



Investment Adviser vs. Broker/Dealer

Description	Investment Adviser (IA)	IAR	Broker/ Dealer (BD)	Agent
Type	Firm	Natural Person	Firm	Natural Person
Role	Investment advice for a fee	Partner, director, officer, or individual associated with IA	(B) Trades on behalf of others (D) Trades on their own behalf	Represents BD or Issuer
Tasks	Advises others about purchase and sale of securities	Gives securities recommendations, manages client accounts	Facilitates securities trades for themselves or others	Effects securities trades
Compensation	Advisory fees	Salary or fee based	(B) Commission (D) Markup	Salary and/or Commission
Registration Location	SEC or State, but not both	State only	FINRA member and at least one state	At least one state
Records Retention	5 Years	5 Years	3 Years	3 Years
Miscellaneous	Fiduciary	Fiduciary	(B) Agent (D) Principal and Market Maker	Registered Representative



Not Required to Register With SEC

Not an Investment Advisor	Investment Advisor That is Exempt	Register with State Instead
Bank or Bank Holding Company Lawyer, engineer, teacher, or accountant - incidental Broker/Dealer receiving no special compensation Publisher of general circulation publication Advice solely on U.S. government securities	Clients are all residents of advisor's home state (No advice on securities on national exchange) Only insurance company clients Less than 15 clients Director, employee, or volunteer of charity Commodity trading advisor	Assets under management (AUM) < \$100 million AUM \$100-\$110 million - can choose state registration

Register With SEC

- Principal office in Wyoming
- Principal office outside U.S.
- Registered investment companies
- Rating organizations
- Internet investment advisers
- Pension consultants - plan has >\$200 million in assets
- Start-up advisors



Securities - Not Required to Register With State

Not a Security	Exempt Security	Exempt Transaction
Fixed insurance products	Federal covered securities	Isolated nonissuer transactions (<5 trades)
Fixed annuities	U.S. or Canadian government/municipal securities	Unsolicited brokerage transactions (initiated by client)
Collectibles	Foreign government securities	Underwriter transactions
Currency	Securities issued by banks and credit unions	Private placements <=10 persons
Commodities and commodities futures	Stocks/bonds issued by insurance companies	Institutional investor transactions
Condo used as a personal residence	Public utility securities	Offers to existing shareholders
	Securities issued by nonprofit organizations	Real estate mortgages or deeds
	Securities issued for retirement plans	Nonissuer transactions
	Municipal bonds sold outside state of original issue	Transactions made by fiduciaries (executors)
	Promissory notes of >=\$50,000, <=9 month maturity	
	Commercial paper	

Exclusions From Offer to Sell Securities

Gift of nonassessable stock
Stock dividend
Pledging stock as collateral for a loan
Merger, reorganization, or bankruptcy



Federal Liability

Investment Adviser
-Fiduciary-

Broker-Dealer
-Suitability-

Securities Act of 1933
-Anti-Fraud Provisions-

Securities Exchange Act of 1934
-Anti-Fraud Provisions-

Investment Advisers Act
of 1940

-Fiduciary-
1) Duty of Loyalty
Disclosure
Good Faith
Avoid Conflicts
2) Duty of Care
Diligence

FINRA

-Not Fiduciary-
Know Client
Suitability

Dodd-Frank



ABC Company GAAP Financial Statements

GAAP Balance Sheet December 31, 20xx

Assets		
Current Assets		
Cash	A	50,000
Accounts Receivable		125,000
Inventory		1,500,000
Marketable Securities		25,075,000
Non-Current Assets		
Buildings & Equipment		300,000,000
Less: Accumulated Depreciation		(10,000,000)
Intangible Assets		5,000,000
Total Assets		321,750,000
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts Payable		6,250,000
Short-Term Debt		4,000,000
Non-Current Liabilities		
Long-Term Debt		200,000,000
Total Liabilities		210,250,000
Shareholders' Equity	F	111,500,000
Total Liabilities and Equity		321,750,000

GAAP Cash Flow Statement For the Year Ended 12/31/20XX

Cash Flow From Operating Activities		
Net Income	B	28,275,000
Add/Deduct Items Not Affecting Cash		
Depreciation Expense	C	3,000,000
Change in Receivables/Payables		320,000
Change in Inventories		(1,125,000)
Cash From/For Operating Activ.		30,470,000
Cash Flow From Investing Activities		
Additions to Buildings/Equipment		(32,750,000)
Cash From/For Investing Activ.		(32,750,000)
Cash Flow From Financing Activities		
Proceeds From Debt Issue		750,000
Proceeds From Stock Issue	G	6,000,000
Purchase of Treasury Stock	E	(1,250,000)
Dividends Paid to Shareholders	D	(3,500,000)
Cash From/For Financing Activ.		2,000,000
Increase (Decrease) in Cash		(280,000)
Cash, Beginning of Year		330,000
Cash, End of Year	A	50,000

GAAP Income Statement For the Year Ended 12/31/20XX

Sales		350,000,000
Cost of Goods Sold		(250,000,000)
Gross Profit		100,000,000
General Operating Expenses		
Advertising		(6,000,000)
Office Expense		(29,000,000)
Depreciation Expense	C	(3,000,000)
Operating Income		62,000,000
Other Income and Expenses		
Investment Income		1,500,000
Interest Expense		(20,225,000)
Income Taxes		(15,000,000)
Net Income	B	28,275,000

GAAP Comprehensive Income

Net Income	B	28,275,000
Other Comprehensive Income		
Unrealized Appreciation		(11,500,000)
Foreign Currency Translation		750,000
Minimum Pension Liability		(2,250,000)
Comprehensive Income		15,275,000

GAAP Changes in Shareholders' Equity For the Year Ended 12/31/20XX

Paid-in Capital:		
Beginning Balance (Jan 1)		19,105,000
Common Stock Issued	G	6,000,000
Ending Balance (Dec 31)		25,105,000
Retained Earnings:		
Beginning Balance (Jan 1)		61,845,000
Net Income	B	28,275,000
Shareholder Dividends	D	(3,500,000)
Ending Balance (Dec 31)		86,620,000
Accumulated Other Comprehensive Income:		
Beginning Balance (Jan 1)		14,525,000
Other Comprehensive Income		(13,000,000)
Ending Balance (Dec 31)		1,525,000
Treasury Stock:		
Beginning Balance (Jan 1)		(500,000)
Repurchase of Shares	E	(1,250,000)
Ending Balance (Dec 31)		(1,750,000)
Shareholders' Equity (Dec 31)	F	111,500,000



Financial Ratios

Profitability Ratios	Measure
Net Profit Margin $\frac{\text{Net Income}}{\text{Sales}}$	Amount of each sales dollar remaining after deducting all expenses for the period
Return on Equity $\frac{\text{Net Income}}{\text{Shareholders' Equity}}$	How profitable the company is relative to shareholder investment

Liquidity Ratios	Measure
Current Ratio $\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Ability to meet current liabilities with current assets
Acid-Test (Quick) Ratio $\frac{\text{Current Assets} - \text{Inventory}}{\text{Current Liabilities}}$	Ability to pay current liabilities with cash and liquid assets (excludes inventory)

Debt Ratios	Measure
Debt-to-Equity $\frac{\text{Long-Term Debt}}{\text{Shareholders' Equity}}$	Extent company is using debt versus its own funds
Debt-to-Assets $\frac{\text{Total Liabilities}}{\text{Total Assets}}$	Percentage of assets financed by debt

Market-Price-Based Ratios	Measure
Price-Earnings $\frac{\text{Price Per Share}}{\text{Earnings Per Share}}$	How much investors are willing to pay per dollar of earnings
Price-to-Sales $\frac{\text{Price Per Share}}{\text{Sales Per Share}}$	How much an investor is paying for a revenue stream
Price-Earnings-Growth $\frac{\text{Price-Earnings Ratio}}{\text{Projected Growth Rate of Earnings}}$	More complete picture than the P/E ratio
Price-to-Book $\frac{\text{Price Per Share}}{\text{Book Value Per Share}}$	Compares market price to book value per share



Option Summary

	Long Call	Short Call	Long Put	Short Put
Action	Purchase	Sale	Purchase	Sale
Max Gain	Unlimited	Premium received	Exercise price less premium	Premium received
Max Loss	Premium paid	Unlimited (if naked)	Premium paid	Exercise price less premium
Price Desire	Rise	Decline	Decline	Rise

Types of Orders

	When Trade Occurs	Example
Market	Immediately	Sell 1,000 shares immediately
Limit	At a given price or better	Security trading at \$30, sell if increases to \$40 or more
Stop	Once price reaches a specified stop price	Security trading at \$30, sell if drops to \$29
Stop Limit	Combines features of a stop order and a limit order	Security trading at \$30, sell if drops to \$29 but not below \$28



Summary of Life Insurance

Term Insurance					
Description	Protection Period	Premium	Cash Value	Death Benefit	Considered Security
Term	-Temporary	-Increases with each renewal	-None	-Level -Nonlevel: increasing or decreasing	-No
Yearly Renewable	-Annual	-Increases annually	-None	-Level -Nonlevel: increasing or decreasing	-No

Whole Life Insurance					
Description	Protection Period	Premium	Cash Value	Death Benefit	Considered Security
Ordinary	-Permanent	-Fixed -Payable for life	-Guaranteed -Scheduled	-Fixed -Level	-No
Limited-Pay	-Permanent	-Fixed -Payable for specified period	-Guaranteed -Scheduled	-Fixed -Level	-No
Variable	-Permanent	-Fixed -Level	-Based on investment performance -No guarantee -Investment choice	-Based on investment performance -Cannot decrease below face value	-Yes -Prospectus required
Universal	-Permanent	-Complete flexibility after first year	-Guaranteed minimum interest rate -Excess interest -Withdrawals allowed	-Option A: Level -Option B: Increasing	-No
Variable Universal	-Permanent	-Complete flexibility after first year	-Based on investment performance -No guarantee -Investment choice -Withdrawals allowed	-Based on cash value -No guarantee -Adjustable	-Yes -Prospectus required



Forms of Doing Business

	Business Form					
Characteristic	Proprietorship	General Partnership	Limited Partnership (LP)	C Corporation	S Corporation	Limited Liability Company (LLC)
Owners	Sole Proprietor	General Partners	At least one General Partner, and one Limited Partner	Shareholders	Shareholders	Members
Liability	Unlimited	Unlimited	Unlimited for General Partners, limited for Limited Partners	Limited for all Shareholders	Limited for all Shareholders	Limited for all Members
State Filing Required	No	No	Yes	Yes	Yes	Yes
Taxation	Flow-through	Flow-through	Flow-through	Entity pays its own tax	Flow-through	Generally flow-through
Tax Filing	Schedule C (Form 1040)	Form 1065 (Partners receive Schedule K-1)	Form 1065 (Partners receive Schedule K-1)	Form 1120	Form 1120S (Shareholders receive Schedule K-1)	Generally Schedule C or Form 1065 required
Salary Paid to Owner-Employee	No	Yes - Guaranteed Payment to General Partner	Yes - Guaranteed Payment to General Partner	Yes	Yes	Depends on income tax treatment elected
Formation	Tax-free, since no assets change ownership	Cash and Property contributions are tax-free to partner	Cash and Property contributions are tax-free to partner	Cash and Property contributions are tax-free to shareholder if he/she controls corporation after contribution	Cash and Property contributions are tax-free to shareholder if he/she controls corporation after contribution	Depends on income tax treatment elected; generally formation is tax-free
Management	Sole Proprietor manages the business	General Partners manage the business	General Partners manage the business; Limited Partners are passive investors	Board of Directors, Officers manage the business	Board of Directors, Officers manage the business	Managing Members manage the business
Raising Capital	Difficult; can only be accomplished through borrowing	Difficult; can be accomplished by taking on new partners, which may be undesirable	Easy; can raise capital by selling limited partnership interests	Easy; can raise capital by selling shares of stock	Somewhat Difficult; can raise capital by selling shares of stock, but limits on number and types of shareholders	Easy; can raise capital by selling LLC interests



Retirement Plan Summary Chart

Qualified Plans		Tax-Advantaged Plans	Nonqualified Plans
Pension Plans	Profit Sharing Plans		
Defined Benefit Plan (P)	Profit Sharing Plan	SEP	Salary Reduction Plan (EE)
Cash Balance (P)	Stock Bonus Plan	SIMPLE IRA (EE)	Section 457 Plan
Target Benefit Plan	ESOP	Traditional IRA	
Money Purchase Plan	401(k) Plan (EE)	Roth IRA	
	Age-Based Profit Sharing Plan	403(b) Plan (EE)	

Blue – Defined Benefit Plan (Employer Bears Investment Risk)
 Red – Defined Contribution Plan (Employee Bears Investment Risk)
 Green – Individual Retirement Account (No Loans Allowed)
EE - Allows Employee Contributions
P - Requires PBGC Insurance



Performance Measures		
Description	Formula	Overview
Sharpe Ratio	$S_i = \frac{r_p - r_f}{\sigma_p}$	Uses Standard Deviation Not an absolute measure Use when important to consider total risk, not just exposure to systematic risk
Treynor Ratio	$T_i = \frac{r_p - r_f}{B_p}$	Uses Beta Not an absolute measure Use when overall portfolio is allocated to multiple active managers
Alpha	$\alpha_j = R_i - [R_f + \beta_{iM} (R_m - R_f)]$	Uses Beta If positive, investment outperformed market Absolute measure

General Return Measures		
Description	Formula	Overview
Holding Period Return	$\frac{\text{Income} + (\text{End of Period Value} - \text{Initial Value})}{\text{Initial Value}}$	What you made over what you paid Measures return for entire period asset held Can be negative
Arithmetic Mean Return	$\bar{r}_{AM} = \sum_{i=1}^n \frac{r_i}{n}$	Measures return as a simple average Overstates return More than Geometric Mean Return
Time-weighted Return	N/A for exam	Geometric Mean Return Used by fund managers Ignores interim cash flows
Dollar-weighted Return	N/A for exam	Internal Rate of Return Equates PV of cash flow to investment Used by investors (not fund managers)
Expected Return Using CAPM	$R_a = R_f + \beta(R_m - R_f)$	Uses beta in calculation Used in Alpha calculation