, as well as in the state where it is received or directed. An offer will not be considered to have been made if it was received through a television or radio broadcast originating outside the state. Additionally, an offer will not be considered to have been made if received by a newspaper or magazine published out of the state or by a magazine published in state that has two-thirds of its paid circulation outside of the state.

### **Sale/Sell**

To sell a security, its ownership must be conveyed for value. A sale is considered to have been made at the time of the contract (trade). A sale of a security that has warrants or a right attached is also considered a sale of the attached security. A sale of any security that is convertible or exercisable into another security is considered to include a sale of the security for which the security is convertible or exercisable. A gift of assessable stock is also considered a sale. Assessable stock is stock that may require the holder to make additional payments as a term of ownership. A sale does not include a dividend or the pledge of a security for a collateral loan.

### **Guarantee/Guaranteed**

The term guarantee means that another party, other than the issuer of the security, has guaranteed the payment of principal, interest, or dividends. Only three parties may guarantee something. They are:

- ✓ U.S. government
- ✓ Insurance company
- ✓ Parent company—they may guarantee obligations of a subsidiary

### **Contumacy**

Contumacy is the willful display of contempt for the administrator's order. An act of contumacy may result in the agent's or firm's registration being revoked or other disciplinary action.