Contents

ABOUT THE SERIES 4 EXAM	XIII
ABOUT THIS BOOK	XVII
ABOUT THE TEST BANK	XIX
ABOUT THE SECURITIES INSTITUTE OF AMERICA	XXI
CHAPTER 1 OPTION BASICS	1
Option Classification	1
Option Classes	2
Option Series	2
Bullish vs. Bearish	2
Possible Outcomes for an Option	3
Characteristics of All Options	4
Managing an Option Position	4
Buying Calls	5
Selling Calls	6
Buying Puts	8
Selling Puts	9
Option Premiums	11
Intrinsic Value and Time Value	13
Pretest	15

vi Contents

CHAPTER 2 OPTION STRATEGIES	19
Using Options as a Hedge	19
Long Stock Long Puts/Married Puts	19
Long Stock Short Calls/Covered Calls	22
Ratio Call Writing	24
Short Stock Long Calls	24
Short Stock Short Puts	27
Multiple Option Positions and Strategies	29
Long Straddles	29
Short Straddles	32
Selling a Straddle Against Long Stock	34
Spreads	35
Analyzing Spreads/Price Spreads	36
Bull Call Spreads/Debit Call Spreads	37
Spread Premiums Bull Call Spread	38
Selling a Straddle Against Long Stock Spreads Analyzing Spreads/Price Spreads Bull Call Spreads/Debit Call Spreads Spread Premiums Bull Call Spread Bear Call Spreads/Credit Call Spread Bear Put Spreads/Debit Put Spreads	39
Spread Premiums Bear Call Spread	41
Bear Put Spreads/Debit Put Spreads	41
Spread Premiums Bear Put Spread	43
Bull Put Spreads/Credit Put Spreads	43
Spread Premiums Bull Put Spread	45
Condor Spreads	47
Combinations	49
Collars	49
Synthetic Risk and Reward	50
Using a T Chart to Evaluate Option Positions	51
Pretest	57
CHAPTER 3 INDEX, INTEREST RATE, AND CURRENCY OPTIONS	61
Index Option Settlement	61
Exercising an Index Option	62

Index Option Positions	63
Capped Index Options	63
Interest Rate Options	64
Price-Based Options	64
Premiums Price-Based Options Treasury Notes and Bonds	64
Premiums Price-Based Options Treasury Bills	65
Rate-Based Options	65
Currency Markets	66
Spot Rates	66
Foreign Currency Options	67
Foreign Currency Option Basics	67
Buying Foreign Currency Calls and Puts	68
Market Volatility Options/VIX	69
Flex Options	70
Weekly Options	71
Binary Options	71
Pretest	73
CHAPTER 4	
Buying Foreign Currency Calls and Puts Market Volatility Options/VIX Flex Options Weekly Options Binary Options Pretest CHAPTER 4 THE OPTIONS MARKETPLACE	77
The Option Clearing Corporation	77
The Options Markets	78
The Chicago Board Option Exchange	79
Opening and Closing Option Prices	81
Fast Markets and Trading Halts	81
Order Execution	82
Types of Orders	82
Priority of Option Orders	85
Trade Reporting	85
Option Order Tickets	86
Cabinet Trade/Accommodation Trade	87
Expiration and Exercise	87
American vs. European Exercise	88
· · · · · · · · · · · · · · · · · · ·	

riii	Contents
------	----------

Position and Exercise Limits	88
Stock Splits and Stock Dividends	89
Reverse Stock Split	90
Pretest	93
CHAPTER 5	
OPTION TAXATION AND MARGIN REQUIREMENTS	97
Taxation of Options	97
Closing an Option Position	98
Exercising a Call	98
Exercising a Put	99
Protective Puts	99
Protective Puts Covered Calls Establishing a Long Position in a Margin Account	99
Establishing a Long Position in a Margin Account	100
An Increase in the Long Market Value	101
Special Memorandum Account/SMA Long Margue Account	102
A Decrease in the Long Market Value	104
Minimum Equity Requirement Long Margin Accounts	105
Establishing a Short Position in a Margin Account	106
A Decrease in the Short Market Value	107
Special Memorandum Account (SMA) Short Margin Account	107
An Increase in the Short Market Value	108
Minimum Equity Requirement Short Margin Accounts	109
Combined Margin Accounts	110
Option Contract Margin Requirements	111
Margin Requirements when Exercising a Call	111
Margin Requirements when Exercising a Put	112
Margin Requirements when Writing a Call	112
Margin Requirements Uncovered Call	113
Margin Requirements when Writing a Put	115
Margin Requirements Uncovered Puts	115
Margin Requirements when Establishing a Call Spread	117
Margin Requirements when Establishing a Put Spread	120

Contents ix

Short Straddle Margin Requirements	123
Short Combination Margin Requirements	123
Short Index Option Margin Requirements	124
Short Currency Option Margin Requirements	127
Pretest	131
CHAPTER 6 OPTION COMPLIANCE AND ACCOUNT SUPERVISION	135
Duties of the ROP/ROSFP	135
Additional Duties of the ROP/ROSFP	136
Option Account Compliance	137
Option Agreement	139
Option Account Supervision	139
Large Option Position Reporting Requirements	141
Option Agreement Option Account Supervision Large Option Position Reporting Requirements Operating a Discretionary Account Managing Discretionary Accounts	142
Managing Discretionary Accounts	142
Customer Confirmations and Account Statements	143
Mailing Instructions	144
Account Transfer	144
Customer Complaints	145
Trade Complaints Between Members	146
Broker Dealers on the Premises of Other Financial Institutions	146
Regulation S-P	147
Communications with the Public	148
FINRA Rule 2210 Communications with the Public	149
Pretest	153
CHAPTER 7 SECURITIES INDUSTRY RULES AND REGULATIONS	157
The Securities Act of 1933	157
The Prospectus	158
Tombstone Ads	159
Free Riding and Withholding/FINRA Rule 5130	159

The Final Prospectus	160
Prospectus to Be Provided to Aftermarket Purchasers	160
SEC Disclaimer	161
Misrepresentations	161
Private Placements/Regulation D Offerings	161
Rule 144	162
The Securities Exchange Act of 1934	163
The Securities Exchange Commission/SEC	164
Extension of Credit	165
Margin Accounts	165
Guaranteeing a Customer's Account	167
Day Trading Accounts	167
Day Trading Accounts Commingling Customer's Pledged Securities Currency Transactions The Patriot Act U.S. Accounts Foreign Accounts	167
Currency Transactions	168
The Patriot Act	168
U.S. Accounts	169
Foreign Accounts	169
Securities Investor Protection Corporation Act of 1970 (SIPC)	169
Customer Coverage	170
The Insider Trading and Securities Fraud Enforcement Act of 1988	170
Firewall	171
Trading Suspensions	171
Issuers Repurchasing Their Own Securities	172
Tender Offers	173
Stockholders Owning 5 Percent of an Issuer's Equity Securities	174
Short Sales	175
Affirmative Determination	175
Regulation SHO	176
Rule 200 Definitions and Order Marking	176
Rule 203 Security Borrowing and Delivery Requirements	177
Threshold Securities	178
Market Making During Syndication	179
Regulation M, Rule 101	179

Contents

Penalty Bids	180
Regulation M, Rule 102	180
Regulation M, Rule 103	181
Passive Market Makers' Daily Purchase Limit	181
Regulation M, Rule 104	182
Syndicate Short Positions	183
Regulation M, Rule 105	183
Issuing Research Reports	184
Research Reports Required Disclosures	185
Regulation FD Fair Disclosure	186
Customer Accounts	188
Subsidiary (Secondary) Records	188
Securities Position Book (Ledger) Stock Record	188
Subsidiary (Secondary) Records Securities Position Book (Ledger) Stock Record Order Tickets Confirmations and Notices Monthly Trial Polances and Not Capital Computations	188
Confirmations and Notices	188
Monthly Trial Balances and Net Capital Computations	189
Employment Applications	189
Records Required to Be Maintained for Three Years	189
Records Required to Be Maintained for Six Years	189
Records Required to Be Maintained for the Life of the Firm	190
Hiring New Employees	190
Resignation of a Registered Representative	191
Registration Exemptions	192
Persons Ineligible to Register	192
Disciplinary Actions Against a Registered Representative	193
Termination for Cause	193
Outside Employment	194
Private Securities Transactions	194
Gift Rule	194
Sharing in a Customer's Account	195
Borrowing and Lending Money	196
Customer Complaints	196
Mediation	196

xii	Contents
Code of Arbitration	197
The Arbitration Process	197
Simplified Arbitration	198
Larger Disputes	198
Awards Under Arbitration	198
Investor Information	199
Violations and Complaints	199
Resolution of Allegations	199
Minor Rule Violation	200
Firm Element Continuing Education	200
Regulatory Element	201
Pretest	203
ANSWER KEYS	207
GLOSSARY OF EXAM TERMS	213
INDEX H. PO	279
KKS. MA	