Pass the Test, Inc. – Pass the 6 Lesson 1 Quiz

LESSON 1, SECURITIES MARKETS, INVESTMENT SECURITIES, and ECONOMIC FACTORS (8 of 100 questions on New Series 6 Exam)

1. In order to fight inflation, the FRB/FOMC, in enacting monetary policy, might do all of the following except

A. raise the discount rate
B. raise the reserve requirement
C. raise income tax rates
D. sell T-bills to primary dealers

WHY: typical Series 6-style question. Yes, raising income taxes fights inflation; unfortunately, the FRB/FOMC has nothing to do with taxation and spending, which is "fiscal policy." The question could have turned another way--rather than providing an answer choice about something outside the FRB/FOMC's domain, any of the following answers would have also been correct, as they would increase inflation: cut discount rate, reduce reserve requirement, buy Treasuries.
ANSWER: C

2. All of the following investors are bullish except

A. put sellers
B. call buyers
C. put buyers
D. stock buyers

WHY: a good test taker figures that the guy who buys the put and the guy who sells it have opposite opinions. One is bullish, the other bearish. Bears buy puts (and sell calls). Bulls buy calls (and sell puts). Why you need to know that for your Series 6--no idea.
ANSWER: C

3. The board of directors for ABC Corporation has failed to declare a dividend on ABC non-cumulative, non-convertible 4.5% preferred stock. Therefore, holders of the preferred stock will be able to

A. sue the corporation for breach of contract
B. sue the corporation for breach of fiduciary duties
C. convert the shares to the underlying ABC common stock
D. hope for the dividend to be declared in the future

WHY: be a good test-taker. Even if your understanding of preferred stock is murky, when you see the word "non-convertible," it's pretty tough to choose an answer telling the exam that the owners can convert to common stock.
Did "sue the corporation" look tempting? To be honest, shareholders can and do file lawsuits all the time, especially when their share price goes down inconveniently. But, if you liked "sue the corporation," how in the world did you distinguish between "breach of contract" and "breach of fiduciary duties”? Since you couldn't distinguish

between the two, they are eliminated, along with the poppycock about converting a non-convertible preferred stock. Again, you don't want the right answer. You want to eliminate the three wrong answers.
ANSWER: D

4. All of the following investors are bearish except

A. call buyers
B. short sellers
C. call writers
D. put buyers

WHY: a good test taker would assume that the guy who buys the call and the guy who sells the call have opposite opinions. Even if you miss the question, take a stab between call writer and call buyer. Not that they give you partial credit on the exam--but when you're narrowing your guesses down to 50-50, the odds will work out in your favor.
ANSWER: A

5. XYZ 3% non-cumulative preferred stock holders just discovered that, after paying only $1 last year, XYZ Corporation has decided to suspend the dividend payment entirely this year due to unforeseen business developments and an overall weak economy. Should XYZ decide to declare a dividend on the common stock next year, holders of the preferred must first be paid

A. nothing
B. $8 per share
C. $8 per share plus interest
D. $3 per share

WHY: preferred holders must be paid the current dividend before common stock gets a dime. That's why the term "earnings per share" only counts the "earnings available to common." After the preferred holders get their pie, the common folk get their piece, too. Non-cumulative means--surprisingly--that missed dividends do not accumulate. By the way, the only other tempting answer here was "$8 per share." Plus interest? Nothing? How could you justify those answers? Since you can't, they're eliminated. Take control of these questions; otherwise, they will smack you around without mercy.
ANSWER: D

6. An investor purchases a corporate bond on the secondary market for more than the bond's par value. Therefore

A. the investor's nominal yield will be lower than the stated rate of return
B. the investor's yield to maturity will be higher than the nominal yield
C. the investor's yield to maturity will be lower than the current yield
D. the investor's current yield will be the same as the nominal yield

WHY: you'll be selling bond funds to investors, and some may be just a little curious from time to time as to why the NAV of their fund is down. That would happen when interest rates rise. Why would bond prices go up? Interest rates are falling. The price of the bond is up in this question, so the yields go in this order: nominal, current, maturity. The

nominal yield never changes; the current yield is lower than the nominal (stated) yield, and the yield to maturity lower than both.
ANSWER: C

7. Use the following four dates to answer the question:

Friday, March 1	Declaration Date
Tuesday March 12th	Ex-Dividend Date
Thursday March 14th	Record Date
Monday, April 1	Payable Date

In order for an investor to receive the dividend declared, she must purchase the stock in a regular-way settlement no later than
A. Tuesday, March 12th
B. Monday, March 11th
C. Thursday, March 14th
D. Monday, April 1

WHY: on the ex-date, it's too late. So, if you want the upcoming dividend, buy the stock the day BEFORE the ex-date. Ex- means "without." On the "ex-date" the stock trades without the dividend, since folks who buy the stock that day won't get the next dividend.
ANSWER: B

8. Which of the following represent equity investments?
I. participating preferred stock
II. non-participating preferred stock
III. convertible debentures
IV. cumulative preferred stock

A. II, IV
B. III
C. I, II, III, IV
D. I, II, IV

WHY: stock equals equity. Bonds (debentures) do not. If you chose any other answer, please remember that stock equals equity, while bonds do not.
ANSWER: D

9. Ricardo Ramirez reckons that interest rates have peaked. Which of the following would likely offer the largest capital gain if Ricardo's assumption is, in fact, correct?
A. 20-year T-bonds
B. T-notes
C. 90-day T-bills
D. 10-year callable corporate bonds with low call premiums

WHY: we spend lots of effort saying that long-term bonds are more susceptible to a change in interest rates. True, but who says rates are going up? When rates fall, guess which

bonds are--again--more sensitive to rates? Long-term bonds. They go up more when rates fall, and they go down more when rates rise. How do we know that rates are going down? We don't. But if somebody feels that rates have peaked, that means that rates have nowhere to go but down. Or, they're completely wrong and lose a bunch of money speculating on interest rates when they should really be working.
ANSWER: A

10. A bond with which of the following credit ratings would likely be associated with the highest yield?

A. AAA
B. Baa
C. B
D. Aa

WHY: a low credit rating equals a low price for the bond. When price drops, yield rises. On the other hand, high-rated bonds carry high market prices. When you pay a high price for quality, you get a lower yield. You also get to sleep at night.
ANSWER: C

11. ABT 4 1/2s subordinated debentures of '11, callable @103 1/8 in '08 have a nominal yield of

A. 1.1%
B. 4.5%
C. 1.038%
D. .08%

WHY: notice how every answer choice had a corresponding number somewhere in the question? Oh, you're welcome. 4 1/2s = 4.5%. After the issuer, what would the investor want to know—probably the interest rate paid on the bond.
ANSWER: B

12. Whenever a corporation issues more stock, they must send securities to existing shareholders that allow the shareholders to maintain their proportionate ownership of the corporation. These securities are referred to as

A. subscription rights
B. warrants
C. buyers' options
D. coupons

WHY: subscription rights/stock rights allow existing shareholders to buy their % of the new stock to be offered . . . if they want to.
ANSWER: A

13. Your customer just purchased a 5% corporate bond @93 1/2, maturing in 10 years. Therefore the YTM is

A. the same as nominal yield
B. higher than nominal yield
C. lower than nominal yield
D. lower than current yield

WHY: a bond see-saw question. The bond is purchased at a discount (93.5% of par), so the yields go up. After nominal, we have current yield higher than that, then yield to maturity higher than either.
ANSWER: B

14. On April 5 the board of directors declared a dividend of $1 per share. The record date is Monday, June 2. The ex-date, therefore, is

A. Thursday, June 5
B. Friday, June 6
C. Thursday, May 29
D. Wednesday, May 28

WHY: just go back two business days from the record date.
ANSWER: C

15. Use the following four dates to answer the question:

Friday, January 10	Declaration Date
Tuesday March 18th	Ex-Dividend Date
Thursday March 20th	Record Date
Tuesday, April 1	Payable Date

In order for an investor to receive the dividend declared, she must purchase the stock in a regular-way settlement no later than

A. Tuesday, March 18th
B. Monday, March 17th
C. Thursday, March 20th
D. Tuesday, April 1

WHY: on the ex-date it's too late. Buy it the day before the ex-date if you want the dividend. And, never entice your customer to hurry up and buy the next dividend—that's a violation called "selling dividends."
ANSWER: B

16. A registered representative may use the preliminary prospectus during the cooling off period to

A. obtain the SEC's approval of the stock
B. solicit sales of IPO shares
C. solicit indications of interest
D. confirm unsolicited sales to institutional investors

WHY: there is no such thing as "SEC approval," and no sales may take place during the cooling off period.
ANSWER: C

17. Your best customer requests that you highlight the three most important paragraphs of the prospectus for the Samson and Delilah Conservative Income Fund. Therefore, you should
A. comply with the request
B. refuse to comply and report the customer to the SEC
C. refuse to comply and report the customer to the NASD
D. refuse to comply

WHY: don't comply with the request, but it would be rather rude and bad for business if you started narcking out your customers.
ANSWER: D

18. If gross domestic product is declining, Congress and the President might
A. sell T-bills from primary dealers
B. raise the reserve requirement
C. cut spending
D. increase spending

WHY: if GDP is declining that means that businesses are not exactly firing on all eight cylinders. One way to rev up those businesses is for the federal government to go on a shopping spree: let's see, we'll take 100 fighter jets from Boeing, 10,000 laptops from Dell, 5,000 printers from HP, and--what the heck--could you please send 17,698 McDonald's cheeseburgers to the Pentagon by 12:30 this afternoon? Those companies will spend more money on materials, hire more workers, and sell more product. Gross Domestic Product.
ANSWER: D

19. A cell phone manufacturer in Sweden has gathered much interest on the part of American investors, who purchase dollar-denominated
A. rights
B. warrants
C. ADR's
D. Debentures

WHY: there are a few easy questions on every Series 6 exam. Missing a question like this is like missing a 4-inch putt. It could happen, but it can't happen. If you missed it, drop and give us 25 push-ups.
ANSWER: C

20. Shares of MSFT trade regularly in which of the following markets?
A. Primary
B. Secondary
C. First
D. Third

WHY: look at questions from more than one angle. Maybe this one isn't about first-second-third-fourth market. Maybe it's about the category heading for those four markets--SECONDARY. In the primary market securities are ISSUED. On the secondary market, securities are TRADED.
ANSWER: B

21. Which of the following is considered a "negotiated market"?
A. NYSE
B. Regional exchanges
C. OTC
D. Options

WHY: first-exchanges-auction. Second-OTC-negotiated.
ANSWER: C

22. What is true of the difference between "BID" and "ASK"?
A. market makers sell at the bid, buy at the ask
B. market makers buy at the bid, sell at the ask
C. customers buy at the bid, sell at the ask
D. the terms are synonymous

WHY: bid-ask is more intuitive than most people realize. You see that the quote or the market for Microsoft is Bid - $25, Ask - $25.20. If you want to sell, the market maker will let you sell it to him for $25--which means he'll buy at $25. If you want to buy, the market maker will sell it to you for $25.20.
ANSWER: B

23. Which of the following is considered an "auction market"?
A. OTC Bulletin Board
B. NASDAQ
C. NYSE
D. all choices listed

WHY: first-exchanges-auction. Second-OTC-negotiated.
ANSWER: C

24. Which of the following debt securities has the highest duration?
A. T-bill
B. 7-year debenture
C. 10-year T-note
D. 10-year STRIP

WHY: but, but, they're BOTH 10-year debt securities--no fair!

Then, you take a deep breath and say, well, I know that long maturities = high/long durations. So, which debt security would make you feel more nervous--the one that pays interest every six months, or the one that pays nothing until the end?

A zero coupon bond, such as a STRIP, will always have a higher duration than an interest-paying bond with the same maturity. When income is paid to the investor, the investor feels better about things, just like I'd feel a little better about the $1,000 I lent my buddy back in November if he were to make, you know, a payment. A hundred bucks would sure make me feel more confident that he A) recognizes that this was not an early Christmas present and B) might actually be interested in paying me back some day.

ANSWER: D

25. Advantages of owning common stock include all of the following EXCEPT:

A. claim on earnings
B. claim on dividends
C. seniority
D. right to vote on mergers, acquisitions

WHY: common stock is the most junior security. Preferred stock and bonds are senior to common stock.

ANSWER: C

26. Which of the following represent(s) accurate statements concerning the various revenue sources for funding the debt service on municipal securities?

A. revenue bonds have an identified source of revenue and if that source falls short, uninsured revenue bonds could default
B. if revenues used to retire debt service on general obligation bonds fall short, the issuer is legally obligated to pay the bondholders
C. revenue bonds tend to yield more than general obligation bonds
D. all choices listed

WHY: there is an internal logic to this question. Because the revenue bond is backed up only by the revenues generated at the facility, and because the GO bonds are backed by the full faith and credit of the issuer, revenue bonds yield more than GO bonds. Higher risk = higher yield.

ANSWER: D

27. Certificates of Deposit issued with denominations exceeding $100,000 are

A. not fully insured by the FDIC
B. negotiable securities
C. considered money market securities
D. all choices listed

WHY: you will get one or two questions on the money market. No reason to miss these. Short-term debt securities. A CD with a huge denomination is marketable/negotiable and not insured by the FDIC. Why would you want a CD not fully insured by the FDIC; isn't

that riskier? Exactly--I want a higher yield, and I'm willing to take the risk that this financial institution, with $20 billion of assets, might accidentally stiff me.
ANSWER: D

28. Which of the following represent(s) accurate statements concerning Exchange-Traded Funds?
A. allow investors to bet against the overall market and capture intra-day movements of a particular index
B. are cost-efficient, especially with smaller investments
C. charge no operating expenses
D. guarantee a minimum rate of return above a particular index

WHY: were you tempted by "guarantee a minimum rate of return above a particular index"? Even if you thought an ETF was an indexed annuity, is that how the indexed annuity works? Drop and give us 25 pushups. Were you tempted by "charge no operating expenses"? Let's fix that--there is no such thing as a fund that does not charge operating expenses--what are they, a charity? Why aren't ETF's cost-effective in small doses? You pay a commission to buy and sell, so you need to make that commission a tiny % of what you invest. I use TD Ameritrade, myself, and their $9.99 commissions are extremely low. However, if I put $100 into an ETF today, that commission would represent about 10% of my investment, which would be higher than ANY mutual fund could legally charge me. If I put in $100,000, however, that little commission would not be worth worrying about, and--going forward--the very low operating expenses would be quite efficient. I could sell the ETF short to bet against the market, and I could sit here daytrading the S&P 500 with the Spider or the NASDAQ 100 with the QQQQ. Luckily, I have better things to do, such as helping you pass the Series 6.
ANSWER: A

29. Inflation, as measured by the CPI, generally results from
A. a tight money supply
B. demand for goods and services exceeds supply
C. supply of goods and services exceeds demand
D. high interest rates

WHY: when the demand for things is high while the supply is tight, prices rise. Why are you paying $3-4 per gallon of gas? Because the supply of gasoline is rather tight while American soccer moms continue to drive vehicles large enough to haul the entire team plus the two goals. After Katrina, supply was reduced, but demand kept right on humming along. Which was why the oil companies made huge profits for their shareholders. This "test world" stuff actually does apply to the "real world" if you're willing to make the connections.
ANSWER: B

30. Which of the following would benefit from a devaluation of the US Dollar versus foreign currencies?

A. exports from the United States
B. value of ADR
C. dividend received from an ADR
D. all choices listed

WHY: if the stuff we make is suddenly cheap to foreign consumers, it will be very easy to export our cheaper stuff to them. If you hold an ADR, the dividend is declared in, say, the Yen. When the Yen is converted/exchanged to dollars, in which case would you receive MORE dollars? If the little suckers were so weak that it took maybe five of them to equal just one Yen.

ANSWER: D

31. Which of the following represent accurate statements of an investment banker?

A. raises capital for corporations within the primary market
B. raises capital for state and local governments within the primary market
C. purchases securities from issuers and re-offers the securities to investors
D. all choices listed

WHY: investment bankers such as Citigroup, Morgan-Stanley, Goldman Sachs, etc. raise capital ($) for issuers on the primary market. They buy their securities and re-sell them for a little more to investors, keeping the "spread" for their trouble.

ANSWER: D

32. Which of the following represent(s) accurate statements of the primary market?

A. issuers receive the proceeds of the transaction minus the spread due the syndicate
B. most corporate issuers register with the Securities and Exchange Commission under the Securities Act of 1933
C. most corporate issuers who register with the SEC under the Securities Act of 1933 are also required to file quarterly and annual reports to the SEC under the Securities Exchange Act of 1934
D. all choices listed

WHY: you'll need to get to the point where you simply know that all three of these answer choices are true. I mean, before I tell you.

ANSWER: D

33. A $10,000,000 debenture offering of the ABC Corporation is convertible @$50. Therefore, which of the following represent(s) accurate statements?

A. ABC would likely pay a lower nominal yield on this series of debentures than on a non-convertible series with similar terms
B. each bond allows the investor to convert to 20 shares of ABC common stock
C. the bondholders are creditors
D. all choices listed

WHY: if you eliminated any of the three answer choices, ask yourself why you did that.
Bond holders are always creditors. If they can take their par value of $1,000 to buy common stock at $50, each bond would turn into 20 shares. Why are they giving the bondholders some upside on the common stock? Because they're a very nice corporation whose CEO and board of directors is simply committed to making other people rich.
No--because they want to offer the bondholders a lower interest payment.
ANSWER: D

34. The ABC Corporation is about to issue three series of bonds. Each offer is of the same size and term to maturity. ABC will issue mortgage bonds, a series of debentures, and a series of subordinated debentures. Therefore, which of the following represents a true statement?
A. The subordinated debentures would offer the lowest yield to investors
B. The mortgage bonds would offer the highest yield to investors
C. ABC is using leverage
D. The debentures would offer the highest yield to investors

WHY: wow, that's an annoying question. True statements would be telling you that the highest yield is paid on the subordinated debentures, with the lowest yield paid on the secured bonds. Which loan charges you the higher rate--your mortgage, backed up by real property, or the cash advance from VISA, backed up by your good name? Your mortgage is just like a mortgage bond—lower interest rate due to the collateral backing up the loan. The subordinated debenture is more like a cash advance to a credit card holder with serious debt. They'll lend him the money, but he scares the bejeezus out of them and, therefore, has to pay a rate commensurate with his shaky credit situation.
ANSWER: C

35. Whose credit is used when S&P and/or Moody's analyze the creditworthiness of an Industrial Development Revenue Bond?
A. the issuer's
B. the corporation's
C. the lead underwriter's
D. any choice listed

WHY: the issuer is, say, Detroit. The corporation leasing the facility built by the revenue bonds is backing up the bonds. If they can't pay the lease, I sure hope somebody bought insurance against default. Otherwise, the bondholders are screwed.
ANSWER: B

36. All of the following represent securities typically found in the portfolio of a money market mutual fund except
A. bankers acceptances
B. commercial paper
C. convertible preferred stock
D. negotiable CD's

WHY: money market securities are debt securities which mature in one year or less.

Convertible preferred stock is not a debt security.
ANSWER: C

37. Which of the following represents an accurate statement concerning hedge funds?

A. they are generally liquid
B. non-accredited investors may invest directly in hedge funds
C. non-accredited investors may invest indirectly through "funds of hedge funds," given certain requirements
D. they charge relatively low fees

WHY: hedge funds typically charge management fees of 2 % plus the first 20% of all profits. Now, let's say your hedge fund investment doesn't work out, and you want to sell it. Sorry, not at this time. Hedge funds are illiquid, high-risk, and open directly only to accredited investors. Non-accredited investors can buy funds of hedge funds, but there are, again, high fees and a lack of liquidity.
ANSWER: C

38. If the current FOMC objective is to battle the threat of deflation, the likely actions would include

I. sell Treasury and agency securities to primary dealers
II. purchase Treasury and agency securities from primary dealers
III. raise the discount rate
IV. lower the discount rate

A. I, III
B. I, IV
C. II, III
D. II, IV

WHY: not sure the Series 6 would play quite that mean, but in case it does, remember that there are three things the FOMC/FRB can do to pump a little air (inflation) back into the economy--cut discount rate, lower reserve requirement, purchase Treasuries. To slow down the economy/fight inflation, they would do the opposite.
ANSWER: D

39. If the current FOMC policy is anti-inflationary, the likely actions would include
I. sell Treasury and agency securities to primary dealers
II. purchase Treasury and agency securities from primary dealers
III. raise the discount rate
IV. lower the discount rate

A. I, III
B. I, IV
C. II, III
D. II, IV

WHY: to fight inflation, the FRB/FOMC can do three things--raise discount rate, increase reserve requirement, sell Treasuries. To stimulate the economy, they would do exactly the opposite on all three counts.
ANSWER: A

40. Which of the following represent accurate statements concerning monetary policy?
I. it is enacted by Congress and the President
II. cutting the discount rate is inflationary
III. raising the discount rate is anti-inflationary
IV. to curb inflation, the FOMC pursues a loose money policy

A. I
B. II, III
C. II
D. IV

WHY: to curb inflation, the FOMC would pursue a tight--not loose--money supply. Congress & President enact fiscal--not monetary--policy.
ANSWER: B

41. Which of the following actions would tend to stimulate the economy?
I. increasing government spending
II. decreasing taxes
III. cutting the discount rate
IV. relaxing the reserve requirement

A. I, III
B. II, III
C. I, II, III, IV
D. IV

WHY: we're mixing monetary and fiscal policy here, and all four examples would stimulate the economy or at least keep it from falling flat.
ANSWER: C

42. An investor is considering investing in a foreign equity fund specializing in manufacturing products, primarily for the US market. Which TWO of the following statements would be accurate to make to the investor?

I. if the dollar weakens, foreign exporters to the United States will do poorly
II. if the dollar weakens, foreign exporters to the United States will do well
III. if their own currency weakens, foreign exporters will do poorly
IV. if their own currency weakens, foreign exporters will do well

A. I, III
B. II, IV
C. I, IV
D. II, III

WHY: again, I doubt the Series 6 would play quite that mean, but in case it does, remember that if our dollar is weak, it's tougher for them to sell to us. If the foreign currency weakens, well, that's just a weird way of saying that the American dollar is strong, making it easier to sell their foreign goods to Americans, whose dollar can buy more of their foreign goods.
ANSWER: C

43. One of your customers, Joe Myers, calls to inquire about something he heard but did not quite understand on CNBC. "Why is the price differential between low-risk and high-risk debt securities smaller than usual?" he asks. You would respond

A. turn off the TV and get a life, Joe
B. it means investors are confident in the overall economy
C. it means investors are not insisting on safety to the same degree
D. both B and C

WHY: as a favor to you and your sanity, let's just say it is what it is. It could show up on your exam, although I'd be betting against it.
ANSWER: D

44. Which of the following represent characteristics of exchange-traded funds or "ETF's"?

I. cost-effective through a modest dollar-cost-averaging funding technique of $100 per month
II. typically designed to track an index such as the S&P 500 or NASDAQ 100
III. very low operating expenses
IV. redeemable

A. I only
B. II, III, IV
C. II, III
D. I, II, III, IV

WHY: closed-end index funds (ETF's) are still closed-end funds, so you can't redeem the shares. There are very low operating expenses, because these funds only have to buy whatever Standard & Poor's, Dow, or NASDAQ (for example) put into their respective indices. They don't need talented portfolio managers charging big management fees. The operating costs would generally be in the tenth-of-one-percent range, which is amazingly low, maybe 10-15 times cheaper than an actively managed growth fund. However, you buy and sell these shares of stock as you do any other shares of stock--you pay a commission. So, they only work well in larger quantities. If you pay a $10 commission on a $100 purchase, that's 10% of your investment, which sort of nullifies the whole low-operating-expense thing you were going for.
ANSWER: C

45. Which of the following statements concerning hedge funds is/are accurate?
I. investors must be accredited
II. liquidity is a major advantage
III. non-accredited investors may purchases hedge funds indirectly through funds of hedge funds
IV. hedge funds must register with the SEC

A. I, III only
B. I, II only
C. III only
D. I, II, III, IV

WHY: hedge funds are illiquid. That means that when you buy one, you usually have to hang onto it for a year or two, even if you want to sell. Since they're open to accredited investors, the SEC doesn't make them register.
For now.
ANSWER: A

Pass the Test, Inc. – Pass the 6© Lesson 2 Quiz

LESSON 2 SECURITIES & TAX REGULATIONS (23 of 100 Questions on Exam)

1. All of the following would be considered "management companies" under the Investment Company Act of 1940 except
A. non-diversified fund
B. open-end fund
C. closed-end fund
D. face-amount certificate

WHY: the three types of investment companies are face amount, UIT, management companies. Management companies are either open- or closed-end funds. Whether the fund is diversified is not really relevant here.
ANSWER: D

2. Which of the following best explains the tax consequences of investing in municipal securities?
A. interest payments to the investor are generally exempt from federal taxation
B. interest payments are generally taxable by the investor's state of residence if the bonds are issued outside the investor's state
C. capital gains are fully taxable
D. all choices listed

WHY: a municipal bond's interest payment is generally tax-exempt at the federal level, which is a big deal. If you're in the 25 or 35% bracket, you pay ZERO PERCENT to the IRS for the bond interest. If the bond was issued outside your state, though, your state will probably charge income taxes on the bond interest. Now, your state tax bracket could be the difference of, say, 3% here in Illinois, or 14% in some crazy, tax-happy state such as Maryland. What about capital gains on municipal bonds?
Capital gains are taxable.
ANSWER: D

3. Which of the following represent accurate statements concerning statutory disqualification under NASD rules?
A. a member firm may be disqualified if principals have been convicted of a non-securities-related felony in the past 10 years
B. an individual may be disqualified from associating with a member firm if he/she has been convicted of a securities-related misdemeanor in the past 10 years
C. an individual may be disqualified from associating with a member firm if he/she has been convicted of any felony in the past 10 years
D. all choices listed

WHY: any securities-related misdemeanor, and any felony over the past 10 years.
ANSWER: D

4. Rule 17f-2 of the Securities Exchange Act of 1934 requires officers and certain employees of member firms to submit fingerprints. Which of the following is/are subject to this rule?
I. director of a NYSE-member broker-dealer
II. officer of an NASD-member broker-dealer
III. registered representative of an NASD-member broker-dealer
IV. employee of an NASD-member broker-dealer not involved in sales or clearing of transactions

A. I
B. I, II, III
C. III
D. I, II, III, IV

WHY: they fingerprint the people selling securities, processing the trades, keeping the records, etc. Employees who have nothing to do with sales/money/recordkeeping do not have to submit fingerprints under this rule. Also, if the firm does nothing but sell investment company securities where no certificates are issued, they don't need to be fingerprinted either.
ANSWER: B

5. Which of the following investments most likely meet(s) the definition of a "security" as defined in the Securities Exchange Act of 1934, the Uniform Securities Act, and the Howey decision?
I. certificate evidencing a 10% ownership of a prize-winning racehorse
II. 5% ownership of the income stream provided by 5 ATM machines
III. fixed annuity
IV. variable annuity

A. I, III, IV
B. I, II, IV
C. II
D. IV

WHY: a fixed annuity is a pure insurance product. Remember that the Howey decision says that an investment of money in a common enterprise where the investor will benefit through the efforts of others . . . that's an investment contract, which is a security. The actual decision can be found via Google, and is actually quite easy to read.
ANSWER: B

6. According to SEC Release IA-1092, which of the following least likely meets the definition of "investment adviser"?
A. broker-dealer
B. lawyer who sells quarterly reports on small cap stocks to certain large pension funds
C. accountant who charges a small fee to advise clients on 401(k) and IRA allocations
D. financial planner

WHY: most planners easily fit the definition of investment adviser. I keep messing with you on the LATE thing and probably shouldn't. If the Lawyer/Accountant/Teacher/Engineer talks about securities in a way that is incidental to their profession, they're not an adviser. But in this question both the lawyer and the accountant are providing investment advice and getting compensated.
Sorry--that fits the definition of "investment adviser," which means they'll have to register, pay their fees, and keep really good records from now on.
ANSWER: A

7. None of the following are prohibited except
A. buying stock on NYSE while simultaneously selling it on the Chicago Stock Exchange
B. sharing commissions with other agents at the firm
C. sharing gains and losses with a customer in an approved joint account in proportion to the capital commitment on the part of the registered rep
D. recommending a security to all 200 clients on a broker's book of business.

WHY: translate weird questions back to English. You are being asked which of the four choices is okay? No--which one is not okay? Wait--which is it? Make sure you know what you're being asked before you try to answer. In this question you’re being asked which of the four represents a prohibited practice--blanket recommendations. Registered rep's need to make suitable recommendations based on an individual's time horizon, investment objectives, risk tolerance, and financial situation. If you recommend the same thing to every customer, there's no way you could be meeting suitability requirements.
ANSWER: D

8. Your sister is the CFO for a large publicly traded company. Over a few too many martinis she tells you that her company is about to surprise Wall Street by beating earnings estimates by over 20 cents a share. Next morning you call your best clients and tell them to buy the company's stock in advance of the earnings announcement. This practice is
A. punishable up to 25 years in a state penitentiary
B. perfectly acceptable, provided you do not mention your sister as the source
C. known as pegging
D. insider trading

WHY: textbook example of trading on material inside information. Don't go there, especially if there's a chance you'll get caught. And, there's always a chance you'll get caught, since the SEC pays bounties of 10%.
ANSWER: D

9. The CEO of a pharmaceutical company tells a well-known TV personality that the FDA will announce tomorrow that the company's promising new drug has not been approved for sale. The TV personality sells her shares immediately, avoiding a $200,000 loss that would have occurred had she held the shares until after the announcement. This violation of the Insider Trading Act would most likely result in a fine of

A. $200,000 plus interest
B. $1,000,000
C. $600,000
D. as determined by Congress and the President

WHY: "treble damages" means three times the amount of the benefit.
ANSWER: C

10. The Securities Exchange Act of 1934 covers all of the following except

A. contents of a preliminary prospectus
B. anti-fraud statutes
C. registration of persons
D. insider trading

WHY: contents of the prospectus would be covered in the Securities Act of 1933.
ANSWER: A

11. All of the following investments are redeemable except

A. UIT's
B. closed-end funds
C. open-end funds
D. face-amount certificates

WHY: the main thing to know about closed-end funds is that they trade like shares of stock between investors, which is the opposite of being redeemable.
ANSWER: B

12. The NASD was chartered as the SRO for the OTC market through the passage of

A. The NASD Authorization Act
B. The SRO-OTC Act
C. The Maloney Act
D. The Securities Act of 1929

WHY: easy way to remember this--the Maloney Act of 1938 created the NASD as the SRO for the OTC.
ANSWER: C

13. Whenever a registered representative receives a written complaint from a customer, he must immediately take the complaint to

A. the nearest shredder
B. the NASD
C. his principal
D. the SEC

WHY: don't be afraid to take the few questions the exam is giving away for free.
ANSWER: C

14. Your client has granted you discretion over her account. She is a fixed-income investor nearing retirement, with a low risk tolerance. If you purchase penny stocks for this account, you have

A. made an unauthorized purchase
B. made a contrarian acquisition
C. performed a merger/acquisition
D. violated the Securities Act of 1929

WHY: you were authorized to purchase suitable securities. If you purchase unsuitable securities that was, clearly, unauthorized. Usually an "unauthorized trade" is where the agent simply starts trading a customer account, convinced the customer will never notice. Tip--if you're ever about to do something because you're convinced the customer won't find out, stop right there, take a vacation, regroup, and then come back to your little career.
ANSWER: A

15. A broker-dealer's advertising and sales literature must be on file for

A. 90 days
B. 1 year
C. 2 years
D. 3 years

WHY: three years on file, two years in a readily accessible place and format.
ANSWER: D

16. In order to close a big sale, a registered representative omits an immaterial fact to avoid distracting the customer. This activity

A. is perfectly acceptable
B. is perfectly acceptable for high-net worth clients
C. is a violation
D. is fraudulent

WHY: read carefully--the word 'immaterial' means "nothing to do with nothing." Don't omit MATERIAL facts, which are relevant to the investment.
ANSWER: A

17. Amber Adams is a registered representative with Smith & Wesson Broker-Dealers. If Heather also provides investment advice to clients outside the scope of her employment with Smith & Wesson, she would be classified as a(an)

A. principal
B. fiduciary
C. investment adviser
D. stock broker

WHY: real simple--if you get compensated for providing investment advice, you are an investment adviser. Usually, an individual (natural person) such as Heather would be an "investment adviser representative." But, she isn't representing an advisory firm--she is the advisory firm.
ANSWER: C

18. Charla Davenport works in the investment banking division of a large broker-dealer. While working on the registration statement for a client's new issue of debentures, Charla learns of certain negative financial information about the client company. Prior to the public release of this information Charla calls one of her best customers and reveals that "there could be trouble ahead" for the company's common stock. If the customer sells the company's stock to avoid a loss:

A. only the customer who sold the stock has violated insider trading rules
B. only Charla has violated insider trading rules
C. both Charla and the customer have violated insider trading rules
D. no violation of insider trading rules has occurred

WHY: both the tipper (Charla) and the tippee (the customer) have violated insider trading rules.
ANSWER: C

19. Joanie Jenkins, a registered representative for XYZ Broker-Dealers, has a client who is an income investor. Knowing that the E-town Equity Income Fund is about to pay a dividend of $1.00 per share, Joanie recommends that the client purchase the fund promptly in order to receive the upcoming dividend. What is true of this situation?

A. Joanie has made a suitable recommendation for an income investor.
B. The E-town Equity Income Fund is unsuitable for an income investor, who would purchase bonds.
C. Joanie has violated the rule against selling dividends.
D. Joanie has committed a violation known as breakpoint selling.

WHY: selling an investment because it pays consistent dividends is perfectly suitable for an income investor. But, never try to sell the upcoming dividend itself. The price drops when the dividend is paid, and the investor gets taxed. Any mutual fund prospectus explains this so that investors understand there is no reason to hurry up just because of an upcoming dividend. The prospectus on my desk says that the investor is “effectively buying the dividend that will be returned to you and also taxed.”
ANSWER: C

20. A Series 6 licensee may accept orders for which of the following?
A. closed-end fund in the primary market
B. REITs
C. preferred stock
D. Treasury bonds

WHY: the Series 6 allows you to sell mutual funds, variable annuities, variable life insurance, and you can also be part of a primary offering for a closed-end fund. In other words, you can sell investment company shares that are purchased on the primary market. Once the closed-end shares trade among investors on the secondary market, you would have to let a Series 7 licensee take those orders. Or, sign yourself up for a 6-hour exam with 250 questions on it.
ANSWER: A

21. An arbitration claim may not be initiated after
A. 3 years
B. 5 years
C. 6 years
D. 10 years

WHY: that's why customer written complaints are kept on file six years. After six years elapse, they hold the annual office shredding party emceed by former Arthur Andersen, Enron, and WorldComm communications disposal experts.
ANSWER: C

22. A person is subject to disqualification from the NASD if the person
I. Has been suspended or expelled from membership in a self-regulatory organization
II. Is subject to an order of the SEC or other regulatory agency denying, suspending, or revoking registration
III. Has made a false or misleading statement in an application
IV. Has been convicted within the last ten years of any felony

A. III and IV only
B. I and II only
C. I and III only
D. I, II, III, and IV

WHY: looks like four pretty good reasons to keep somebody away from the securities/money business, right? Dude's already lying on his application--what are the chances he'll try to mislead an investor if he's already misleading us? Dude's already been in trouble with other regulators. Dude's a convicted felon, for crying out loud. Congress, maybe, but surely not the financial services industry. Next?
ANSWER: D

23. All of the following are funded with after-tax contributions except

A. non-qualified variable annuity
B. non-qualified fixed annuity
C. 403b Plans
D. 529 Plans

WHY: like the 401(k), the 403b plan is typically funded with tax-deductible contributions. The others are funded with after-tax contributions. Keep those two categories very clear in your mind--which contributions are pre-tax/after-tax, and how is the money treated when it is distributed to the individual.
ANSWER: C

24. Wilson Jones recently decided to exchange shares of the ABC Aggressive Growth Fund for shares of the ABC Conservative Income Fund. Which of the following accurately describes this transaction?

A. it is tax-free
B. it is a tax-deferred 1035 contract exchange
C. no sales charges are levied on the purchase of the Conservative Income Fund if ABC offers a conversion/exchange privilege
D. all capital gains are deferred until the Conservative Income Fund shares are eventually sold

WHY: this is a purchase and a sale of two mutual funds in the same family. If the family is smart, they won't hit the guy with a sales charge, but this has absolutely nothing to do with tax benefits. It's a purchase and a sale.
ANSWER: C

25. Uncle Jasper purchased 2,000 shares of the YTR Aggressive Growth Fund back in 1978, with the NAV at $9.92 and the POP at $10. Uncle Jasper dies and wills all 2,000 shares to you. On the date of death the NAV is $12. If you redeem the shares 7 months later with the NAV at $13.00 and the POP at $13.25, your capital gain will be:

A. short-term gain of $3.00 per share
B. long-term gain of $1.00 per share
C. short-term gain of $3.33 per share
D. short-term gain of $1.00 per share

WHY: the IRS is very clear on this one—when you inherit securities that have appreciated, your cost basis is the fair market value as of the date of death. And, when you sell, it's a long-term gain, period. So, if Grandma bought the stock at $10 and it's now worth $50, that's your cost basis. Sell it a week later for $55, and it's only a capital gain of $5 per share, taxed at the kinder, gentler, long-term capital gains rate. See? The IRS has a heart—they know that somebody close to you just died, so they let you step up your cost basis and treat any gain as long-term.
ANSWER: B

26. The maximum gift that a donor may make to an UGMA account for tax year 2006 is

A. $11,000
B. $12,000
C. $1.5 million plus an inflation index
D. unlimited

WHY: no such thing as a maximum gift to an UGMA. The donor might pay gift taxes on part of it, but that's a whole different question.
ANSWER: D

27. Myron purchased 1,000 shares of GE on January 1st, 2004. On December 31st, 2004, Myron sells the shares for a $300 capital gain. If the trade settles on January 4th, 2005, which of the following accurately describes the tax consequences?

A. the gain will be considered long-term
B. the gain will be considered short-term
C. the gain will be treated as dividend income
D. Myron will report the gain or loss for tax year 2005

WHY: a long-term gain happens when you hold securities for one year plus one day. Is there any way you could buy and sell a security in the same year and have it counted as one year plus one day? Settlement has nothing to do with it either--if it did, people would start using funky settlement methods like RVP/DVP and drag it all out another 35 calendar days. No--when you enter the sell order, you're done holding the security.
ANSWER: B

28. If an investor elects to receive dividend and capital gains distributions from a mutual fund in cash, rather than reinvesting into new shares, within a 401(k) or Traditional IRA plan, which of the following best describes the tax ramifications of this decision?

A. the decision will have no ramifications
B. the dividends will be taxed as long-term capital gains
C. the long-term capital gains will be taxed as long-term capital gains
D. dividends will grow tax-deferred, but capital gains will be taxed annually

WHY: kind of a weird question, but it isn't saying that the individual is taking the cash out of the account. Just means that in an IRA, the dividends can be credited to your cash balance and reinvested if/when you feel like it. Or, they can be automatically reinvested into more shares.
ANSWER: A

29. A 1035 contract exchange may take place in all of the following ways except
A. one insurance policy to another issued by the same company
B. one insurance policy to another issued by a different company
C. one annuity to another offered by a different company
D. one annuity to a life insurance policy issued by the same company

WHY: can't turn an annuity into a life insurance policy.
ANSWER: D

30. If an employee wants to know when she will be fully entitled to the contributions made by her employer to her 401(k) plan, she should read the section of her plan literature describing
A. participation
B. eligibility
C. vesting
D. beneficiaries

WHY: when she's fully vested, the employer contributions belong to her, even if they fire her or she up and quits. Which is why they might make her wait five years to become fully vested.
ANSWER: C

31. If an individual transfers a 401(k) from one custodian to another upon leaving a job
A. The employee must be 59 1/2 to avoid penalties.
B. The employee may only perform one transfer per year.
C. The employee must pay tax on the excess above cost basis.
D. There will be no penalties or taxation to pay at this time.

WHY: to avoid hassles, have the custodian transfer the account balance to the other custodian. If you do a rollover whereby they cut a check in your name, you're going to have all kinds of hassles, and you're going to have to complete the thing in 60 days, doing no more than one per year. Note that a transfer does not count as a current year contribution. If you have $20,000 moved from a 401(k) to another 401(k) or even into an IRA, that's just a transfer of funds. You could also put in your maximum contribution for the year.
ANSWER: D

32. Withdrawals from a Traditional IRA must begin
A. when the individual turns 59 1/2
B. when the individual turns 70 1/2
C. on April 1st of the year that the individual turns 70 1/2
D. on April 1st of the year following the year that the individual turns 70 1/2

WHY: don't grab the first answer that looks decent. Be patient, skeptical, and analytical.
ANSWER: D

33. A school teacher participated in her school district's tax-sheltered annuity for 20 years. During her employment the school district contributed $30,000 into the plan. At retirement the teacher takes a lump-sum distribution of $50,000. What is the tax treatment of the distribution?

A. $20,000 taxed as ordinary income
B. $50,000 taxed as ordinary income
C. $20,000 taxed at long-term capital gains rates
D. $50,000 taxed at long-term capital gains rates

WHY: two real simple things here--the money has not been taxed yet, so it's now going to be. And, we never pay cap gains rates on retirement money. We might dream of doing that, but, instead, we pay ordinary income tax rates on retirement money. In other words, through 2010, you can sell a stock for a long-term cap gain taxed at 15% in a regular old brokerage account, but the money coming out of your retirement plan is taxed as high as 35%. Which is why I—like many folks—have gotten hip to the notion of saving for retirement in a regular old taxable account. Even if the 15% thing expires after 2010, chances are long-term capital gains will still be taxed at a lower rate than ordinary income. I mean, right now, the spread between the maximum cap gains rate and the maximum ordinary income rate is 20%, so it's not a bad bet.
ANSWER: B

34. Gretta Gundersen is a college student studying metallurgy and mining. Gretta earned $1,100 last year waiting tables at a campus bistro. She also earned $500 modeling for art school classes. If Gretta also received $1,400 in T-bond interest, she may contribute how much to her traditional IRA?

A. $3,000
B. $1,100
C. $1,600
D. $2,500

WHY: it has to be EARNED income, not bond interest or dividends from stock. If the maximum contribution is $4,000, and the individual earns $1,600, $1,600 is her maximum contribution.
ANSWER: C

35. Which of the following may be purchased inside a Traditional IRA?

I. U.S. minted gold coins
II. Collectible items, i.e. Beanie Babies(TM)
III. Junk Bonds
IV. Variable Annuities

A. III only
B. IV only
C. I, II, III only
D. I, III, IV only

WHY: memorization points.
ANSWER: D

36. You have contributed to your Traditional IRA for each of the past four years. You recently took a job with an employer paying you $15,000 per year. If you participate in the employer's defined benefit pension plan, what is true of your IRA?

A. It must be closed.
B. It may remain open, but no contributions are allowed.
C. You may continue to make pre-tax contributions to your IRA.
D. You may make only after-tax contributions to your IRA.

WHY: you never have to close out your IRA, and as long as you have earned income, you can contribute to it. The question could become, "Will I get to deduct the contribution?" You'd have to be making a lot more money than $15,000 for that to become an issue, though.
ANSWER: C

37. The net investment income from an open-end investment company equals

A. Net income from dividends and interest paid on securities in the fund's portfolio
B. Dividends, interest, and capital gains on sales of portfolio securities
C. Only net capital gains on sales of portfolio securities
D. All profits from the investment company's operations

WHY: net income for a mutual fund is the dividends and interest income minus the expenses of the fund. The profits of the mutual fund company go to--get this--the mutual fund company. So, the investors in the TRowe Price Equity Income Fund receive dividends from the fund--what's left after paying management fees and other expenses. Who keeps the profits made off the management fees?
TRowe Price. They're not a charity.
ANSWER: A

38. Which of the following represent(s) accurate statements concerning Traditional IRA's?

I. the owner will be penalized if required minimum withdrawals do not begin by April 1st following the year the owner becomes 70 1/2
II. when a beneficiary inherits an IRA, no taxes are due for five years
III. if the owner dies before the required beginning date, the non-spouse beneficiary can take the money out over five years, or over her life expectancy
IV. if the beneficiary is the owner's spouse, the account may be treated as if it is the account of the surviving spouse

A. I
B. II
C. I, III, IV
D. IV

WHY: three things to know about IRA's, which are highly testable on the Series 6.
ANSWER: C

39. Your client's 73-year-old mother passes away, with your client named as beneficiary on the IRA account. Your client may receive the proceeds:

A. over the life expectancy of his mother
B. over his own life expectancy
C. the longer of his life expectancy or that of the account owner's
D. tax-free

WHY: how the life expectancy of a dead person could be longer than the beneficiary's (who is, you know, still alive) is a little weird, but if the question says that somebody's mother or father died, we have to assume the "child" will have a longer life expectancy than a 73-year-old mother. If the "child" wants to stretch things out, she can take out the required minimum based on her longer life expectancy.
ANSWER: C

40. Which of the following retirement plans allow(s) for flexible contributions on behalf of the employer?

I. profit sharing
II. SEP-IRA
III. money purchase
IV. defined benefit

A. I
B. II
C. III
D. I, II, IV

WHY: the profit sharing plan is based on profits. So, in a year of no profits, no sharing. Money purchase plans require the company to put in a % of the worker's salary, whether the company was profitable or not. The benefit paid from a pension plan might be rather inflexible, but the amount of the contributions varies greatly depending on all kinds of things we aren't going into. An employer has to be fair among employees in a SEP, but they are not required to make contributions.
ANSWER: D

41. Which of the following statements accurately describe(s) SIMPLE Individual Retirement Arrangements?

A. SIMPLE IRA's are for businesses with no more than 100 employees
B. SIMPLE IRA'S are for businesses with no other retirement plan
C. Employees are immediately vested
D. All choices listed

WHY: three things to know about the SIMPLE Plan. Remember that the letters "IRA" tell you that the individual is immediately vested. The contributions belong to the individual as soon as they are made, in other words. It's not a 401(k) where you become fully vested over a period of years.
ANSWER: D

42. Which of the following is a non-qualified plan for state and local government employees?

A. 403b
B. Section 457
C. Traditional IRA
D. Money Purchase

WHY: that's the definition of a Section 457 plan. Pretax contributions with the same maximum as the 401(k). Available to state and local government employees.
ANSWER: B

43. Under the "conduit theory" which of the following would be taxable to the mutual fund?

I. unrealized capital gains
II. undistributed net income
III. net income distributed to shareholders representing 90% + of net income

A. I
B. II
C. I, III
D. III

WHY: if the fund distributes 90% + to the shareholders, it only pays tax on the undistributed income, the 10% they kept. Unrealized capital gains only exist on paper—you only pay capital gains tax when you "realize the gain" by selling.
ANSWER: B

44. Which of the following represent(s) accurate statements concerning the tax implications of mutual fund investing?

I. because the mutual fund provides a 1099 form, the investor is relieved of the responsibility to report dividend income to the IRS and state tax collection agencies
II. capital gains distributions are determined by the fund's holding period, even if the investor has held the shares for less than one year
III. all dividends distributed are currently taxed at a maximum of 15%
IV. purchase and redemption dates for purposes of capital gains reporting are considered to be the trade date plus three business days

A. I
B. II
C. III, IV
D. I, II, III, IV

WHY: the fund provides a 1099-DIV, but it's the investor's responsibility to report the income on his own income taxes. Most dividends are taxed at a maximum 15% through 2010, but there are still ordinary dividends taxed at ordinary income rates in order to keep the tax code nice and simple. There is no T +3 settlement process for mutual funds, because you aren't buying shares from some customer in Bonners Ferry,

Idaho. The fund creates new shares whenever somebody wants to put money into the fund.
ANSWER: B

45. JoAnn originally invested $10,000 into the Argood Value Fund. She has since reinvested dividend distributions of $1,000 and capital gains distributions of $500. If JoAnn currently holds 1,000 shares of the Argood Value Fund, her cost basis is

A. indeterminable
B. $11.50 per share
C. $11.50 per share plus sales charges
D. $11.50 per share plus commissions

WHY: just take the amount she has invested and reinvested divided by the number of shares she now holds.
ANSWER: B

46. Which of the following statements accurately describes the taxation of capital gains?

A. a profit realized on a stock held for 11 months is currently taxed at the investor's ordinary income rate
B. a loss realized on a bond held for 13 months is treated as a long-term capital gain
C. commissions are subtracted from the purchase price and added to the sales price of stock to determine cost basis and proceeds
D. investors offset long-term gains with short-term losses, and short-term gains with long-term losses

WHY: don't let a weird answer convince you that a loss is somehow treated as a gain. I mean, the tax code is weird, but it isn't that weird. Commissions would be added to what you pay (cost basis) and subtracted from what you receive when selling (proceeds). And, investors match up long-term gains with long-term losses, and short-term with short-term.
ANSWER: A

47. Milton contributed $50,000 into a non-qualified variable annuity at age 41. Eleven years later Milton takes a random withdrawal of $15,000 with the account value at $75,000. His tax liability on the withdrawal is

A. none, as his contributions exceed the amount withdrawn
B. none, as he has held the investment longer than 12 months plus 1 day
C. partially subject to ordinary income rates
D. ordinary income rates on $15,000

WHY: there is an "excess over cost basis" of $25,000 here, so the IRS treats all the money coming out first as that excess. Not only is this $15,000 fully taxed, but so is the next $10,000, no matter how randomly he withdraws it.
ANSWER: D

48. Which of the following represent(s) accurate statements concerning variable annuities?

A. an investor younger than 59 1/2 may take a series of substantially equally periodic payments for 5 years or until age 59 1/2 (whichever occurs last) tax-free
B. an investor younger than 59 1/2 may take a series of substantially equally periodic payments for 5 years or until age 59 1/2 (whichever occurs last) without incurring a 10% penalty tax
C. when a beneficiary receives the proceeds of the death benefit, the proceeds are taxed at long-term capital gains rates
D. when a beneficiary receives the proceeds of the death benefit, the excess over cost basis is tax-free

WHY: when you take money out of your annuity, the excess over cost basis is taxable as ordinary income. Will you also pay a penalty? Not if you're at least 59 ½ , or you're using a qualified excuse, such as a 72t. You can avoid the penalty, but not the taxes due, just as you could on your Traditional IRA. Money coming out of annuities is not taxable at capital gains rates. It is also neither all taxable nor all tax free--part of it represents the return of the after-tax cost basis, and part represents the "excess over cost basis."
ANSWER: B

49. Which of the following statements accurately describe(s) the tax implications of insurance contracts?

A. the policyholder may surrender the part of cash value representing net premiums paid into the contract tax-free
B. loans against the policy are charged interest, and both the principal and interest reduce the contract values
C. death benefits are not taxable to the beneficiary, but are includable in the insured's estate for purposes of estate taxes
D. all choices listed

WHY: three good things to know about the taxation of insurance.
ANSWER: D

50. All of the following offer tax deferral except

A. SEP-IRA
B. ARG Aggressive Growth Fund
C. Non-qualified variable annuity
D. Variable Life Insurance

WHY: mutual funds do not offer tax deferral.
ANSWER: B

51. Which of the following represents a true statement concerning Traditional and Roth Individual Retirement Arrangements?

A. An individual may not make contributions to both for the same tax year
B. A Roth IRA may be converted to a Traditional IRA if taxes are paid on the entire amount going into the Traditional IRA
C. The owner of a Roth IRA may always take distributions tax-free after maintaining the account 5 years
D. Rollovers must be completed within 90 days to avoid taxes and penalties

WHY: well, I know "A" is true since I have both a Roth and a Traditional IRA myself. In fact, I also have a SIMPLE IRA, which shows my confidence in the Social Security system. Choice C was probably tempting, but to make sure your withdrawals are tax-free, you need to have the account five years and be 59 ½ --it's a package set, not an either-or. True "rollovers" must be completed in 60 days. Otherwise, the money is treated as an early distribution, which means you pay ordinary income tax plus a 10% penalty. And, your ordinary income rate probably got pushed up by taking a big, fat distribution.
ANSWER: B

52. Which of the following reflect accurate statements concerning Individual Retirement Arrangements?

A. the balance from a 401(k) plan may be transferred to a Traditional IRA without tax consequences
B. the balance from a 401(k) plan may be transferred to an existing IRA only
C. the balance from a 401(k) plan may be transferred to a Traditional IRA provided the amount does not exceed the current maximum contribution limit for the IRA
D. the balance from a 401(k) plan may be transferred to a Roth IRA without tax implications

WHY: the 401(k) is typically pre-tax money, so it needs to go into a pre-tax (Traditional) IRA, not a Roth. If the IRA is not already set up, no problem. Just set up a "rollover IRA." Annoyingly, when you log into your account 15 years later, it will still be called a "rollover IRA.” The money that was transferred from the 401(k) to the IRA is not a current year contribution, which is why it's really important that you pay attention when filling out the paperwork. If they transfer a $20,000 401(k) balance to your IRA, you can still make the year's maximum IRA contribution.
ANSWER: A

53. Which of the following retirement plans are available only to sole proprietors?

A. SIMPLE IRA
B. SEP-IRA
C. Keogh
D. Section 457

WHY: memorization point. Also called “qualified plans for sole proprietors.”
ANSWER: C

54. Which of the following statements accurately describe(s) defined benefit and defined contribution plans?

A. defined benefit plans pass the investment risk to the employer
B. defined contribution plans include 401(k) and profit sharing
C. defined benefit plans require the services of an actuary
D. all choices listed

WHY: was there an answer choice you could eliminate? Remember, eliminating answer choices is the name of the game, but you only eliminate answer choices when you're sure they can be eliminated. Otherwise, you’re just guessing and might as well close your eyes to save time for a question you actually know something about.
ANSWER: D

55. Which of the following represents an accurate statement concerning 529 Savings Plans?

A. a gift can be made for the current gift tax exclusion times five years without triggering gift taxes
B. contributions are made on a pre-tax basis
C. contributions are tax-deductible up to the current gift tax exclusion
D. distributions are taxable to the beneficiary of the plan

WHY: expect several questions on 529 plans, as the regulators have recently stepped up their regulatory efforts for these investments. First, the person making the gift to the plan does not get a tax deduction from the federal government. The tax benefits work like this--the investments grow tax-deferred, assuming they grow at all. The money coming out of the plan (distributions) is tax-free to the beneficiary, provided it is used for qualified education expenses. But, that "tax-free" thing has to do with the federal government. If the beneficiary's state doesn't sponsor/sanction the plan, they could tax the money, which is why it's really important to know how the state will treat the money before setting up the plan. Recently, a firm was busted by the NASD for selling residents of, say, Arizona, a plan that would only get favorable tax treatment by Wisconsin. Must have slipped the registered representatives' minds, I reckon.
ANSWER: A

56. A married couple would like to maximize contributions to a 529 Savings Plan. For Tax Year 2006, the maximum contribution that could be made without triggering gift taxes is

A. $11,000
B. $12,000
C. $60,000
D. $120,000

WHY: in order to avoid gift taxes, each one could use the current gift tax exclusion of $12,000 times 5 years. They would then not make any more gifts to that beneficiary for five years.
ANSWER: D

57. For purposes of Reg D under the Securities Act of 1933, which of the following investors is/are eligible to purchase a private placement?

A. CEO of the issuing corporation
B. Wife of the issuing corporation's CEO
C. Individual with over $1,000,000 net worth
D. all choices listed

WHY: a private placement allows the issuer to sell stock without registering it. Why? Because the investors include the CEO/CFO/COO, the board of directors, the immediate family of those folks, institutional investors like mutual funds/pension funds, and other people with lots of money to invest. The regulators insist that the little kids play tee-ball, but these are all big kids who should be allowed to play hardball if they want to.
ANSWER: D

58. Which of the following represent accurate statements concerning private placements effected via Reg D under the Securities Act of 1933?

A. investors agree to hold the shares fully paid for one year before transferring ownership
B. a married couple filing jointly that jointly owns over $1,000,000 in net assets and earns in excess of $300,000 is considered an accredited investor
C. the shares purchased are unregistered
D. all choices listed

WHY: just three things to know about private placements under Reg D of the Securities Act of 1933.
ANSWER: D

59. Which of the following represent(s) accurate statements concerning definitions under the Securities Exchange Act of 1934?

A. a broker is any person engaged in the business of effecting transactions in securities for the account of others
B. a dealer is any person engaged in the business of buying and selling securities for such persons' own account
C. a dealer does not include a person that buys and sells securities for such person's own account if not part of a regular business
D. all choices listed

WHY: you can see these acts in their entirety by doing a quick web search. Go to Google and type in "securities lawyers desk book." Or just type in the name of the Act.
ANSWER: D

60. Under both the Securities Exchange Act of 1934 and the Uniform Securities Act, which of the following investments meet(s) the definition of a "security"?

I. note
II. commodity futures contract
III. investment contract
IV. fixed annuity

A. I
B. II
C. I, III
D. IV

WHY: there are a few investments of money that do not equal "securities." Those would be fixed annuities, whole/term/universal life insurance, commodities futures, FDIC-insured deposits, and precious metals/stones.
ANSWER: C

61. According to the "Howey Case," which of the following most likely meet(s) the definition of an "investment contract"?

A. Joe purchases a 5% ownership stake in a California vineyard
B. Ellen purchases a 9% ownership stake in a prize-winning thoroughbred
C. Dale purchases a viatical settlement
D. all choices listed

WHY: the Howey Case came about back in the 1940's when a Florida company sold interests in a citrus growing operation and swore they didn't need to be registered as "securities" because the company was really selling farm land. The way the Supreme Court saw it, though, the Howey company was not selling farm land to investors for several reasons: the investors generally lived nowhere near Florida; the acre or so they bought was inherently unprofitable to farm all by itself; the investors knew nothing about farming; the investors got a share of the net profits of the enterprise, rather than say, 10 crates of juicy oranges on their front porch at Christmas time each year. In other words, the investors weren't buying farm land or oranges—they were investing money into a common enterprise and taking a share of the profits generated through the efforts of others. So, "an investment of money in a common enterprise where the investor hopes to profit solely through the efforts of others" is how we define an "investment contract," which was already defined as a "security."
ANSWER: D

62. Under the Securities Exchange Act of 1934, which of the following must register with the SEC?

A. national securities associations, such as the NASD
B. broker-dealer member firm of the NASD
C. stock exchanges
D. all choices listed

WHY: remember, all of these Acts of Congress are available online. You can take my word for it, and you can also double check by reading the source.
ANSWER: D

63. A federally registered investment adviser who willfully deceives clients could be held accountable under which of the following?

A. Investment Advisers Act of 1940
B. Securities Exchange Act of 1934
C. Uniform Securities Act
D. all choices listed

WHY: the states always have the authority to enforce anti-fraud regulations. While an investment adviser would certainly be subject to provisions of the Investment Advisers Act of 1940, don't forget that the Securities Exchange Act of 1934 says that anyone who uses deception "in connection with the offer, sale, or purchase of any security," is toast. An adviser telling you what to buy would certainly be connected with the purchase of a security, right? That way, even if the adviser didn't have to register under the Act of 1940, the SEC could always turn his world upside down under the Act of 1934.
ANSWER: D

64. Which of the following professionals least likely meets the definition of "investment adviser"?

A. person providing advice on Real Estate Investment Trusts for a flat fee
B. person providing advice on fixed annuities for a flat fee
C. person providing portfolio management for 150 basis points
D. person selling reports on small cap equities to certain large pension funds

WHY: is a fixed annuity a security? No--investment advisers give advice on securities.
ANSWER: B

65. Which of the following statement(s) accurately describes definitions under the Investment Company Act of 1940?

I. face-amount certificates are investments of periodic or lump sums whereby the issuer is obligated to pay a stated sum on a certain date more than 24 months after issuance
II. a unit investment trust (UIT) is an investment company organized as a trust, having no board of directors, and issuing only redeemable securities
III. an open-end fund is an example of a management company
IV. a closed-end fund is not an example of a management company

A. II
B. III
C. I, II, III
D. I, II, III, IV

WHY: face amount, UIT, management company. The two management companies are open-end and closed-end funds.
ANSWER: C

66. One of your clients is a widowed grandmother looking to contribute to her granddaughter's education. Which of the following represent accurate statements concerning a Coverdell Savings Account?

I. maximum contribution is $4,000 per donor
II. maximum contribution is expressed per-child, not per donor
III. if the funds are not used for education, they may be withdrawn tax-free as part of the donor's retirement savings
IV. contributions from the grandmother must stop when the child reaches age 18

A. I only
B. I, III only
C. II only
D. II, IV only

WHY: 529 savings plans are attractive to people affluent enough to worry about exceeding the $12,000 gift tax exclusion per year. People with less money to contribute probably like the Coverdell plan. The maximum contribution is currently $2,000 per child--not per donor. If the funds aren't used for education, there will be hell to pay, as with the 529. Unlike the 529 plan, the Coverdell is for kids only.
ANSWER: D

67. Which of the following statements is/are accurate concerning a Coverdell Savings Account?

A. maximum contribution is currently $2,000 per child
B. the donor does not have to be a member of the child's immediate family
C. contributions are made after-tax and distributions are tax-free if used for education of the child
D. all of the choices listed

WHY: three things to know about the Coverdell Savings Account
ANSWER: D

68. For purposes of private placements under Reg D of the Securities Act of 1933, an "accredited investor" would include:
A. CFO of the issuing corporation
B. Chairman of the Board of Directors for the issuing corporation
C. Individual with $2.5 million liquid net worth
D. All of the choices listed

WHY: officers and directors of the company can certainly get in on the private placement, as can individuals with over $1 million net worth or $200,000 in annual income.
ANSWER: D

69. Which of the following represent true statements concerning a private placement under Reg D?
I. the maximum number of non-accredited investors is 35
II. there is no maximum number of non-accredited investors
III. the maximum number of accredited investors is 35
IV. the CFO of the issuer is an accredited investor

A. I only
B. I, III only
C. I, IV only
D. II, III only

WHY: no maximum for accredited investors. The regulators protect the little kids more than the big kids, just as parents do.
ANSWER: C

70. Which of the following represent accredited investors for purposes of a Reg D private placement?
A. an individual with over $1 million net worth
B. an individual earning in excess of $200,000 the past two years
C. a married couple holding jointly assets worth in excess of $1 million on net
D. all of the choices listed

WHY: we're probably overdoing the preparation on Reg D private placements, but when the exam adds new information, that's the only approach that makes sense.
ANSWER: D

71. What is required for a non-accredited investor to purchase a private placement variable life insurance policy?

A. an attorney
B. blood relation to an officer/director of the issuer
C. a purchaser’s representative
D. an investment adviser

WHY: something else to memorize in case it shows up on the exam.
ANSWER: C

72. An omitting prospectus for a mutual fund containing performance data must include a legend disclosing which of the following?

I. the performance data quoted represents past performance
II. past performance does not guarantee future results
III. the investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost
IV. current performance may be lower or higher than the performance data quoted.

A. I only
B. I, II only
C. III only
D. I, II, III, IV

WHY: open up a copy of BusinesssWeek or Forbes. It will take you about one minute to find those very words on any of the ads for mutual funds.
ANSWER: D

73. Which of the following represent accurate statements concerning securities?

A. only non-exempt securities are subject to anti-fraud regulations
B. fraud is a violation under federal, not state, law
C. if the investment fits the definition of a “security,” it is subject to anti-fraud regulations and is subject to registration requirements
D. both fixed and variable annuities are defined as securities

WHY: the fraud statutes use the term "any security," so whether the security must register or is exempt has nothing to do with fraud. All securities are subject to anti-fraud rules. What about a fixed annuity? That's not a security. A fixed annuity has as much chance of being involved with securities fraud as the third basemen has of being called for an offsides violation. Both the federal Acts of Congress and state law are primarily concerned with preventing fraud in the securities markets.
ANSWER: C

74. Which of the following represent(s) violations of NASD rules concerning investment company securities?

A. a member firm acts as a distributor with a non-member firm

B. a member firm acts as a distributor with a member firm without a formal sales agreement in place

C. a member firm offers to promote a mutual fund provided the fund increase its trading volume through the firm's trading department

D. all of the choices listed

WHY: three things to know about member firms distributing/selling mutual fund shares.

ANSWER: D

75. An NASD member firm acts as a distributor for variable annuity contracts. The member, who is headquartered in Des Moines, Iowa, would like to provide a training seminar for registered representatives. According to NASD Rule 2820, what is true of this situation?

A. as long as the attending registered representatives are limited to those meeting a specific sales target, this would be acceptable

B. as long as the attending registered representatives achieved at least $1 million in sales, this would be acceptable

C. the member may reimburse registered representatives and one guest for all seminar-related expenses

D. the member may reimburse the registered representative for his/her expenses only and may not precondition attendance on achieving a specific sales target.

WHY: it had better be a true seminar where people could reasonably be expected to learn about more than the finer points of snorkeling or Jell-O shots. And, it can not be for representatives who reach a certain sales target. Otherwise, the distributors would be motivating firms/reps to promote annuities that reward them with tropical vacations rather than annuities that best meet their investors' needs. The sponsor can't cover the guest's expenses--only the rep's.

ANSWER: D

76. Under NASD Rule 2790, certain persons are defined as "restricted persons" who may not purchase initial public offerings through member firms. Which of the following represent restricted persons for purposes of this rule?

A. receptionist for a member firm not involved in the sales or trading operations of the firm

B. portfolio manager for a large insurance company

C. sister-in-law of a registered representative of a member firm

D. all of the choices listed

WHY: because of the abuses during the go-go 90's, just about nobody working at a broker-dealer or their immediate family can buy an IPO now.

ANSWER: D

77. Under NASD Rule 2790, certain persons are defined as “restricted persons” who may not purchase initial public offerings through member firms. Which of the following represent restricted persons for purposes of this rule?

A. A roommate of a registered representative living rent-free for one final semester of college

B. mother-in-law of a sales supervisor of a member firm

C. receptionist of a member firm

D. all of the choices listed

WHY: yes, even the deadbeat roommate is a restricted person. If he's receiving 25% or more of his financial support from the registered rep, he's a restricted person. Remember, it takes about two minutes to read these NASD rules yourself--go to www.nasd.com, click on NASD Manual and have yourself a party.

ANSWER: D

78. Kelly, a registered representative of a member firm, services her mother-in-law’s investment account held at the firm. Recently, Kelly’s mother-in-law offered to lend Kelly $5,000 toward the purchase of a townhouse. Which statement most accurately addresses this situation?

A. it is always a violation for a registered representative to borrow money from a client of a member firm

B. since Kelly’s mother-in-law is a member of the immediate family, the member firm may not set policy on such loans

C. the member firm must have written policy addressing loans of this nature and may decide that notification is not required concerning loans from or to immediate family members

D. the firm must file a suspicious activity report to FinCEN

WHY: as always, you can read the text of the NASD rule at the NASD website. This is NASD Rule 2370.

ANSWER: C

79. Which of the following professionals least likely meets the definition of an “investment adviser”?

A. an individual providing advice on variable annuities for compensation

B. an individual providing advice on variable life insurance for compensation

C. an individual providing advice on fixed annuities for compensation

D. an individual providing advice on convertible debentures for compensation

WHY: investment advisers are compensated for providing advice on securities. A fixed annuity is an insurance contract, not a security.

ANSWER: C

80. Which of the following are federal covered investment advisers?:

A. investment adviser with an office in the state with $42 million in assets under management

B. an investment adviser with an office in the state providing portfolio management services to a registered investment company headquartered in another state

C. an investment adviser with an office in the state with $32 million in assets under management

D. all of the choices listed

WHY: if the investment adviser manages over $30 million or advises registered investment companies, it is federal covered.

ANSWER: D

81. All of the following represent criteria from the so-called "three-pronged approach" provided by SEC Release IA-1092 except:

A. Does the professional provide investment advice?

B. Is the person compensated for providing investment advice?

C. Is the person in the business of providing investment advice with some regularity?

D. Is the person registered as an investment adviser?

WHY: you can not memorize your way through the Series 6. This is not a Psychology 101 exam where you simply take or purchase good notes, study for two hours, and get at least a B. You have to think outside the box and apply your foundation of knowledge in annoyingly creative ways on the Series 6. So, try to make a case for choice "D." The regulators are trying to determine who is an adviser and must register. If choice "D" were a criterion, the regulators would end up saying, "Oh, well since she isn't registered as an adviser, I guess we can't make her register as an adviser."

ANSWER: D

82. Which of the following likely represent(s) securities subject to anti-fraud statutes and registration requirements?

A. a certificate representing a 10% ownership stake in a prize-winning thoroughbred

B. a certificate representing a 40% revenue interest in three ATM machines owned by a third party

C. a variable annuity

D. all of the choices listed

WHY: unlike a fixed annuity, a variable annuity is a security. The other two are investment contracts as defined by the Howey decision.

ANSWER: D

83. Which of the following represents a security?

A. fixed annuity

B. universal life insurance policy

C. $50,000 bank certificate of deposit

D. American Depository Receipt

WHY: the other investments are regulated by insurance and bank regulators. The securities regulators want to regulate securities.
ANSWER: D

84. Under Rule 17f-2 of the Securities Exchange Act, all of the following persons associated with a member firm must submit fingerprints to the Attorney General of the United States except
A. a registered representative
B. a principal who supervises sales activities
C. an agent who sells mutual funds and variable annuities issued in book-entry form only
D. head of the cashiering department of a member firm

WHY: the money goes to the mutual fund, and the transfer agent creates the securities--so there would be no reason to fingerprint people at a firm that does not handle the money or securities.
ANSWER: C

85. Armanov Broker-Dealers has found that complying with NASD Rule 2212 “Telemarketing” is time-consuming and expensive. Therefore, the firm instructs its registered representatives to provide prospects with a 900-number should they wish to contact the firm for purposes of being placed on the firm’s do-not-call list. The charges are minimal and deemed reasonable by the firm’s chief compliance officer. Also, in order to reduce phone charges, the firm has instructed registered representatives to direct prospects to the 900-number if they would like the full name and title of the caller as well as the firm. What is true of this situation?
A. the firm has violated the rule by providing a toll number
B. the firm has violated the rule by instructing agents not to provide their name and the name of the firm they represent
C. the calling representatives must also identify that the purpose of their call is to interest the prospect in securities or related services
D. all of the choices listed

WHY: three things to know about telemarketing rules.
ANSWER: D

86. Which of the following persons may a registered representative call at a primary residence before 8 AM?
A. an investor who has held an IRA account with the firm for two years
B. an investor who has expressed interest in completing a transfer of funds from a 401(k) plan to an IRA at the firm
C. neither choice listed
D. either choice listed

WHY: the cold calling rules protect prospects from unwanted phone calls. If it's an existing customer, or if the person has expressed an interest in writing, you can call that

person even before 8 AM in her time zone. Why you would want to take the chance of interrupting her sleep I have no idea.
ANSWER: D

87. A member firm has entered into an informal agreement with a growth & income mutual fund whereby the portfolio manager of the fund will trade exclusively through the member when the member's sales of the growth & income fund to retail clients exceeds a specified target. What is true of this situation?
A. it represents common, acceptable arrangements between member firms and mutual funds
B. it would not violate NASD rules if the agreement were in writing
C. as long as a compliance offer at the member firm approves the arrangement in writing, no rules have been violated
D. the NASD forbids member firms from offering to promote a particular mutual fund based on the trading business executed on behalf of the fund

WHY: paying for shelf space is fine at supermarkets, but not in connection with investment company shares. The NASD takes the radical view that mutual funds should be sold based on suitability rather than on which fund will put the most trading commission dollars in the member's pocket.
ANSWER: D

88. In which of the following retirement plans is the employee immediately vested?
A. Defined benefit
B. SIMPLE IRA
C. 401(k)
D. Profit Sharing

WHY: associate "IRA" with immediate vesting.
ANSWER: B

89. Which of the following represent(s) methods of penalty-free withdrawals from an IRA even if the account owner is younger than 59 ½?
A. first time home purchase of a primary residence to $10,000
B. permanent disability
C. series of substantially equal periodic payments under IRS Rule 72(t)
D. all of the choices listed

WHY: every rule has exceptions.
ANSWER: D

90. Which of the following would be associated with a 50% insufficient withdrawal penalty?
A. Internal Rate of Return
B. Required Minimum Distribution
C. Substantially Equal Periodic Payments
D. Non-qualified premature distribution

WHY: by April 1st of the year following the account owner's 70 ½ th birthday, required minimum distributions must begin based on life expectancy. If the individual doesn't take out the required minimum, the IRS will help to remind him by imposing a 50% penalty.
ANSWER: B

91. The main advantage of reinvesting dividend distributions from a mutual fund is
A. tax deferral
B. tax deductions
C. purchasing new shares at the public offering price
D. purchasing new shares on a net asset value basis

WHY: mutual funds don't offer tax deferral. Purchasing shares at the POP is not an advantage, but avoiding the sales charge would be.
ANSWER: D

92. Open end funds are typically allowed to do all of the following except
A. sell an unlimited number of shares
B. sell to an unlimited number of investors
C. sell securities short
D. close off purchases to new investors

WHY: typically mutual funds do not sell short, because it is a very high-risk strategy.
ANSWER: C

93. XYZ Aggressive Growth Fund reports net income of $1,000,000 and distributes $880,000 directly to investors. Therefore, the fund will be taxed on what amount?
A. $120,000
B. $880,000
C. $1,000,000
D. as stipulated in the prospectus

WHY: did they distribute at least 90% of net income? If not, they pay taxes on net income.
ANSWER: C

94. All of the following are advantages of mutual fund investing except
A. liquidity
B. tax deferral
C. professional management
D. diversification

WHY: if you want tax deferral, you buy your "mutual funds" inside a variable annuity and call them "subaccounts." Mutual funds do not offer tax deferral in and of themselves.
ANSWER: B

95. Which of the following investment companies is considered a management company?
A. open-end fund
B. closed-end fund
C. neither choice listed
D. both choices listed

WHY: under the Investment Company Act of 1940 there are three types of investment companies: face-amount, UIT, management companies. The management companies are either open-end, or closed-end funds.
ANSWER: D

96. Which of the following investment companies involves installment investments by the investor in exchange for receiving a higher value from the issuer on a specified future date?
A. face amount certificate
B. UIT
C. open-end fund
D. index fund

WHY: doesn't that just sound like a "face amount certificate"? You put in this much; you'll receive the higher face-amount on the certificate in the future.
ANSWER: A

97. An investor who sells common stock at a loss must wait how long before repurchasing the security in order to use the loss under wash sale rules?
A. 15 days
B. 30 days
C. 60 days
D. 90 days

WHY: there are a few memorization questions on the exam. 30 days.
ANSWER: B

98. Roger held 1,000 shares of ABC for 14 months before selling them for a loss of $2,000. If Roger repurchases shares of ABC 23 days later, which of the following accurately describes the tax implications?
A. Roger can be fined by the NASD
B. Roger can be sued for tax fraud by the IRS and/or NASD
C. The loss is disallowed
D. The loss is disallowed but is added to the cost basis of the new purchase

WHY: a "wash sale" is not a violation. It just requires your accountant to treat it correctly. Since Roger did not wait 30 days, he can't use the loss, but he can add it to the cost basis on the new purchase, which means he'll get the benefit of the loss later on when he sells. Just to keep things nice and simple.
ANSWER: D

99. An investor, age 53, would like to withdraw money from her Traditional IRA without incurring penalties. She has already purchased her first home and has no medical emergency. Therefore, she would like to take advantage of IRS Rule 72(t). Which of the following represent accurate statements concerning this withdrawal method?

A. the investor must take a series of substantially equal periodic payments for 5 years or until age 59 1/2, whichever occurs last
B. ordinary income taxes will be due
C. there are several methods used to calculate the amount of the substantially equal periodic payments
D. all choices listed

WHY: remember, you can't avoid ordinary income taxes, but you can avoid the 10% penalty.
ANSWER: D

100. When is a participant fully vested in an IRA?

A. after three work years
B. after three calendar years
C. after five years
D. none of the above

WHY: associate "IRA" with "immediately vested."
ANSWER: D

101. Your client bought a single-premium deferred non-qualified annuity with a deposit of $50,000. At retirement, the separate account is worth $80,000. If your client withdraws $20,000, how much will be taxed?

A. $10,000
B. $20,000
C. $30,000
D. none

WHY: the point we're making by going over this again and again is that all money coming out of the annuity is treated as part of the "excess over cost basis" or "the earnings." There is an excess over cost basis of $30,000 here, so the $20,000 coming out is definitely part of that 30K and fully taxable.
ANSWER: B

102. Your client turned 70 on May 15th, 2002. On January 1st, 2004, she discovers that she has forgotten to withdraw funds from her Roth IRA. What are the consequences?

A. 50% insufficient distribution penalty
B. 50% insufficient distribution penalty, plus ordinary income tax
C. 6% excess contribution penalty
D. none of the above

WHY: read carefully--since the money coming out of a Roth is not taxable, the IRS doesn't care if you take it out. In fact, if you have earned income, you can keep on contributing to your Roth--not your Traditional--IRA.
ANSWER: D

103. All of the following offer tax deferral except
A. non-qualified variable annuity
B. non-qualified fixed annuity
C. mutual fund
D. 403b

WHY: we may be going overboard on this point, but mutual funds do NOT offer tax deferral.
ANSWER: C

104. Which of the following statements are accurate concerning Roth IRAs?
I. The maximum contribution for 2005 is $4,000/$4,500 per year depending on age.
II. Contributions do not qualify for a current tax deduction.
III. Withdrawals prior to age 59 ½ are subject to a penalty.
IV. Withdrawals prior to retirement are not permitted.

A. I and III only
B. I and IV only
C. I, II, and III only
D. I, II, III, and IV

WHY: what does "prior to retirement" mean? When you're 59 1/2, you can withdraw money tax-free, as long as the account has been open 5+ years. Also, since the exam is acting like a frustrated CFP these days, you can take your cost basis (amount contributed) out whenever you want. Why? It's not taxable, so what does the IRS care?
ANSWER: C

105. Lila Lopez is a 72-year-old retired school teacher. She earns $25,000 in retirement benefits from a TSA/403b plan. Last year she earned $1,700 teaching GED classes and received $900 in T-note interest. What is the maximum contribution she may make to her Roth IRA?
A. $0, as she is more than 70 1/2 years old.
B. $1,700
C. $4,500
D. $2,600

WHY: she can contribute the earned income, not the retirement money or the bond/note interest.
ANSWER: B

106. Savannah Somers is 73 years old. She works full time as a dental assistant earning $28,000 per year. She would like to invest in a small cap value fund, but wants to do so within an IRA account. Which of the following statements is correct?

A. Savannah Somers may contribute up to $4,500 pretax income in a traditional IRA.
B. Savannah Somers may contribute up to $4,500 after-tax income in a Roth IRA.
C. Savannah Somers may contribute up to $4,500 after-tax income in a traditional IRA.
D. Due to her age, Savannah Somers may not contribute to an IRA.

WHY: while she can't contribute to a Traditional IRA anymore, she can contribute to an IRA, as long as she has earned income.
ANSWER: B

107. All of the following statements are true of 529 plans EXCEPT:

A. Earnings in the account grow tax-deferred
B. There are no income limits for contributors
C. Contributions are unlimited
D. Withdrawals used for educational purposes may be subject to state taxation

WHY: actually, the states can set maximum contributions per beneficiary.
ANSWER: C

108. Dale and Johanna are a wealthy couple in their seventies with three grandchildren. They want to set aside the maximum amount possible for each grandchild's college education while minimizing their exposure to estate taxes. Therefore, which of the following recommendations would be most appropriate?

A. Establish one 529 plan shared equally by each grandchild, or proportionally by age.
B. Open a Coverdell Education Savings Account for each grandchild.
C. Establish a 529 plan for each grandchild
D. Buy a variable annuity for each grandchild.

WHY: was any of the other three answers tempting? Look again.
ANSWER: C

109. Sergio Menendez has set up 529 plans for each of his nieces. What is the most that Sergio may contribute to each plan without incurring gift taxes?

A. $2,000 annually
B. $4,500 annually
C. $2,000 annually or $10,000 at one time
D. $12,000 annually or $60,000 at one time

WHY: for the 529, five years of contributions can be made upfront.
ANSWER: D

110. The beneficiary of a 529 plan may make qualified withdrawals for:
A. The purchase of a Segway in order to get around a large land-grant campus
B. Dress for an upcoming sorority mixer
C. Tuition for an out-of-state college
D. Producing and sending resumes after graduation

WHY: make sure the educational expenses are legitimate--tuition, room and board, fees, books.
ANSWER: C

111. The assets in a section 529 College Savings Plan may be transferred to another beneficiary without a tax penalty:
A. Provided the second beneficiary achieves a minimum score on the ACT or SAT exams
B. Provided the second beneficiary is a member of the first beneficiary’s family
C. As long as the first beneficiary agrees
D. Annually

WHY: even though the beneficiary does not have to be related to the donor, if the donor changes the beneficiary, the new one has to be related to the original beneficiary.
Just to keep things nice and simple, as always.
ANSWER: B

112. In which of the following plans is the employer required to make a contribution each year?
A. SIMPLE IRA
B. SEP IRA
C. Money Purchase
D. 401(k)

WHY: money purchase plans require the employer to contribute a percentage of the employee's salary, regardless of how well the business did.
ANSWER: C

113. Melanie Myers wants to set up a retirement plan for her small business but does not want to obligate the company to make fixed annual contributions. She also does not wish to establish a complex or expensive plan. Which plan would be the best choice for Melanie's company?
A. SIMPLE IRA
B. Money Purchase Plan
C. Defined Benefit Pension
D. Roth IRA

WHY: you had to be tempted by a plan called "SIMPLE", right?
ANSWER: A

114. Which of the following organizations could establish a SIMPLE IRA plan?
A. company with 100 or fewer employees
B. company with a 401(k) plan established
C. public sector service, i.e. post office or national parks service
D. none of the choices listed

WHY: can't have > 100 employees and can't have another plan. These plans are for the private sector, which means business as opposed to government.
ANSWER: A

115. In order to charge the maximum sales load of 8.5%, a mutual fund sponsor must offer
A. Rights of accumulation
B. Automatic reinvestment at the POP
C. Conversion/exchange privilege
D. Diversification

WHY: just something else to memorize.
ANSWER: A

116. An investor made a $30,000 investment in a non-qualified variable annuity. With the annuity now valued at $45,000, the investor withdraws the entire amount. What are the tax consequences?
A. $30,000 is taxed at ordinary income rates
B. $15,000 is taxed at ordinary income rates
C. $45,000 is taxed at ordinary income rates
D. $15,000 is taxed at long-term capital gains rates

WHY: only the amount above what you put in is taxable. You do not pay capital gains rates on any retirement money, no matter how much you wish you could do that.
ANSWER: B

117. NASD Rule 2830 covers the favoring of investment company shares in exchange for directed brokerage. Which of the following represents an accurate statement(s) concerning this rule?
A. mutual funds may not execute portfolio transactions through members who sell shares of the fund
B. mutual funds may only execute portfolio transactions through members who sell shares of the fund
C. member firms may not favor investment company shares conditioned on portfolio transactions executed or anticipated
D. mutual funds are prohibited from executing portfolio transactions through NASD member firms

WHY: it's not that the member firm can't sell the fund to investors if the fund executes trades through the firm. It's that the firm can't tie their enthusiasm for pushing the fund to how much trading business the fund plans to give them.
ANSWER: C

118. Which of the following represent accurate statements concerning NASD Rule 2830 (k), which deals with the execution by member firms of investment company portfolio transactions?
A. a member firm may not favor the sale or distribution of shares of any particular investment company on the basis of brokerage commissions received or expected
B. a member firm may choose not to sell or distribute shares of an investment company if the investment company refuses to execute portfolio transactions through the firm
C. a member firm may pay extra compensation to sales representatives who sell shares of the investment companies executing significant numbers of portfolio transactions through the firm
D. all choices listed

WHY: mutual funds must be sold to investors based on suitability, not on how much commission business the member firm can squeeze out of the mutual fund in exchange for selling the shares to investors.
ANSWER: A

119. All of the following are features of Section 457 plans EXCEPT
A. they are nonqualified plans
B. contributions to the plan are made through salary deferral
C. earnings are taxable annually
D. they are established by state and local governments and other tax-exempt employers

WHY: it wouldn't be much of a retirement plan if you got taxed every year, right?
ANSWER: C

120. Your customer would like to do a 1035 exchange of his variable annuity for a life insurance policy and wants to be sure there will be no adverse tax consequences. You would inform him that:
A. the contract must be of the same issuer
B. he may do the exchange, but only to a whole life policy
C. he may do the exchange, but must pay income tax on any growth the annuity has experienced
D. 1035 exchanges are not allowed for annuities to insurance

WHY: life to life, life to annuity, annuity to annuity, but you can not turn an annuity into a life insurance policy.
ANSWER: D

121. All of the following concerning Section 529 plans are true except

A. Qualified withdrawals are exempt from federal income taxes.
B. Some states tax the withdrawals as income
C. Contributions are tax qualified.
D. The beneficiary does not have to be a minor child.

WHY: the contributions go in after-tax; they do not give the donor a tax break. They do, of course, reduce the size of the estate that will be taxed to their heirs when they die.

ANSWER: C

122. Which of the following statements are accurate concerning Section 529 Plans?

A. there are no income limitations on making contributions
B. when the beneficiary reaches the age of majority, the funds in the account become his property
C. the dollar amount of contributions is limited by the IRS
D. if the donor dies, the plan becomes part of his estate (no, remain outside the estate)

WHY: doesn't matter how much money Grandma makes; she can contribute to a 529 plan. The maximum contribution per beneficiary would be established by the states, not the IRS. The money gifted to a 529 remains outside the donor's estate, which is a big reason people use these plans.

ANSWER: A

123. Under Regulation D, all of the following would be considered an accredited investor EXCEPT

A. CFO of the issuing corporation
B. The investment adviser of a mutual fund or separate account
C. A registered representative earning $95,000 per year
D. An individual with $5 million net worth

WHY: sorry, but that registered rep is about $105,001 shy of being "accredited."

ANSWER: C

124. Joe purchases an equity income fund in March. In December of that year, Joe reinvests a capital gains distribution from the fund. If Joe redeems his shares the following February for a gain, what are the tax consequences?

I. the distribution is treated as a short-term gain
II. the distribution is treated as a long-term gain
III. the redemption is treated as a short-term gain
IV. the redemption is treated as a long-term gain

A. I, III
B. II, III
C. I, IV
D. II, IV

WHY: assume that the capital gains distributions from the fund to the investor are treated as long-term. But, if you reinvest and then quickly sell the shares, you will realize a short-term capital gain, taxed at your ordinary income rate.
ANSWER: B

Pass the Test, Inc. – Pass the 6© Lesson 3 Quiz

LESSON 3, MARKETING, PROSPECTING, AND SALES PRESENTATIONS
(18 of 100 Questions on Series 6 Exam)

1. If a registered representative describes a mutual fund as being "guaranteed to grow at least 8% annually on average," which of the following represents an accurate statement?

A. since the prospectus makes clear that the fund is not, in fact, guaranteed and may lose value, no violation has occurred
B. investors should focus on the prospectus and not on the communications of their sales representatives
C. the representative is subject to NASD sanctions, including fines and restitution to investors
D. only the principal/supervisor of the registered representative is subject to NASD enforcement actions

WHY: no way you can miss a question like this. It's a regulatory exam. Are the regulators interested to see if you know what you can't do, or to see if you know lots of ways to bend the rules to your advantage?
ANSWER: C

2. Under NASD Rule 2210 "Communications with the Public," a registered representative participating in a chat room about securities products would be defined as:

A. sales literature
B. advertising
C. public appearance
D. institutional sales literature

WHY: memorizing the definitions of various communications under the NASD rule, and be able to stretch a little. What if they ask about a text message, for example? What would that be called?
ANSWER: C

3. A registered representative sees an article in a major national financial magazine talking up the performance of a mutual fund that her firm sells. The registered representative would like to photocopy the article and send it to her clients. What is true of this situation?

A. A principal at the firm must approve the article.
B. Photocopies of magazine articles may not be sent to customers.
C. This is a violation known as "pegging".
D. A principal at the firm must approve the article and file it with the NASD within 10 days of first use.

WHY: for independently prepared reprints, a principal must approve it, but will file it internally. Advertising and sales literature connected to investment company shares that has not been filed previously must be filed with the NASD.
The independently prepared reprint is subject to NASD spot checks, which is why it needs to be filed at the firm.
ANSWER: A

4. Last week you sent a prospectus for the Argood Capital Appreciation Fund to a client. The client calls back, telling you she still has questions about the fund and would like to bring the prospectus in with her for a meeting at your office. You

A. must not further discuss any concepts already explained in the prospectus
B. may highlight the most important pages of the document for your client
C. may provide supplemental sales literature on the fund
D. may draft a brief summary of the prospectus and give it to the client

WHY: never highlight a prospectus or create your own little written summary.
ANSWER: C

5. Using a prospectus in selling a security relieves a salesperson from the responsibility to disclose to a customer

A. Highly competitive nature of the corporation's industry
B. Negative financial information about the company, i.e. Moody's downgrade
C. Neither a nor b
D. Both a and b

WHY: you must present the prospectus, but if you know other material information, you would also need to disclose that to a customer.
ANSWER: C

6. One of your clients calls to inquire about an aggressive growth fund that your firm sells and requests a prospectus. Since her objectives perfectly match the objectives of the fund, you explain the risks involved and discuss the various methods of reducing the front-end sales charges on A-shares. The client invests $3,000 in the fund. Therefore

A. you have complied with suitability requirements
B. no violations have occurred, provided the client does not lose more than % of her principal
C. a prospectus is not required for an unsolicited order such as this
D. you have violated prospectus delivery requirements

WHY: if the client requests a prospectus, can you think of a reason not to deliver one?
ANSWER: D

7. Which of the following information is found in the prospectus for a mutual fund?

A. information on the portfolio manager/investment adviser
B. fees and expenses
C. risk/return summary
D. all choices listed

WHY: you wouldn't even necessarily have to read a mutual fund prospectus--just looking at the table of contents might help you answer a few questions.
ANSWER: D

8. Which of the following represent(s) accurate statements concerning NASD Rule 2210?

A. a cold calling script is defined as sales literature
B. a letter to 15 prospects is considered correspondence
C. a registered representative explaining mutual fund investing to a local Chamber of Commerce is considered a public appearance
D. all choices listed

WHY: this rule can be read in the NASD Manual at www.nasd.com
ANSWER: D

9. All of the following information is typically found in a mutual fund prospectus except

A. list of all portfolio holdings
B. dividend and capital gains distribution policy
C. performance figures for 1, 5, 10 years and "life of fund"
D. disclaimer that investments are not FDIC insured

WHY: the investment adviser trades the mutual portfolio all the time, so providing a list of portfolio holdings that would become stale immediately wouldn't make sense.
ANSWER: A

10. All of the following would be registered with the SEC except

A. Open-end investment company shares
B. Shares of beneficial interest in a newly-created UIT
C. Municipal bond mutual fund
D. Commercial paper

WHY: commercial paper is generally exempt under the Securities Act of 1933.
ANSWER: D

11. Why is selling dividends considered a violation?

A. Dividend distributions are already included in the price paid for the security.
B. Dividends create tax burdens for investors and should, therefore, be avoided.
C. Investors do not actually receive the first dividend distribution until shares have been held fully paid for 30 calendar days.
D. Investors do not actually receive the first dividend distribution until shares have been held fully paid for one financial quarter.

WHY: you pay the price of the mutual fund share, then you get back, say, $1. The day they pay the $1, the NAV drops by $1. So you, effectively, "bought the dividend," which is taxable.
ANSWER: A

12. Registered representatives are warned against the practice of encouraging customers to frequently liquidate shares of a mutual fund in order to purchase shares of another fund, especially if the fund is within a different family. Which of the following represent acceptable justifications for encouraging a customer to switch from one fund to another fund inside a different mutual fund family?

I. The investor's objectives have changed.
II. The investor’s risk tolerance has changed.
III. The fund the investor has owned for three years has a contingent deferred sales charge.
IV. The fund the investor plans to purchase pays higher compensation to registered representatives.

A. I only
B. II only
C. I, II only
D. I, III only

WHY: you can't base the decision on the commissions you'll receive, and if there is a contingent deferred sales charge, the investor will get hit pretty hard in the third year.
ANSWER: C

13. If a mutual fund distributor would like registered representatives to consider recommending a mutual fund to suitable clients, registered representative are permitted to accept from the distributor all of the following except:

A. $75 worth of coffee mugs with the fund's name and logo
B. Four days at a Caribbean resort in reward for selling a certain amount of the fund
C. Two tickets to a professional baseball game
D. Reimbursement for attending a 2-day educational seminar on the funds held in Des Moines, Iowa

WHY: gifts to persons in the industry are not to exceed $100 per year. Rep's can not be rewarded with vacations in exchange for meeting a sales target of the distributor's mutual funds.
ANSWER: B

14. A magazine advertisement for the Oakwood Partner’s Conservative Income Fund lists performance data for 1, 5, and 10-year periods. Which of the following represent true statements concerning such advertising?

A. If a sales load or any other nonrecurring fee is charged by the fund, the advertisement must disclose the maximum sales charge
B. It must be clear whether the performance figures cited are including the deduction of sales loads
C. A disclaimer that past performance does not guarantee future results must be displayed
D. All of the choices listed

WHY: take a look at a BusinessWeek or Forbes magazine and look for mutual fund ads. You'll see exactly what this question is talking about.
ANSWER: D

15. A registered representative works for XYZ Broker-Dealers, a firm with a dealer agreement with the ABC Mutual Fund complex. The registered representative will host a seminar this week at which she plans to use a computer slide show and a prepared script. If the representative also plans to distribute a prospectus, which of the following must be filed with the NASD as sales literature?

I. the slide presentation
II. the script
III. the prospectus

A. I only
B. II only
C. I, II, III
D. I, II only

WHY: the prospectus would have already been filed with the SEC. Read NASD Rule 2210, and you'll see what we're talking about.
ANSWER: D

16. Which TWO of the following are considered sales literature by the NASD?

I. web page
II. letter sent to a client
III. group e-mail sent to 33 recipients
IV. prepared script for a seminar

A. I, II
B. III, IV
C. II, IV
D. I, III

WHY: if the letter/email goes to 25 or more prospects, it leaves the category of "correspondence" and becomes "sales literature." Why would that matter? Sales literature must be pre-approved. Correspondence must be regularly monitored. see the difference?
ANSWER: B

17. All of the following represent sales literature except:

A. Research report
B. Market letter
C. Letter sent to 35 retail prospects in a 90-day period
D. Letter sent to fewer than 25 retail prospects in a 90-day period

WHY: if it's fewer than 25, it's correspondence, not sales literature.
ANSWER: D

18. Which of the following represent(s) sales literature?
A. computer slide shows
B. letter sent to more than 25 retail prospects
C. handouts and invitations connected to a seminar on securities products
D. all of the choices listed

WHY: more details on NASD Rule 2210, one you definitely should read.
ANSWER: D

19. Which of the following statements is/are true concerning the objectives of mutual funds?
I. Objectives of a mutual fund are stated in the prospectus
II. Funds may not simultaneously have multiple objectives.
III. By reviewing the objectives, a prospect can also determine the types of securities the fund will purchase.
IV. Objectives may be changed by the fund's investment adviser if the adviser is registered with the SEC under the Investment Advisers Act of 1940

A. I, III only
B. III only
C. I, II and III only
D. I, II, III, IV

WHY: equity/stock funds basically come down to three categories--growth, value, blend. If the fund wants to invest for both growth and value, it can call itself a blend fund. An asset allocation fund would also be investing for capital appreciation, capital preservation, and income. The adviser does not change the objectives of the fund. They manage the portfolio according to the stated objectives.
ANSWER: A

20. Which of the following reflect accurate statements concerning sales of and offers to sell securities?
A. a sale includes every contract of sale or disposition of a security or interest in a security, for value
B. an offer to sell includes every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value
C. neither term applies to an issuer and its underwriters negotiating terms for an offer of securities
D. all choices listed

WHY: this is pulled from Section 2 of the Securities Act of 1933. Unless they've moved recently, you can get the act at http://www.law.uc.edu/CCL/xyz/sldtoc.html.
ANSWER: D

21. Mutual funds must report to shareholders
A. daily
B. semi-annually
C. quarterly
D. monthly

WHY: there is a semi-annual report, and an annual report that goes to shareholders. Don't confuse these with the prospectus that goes to people considering an investment into the fund.
ANSWER: B

22. Mutual funds must redeem shares
A. immediately, on demand
B. within 5 business days
C. as stipulated in the prospectus
D. within 7 days

WHY: the requirement to redeem shares within 7 days can only be suspended in rare cases.
ANSWER: D

23. Which of the following statements is true concerning 12 b-1 fees?
A. may not be charged by any "no load" company
B. also referred to as "sales charges"
C. may be used to cover management fees
D. annual fees charged quarterly

WHY: management fees are a separate line item in the operating expenses found under "fees and expenses" in the prospectus. The 12b1 fee is separate from that. If it's .25% or lower, they fund is still "no load." A sales charge would be in the table above the operating expenses. These are deducted from the investor's initial investment for A-shares, or deducted from the sales proceeds for B-shares. Operating expenses don't get deducted from the investor's check--they get deducted from fund assets, causing the NAV to drop.
ANSWER: D

24. Preventing an investor from achieving a discount on quantity purchases is
A. punishable by death or dismemberment
B. called double-dip selling
C. called backing away
D. is a violation called "breakpoint selling"

WHY: don't let the easy ones get away from you.
ANSWER: D

25. Which of the following represent accurate statements concerning NASD rules on telemarketing?

A. some firms must tape record all calls between registered representatives and both prospects and existing customers
B. the caller must identify him/herself, identify the member firm, provide an address or telephone number at which the firm may be contacted, and explain that the purpose of the call is to interest the party in purchasing securities or related services
C. callers must first check the firm-specific do-not-call list, then check the national registry and refrain from calling any name on either list
D. all of the choices listed

WHY: three things to know about cold calling rules.
ANSWER: D

26. A registered representative who fraudulently violates securities rules and regulations can be punished by the

I. NASD
II. SEC
III. State where the violation occurred

A. I only
B. II only
C. II and III only
D. I, II, and III

WHY: no doubt about it. The NASD will bust you for violating SEC rules. And when those folks crack the whip on you, they're usually very diligent in reporting their action to the state where you used to have a license.
ANSWER: D

27. Mutual funds may publish expected returns for which of the following periods?

A. 3 years
B. 5 years
C. 1 year
D. none of the above

WHY: past returns can be shown, as long as there's nothing misleading about them. Predictions and projections about future returns are not allowed.
ANSWER: D

28. An open-end fund advertises itself as a "no-load fund," even though it does deduct a 12 b-1 fee. What is true of this situation?

A. it is a violation of NASD rules
B. it is a violation of SEC rules
C. it is permissible provided the fee does not exceed .50% of average net assets
D. it is permissible provided the fee does not exceed .25% of average net assets

WHY: money market mutual funds have to be "no load." Can they have a 12b1 fee? Absolutely. It just can't exceed .25% of average net assets.
ANSWER: D

29. Your firm is the sponsor of an aggressive growth fund. In order to push sales of the fund, you offer $250 to the registered representative of any NASD member firm who sells the most shares. This practice

A. is acceptable
B. is acceptable with approval of the firm's principal
C. is a violation
D. none of the above

WHY: gifts are not supposed to exceed $100 per person per year.
ANSWER: C

30. A registered representative calls several clients in her book of business to interest them in an opportunity to invest in her brother-in-law's new restaurant. The investment contracts are properly registered in the state and, therefore, the registered representative offers and sells them without informing her principal. Which of the following best addresses this situation?

A. since the security was properly registered no violation has occurred
B. this is a violation of NASD conduct rules known as "frontrunning"
C. as long as no commissions were accepted from customers in the state, no violation has occurred
D. this is a violation of NASD conduct rules because the registered representative gave her employer no opportunity to supervise her activities

WHY: this is a violation called "selling away." Never offer investments without letting your firm first know about your crazy intention to ruin your career.
ANSWER: D

31. Which of the following communications by an NASD member firm may exclude the name of the member?

A. sales literature
B. advertising
C. recruiting advertisement
D. research report

WHY: all other advertising must contain the name of the member firm. Recruiting ads might just ask interested candidates to apply for a job and send the resume to a PO Box # without identifying the firm. That way they won't have to field 250 phone calls from over aggressive sales types trying to gain on edge on the hiring process.
ANSWER: C

32. When the subject of the communication is investment companies, which of the following would not require filing with the NASD?
A. advertising
B. independently prepared reprints
C. market letters
D. computer slide shows

WHY: for an article in, say, Forbes, just make sure the principal reviews it for accuracy and other compliance issues. The NASD doesn't need a copy of the article in their files, though.
ANSWER: B

LESSON 4, EVALUATION OF CUSTOMERS (13 of 100 Questions on Series 6 Exam)

1. Which of the following can reduce interest rate risk?
A. the bond is convertible
B. a warrant is attached to the bond
C. the term to maturity is relatively short
D. all choices listed

WHY: if the bond is tied to the price of the stock, that adds another factor outside of interest rates, making the bond less sensitive to interest rate hikes. The shorter the maturity, the less the market panics when rates rise.
ANSWER: D

2. If Maria's investment appreciates 5% during a period in which the CPI increases 2%, her real rate of return is
A. dysfunctional
B. reciprocal
C. 3%
D. -2%

WHY: a "real return" is just the return above the rate of inflation, as measured by the Consumer Price Index (CPI).
ANSWER: C

3. Which of the following investments would most subject an investor to purchasing power risk?
A. variable annuity
B. aggressive growth fund
C. fixed annuity
D. corporate bond rated BB

WHY: fixed annuities pay a guaranteed rate of return, but if inflation is rising, that guaranteed payment generally won't keep up. It's safe and secure, but the fixed annuity leaves the investor with purchasing power or inflation risk.
ANSWER: C

4. Which of the following could cause the NAV of a bond fund to deteriorate?
A. credit downgrade by Moody's or S&P
B. rise in interest rates
C. reduced liquidity in large holdings of the portfolio
D. all choices listed

WHY: you had to like at least two out of the three--when that happens, choose "all choices listed."
ANSWER: D

5. An investor who purchases an emerging market fund is subject to which of the following risks?

A. political
B. market
C. currency exchange
D. all choices listed

WHY: you can't escape market (systemic) risk when buying stock. If it's an emerging market, the political climate isn't as stable as it is in a developed market. If there is a general strike or an uprising, the supply chain will grind to a halt, and the companies whose stock you own won't be selling anything, which is one of the quickest ways to knock a stock price down. "Sales plummet" is not the kind of headline shareholders are looking for. Note that currency risk would also be part of the deal for international or global funds, but the emerging market funds add political/social risk, too.
ANSWER: D

6. Martin purchases shares of the ABC Aggressive Growth fund with one investment of $10,000, with no further plans to invest in the fund. ABC concentrates primarily in start-up companies developing new technologies. Martin is probably least exposed to which of the following risks?

A. purchasing power
B. business
C. market
D. timing

WHY: purchasing power is the last thing that should be keeping Martin up at night. The main risks here include the fact that he invested all at one price--what if he hit the highest price the fund is going to be over the next five years? Dollar cost averaging could have reduced that risk. The companies he's investing in are in a very risky, unproven industry, and their businesses are very immature--that's definitely business risk. Whenever you buy stock, you have to worry about a general market decline or even a panic. If enough investors start freaking out, it's like a nonviolent British soccer riot. And not always completely non-violent, at that.
ANSWER: A

7. To avoid reinvestment risk, an investor would most likely purchase

A. T-bonds
B. STRIPS
C. 10-year debentures
D. 5-year T-notes

WHY: to avoid reinvesting your interest/coupon payments into new bonds when rates are very low, you can buy a debt security that returns all the interest at the very end. That's a "zero coupon," and a STRIP would be the safest version, followed by a high-quality municipal zero coupon. Corporate zero coupon? Well, that would eliminate reinvestment risk and also imply that you have an immense amount of faith in

that corporation's promise to pay you everything they owe you 10-20 years into the future.
ANSWER: B

8. Your investor's objective is to preserve her capital for a period of approximately five years. She would like to earn a rate of interest commensurate with her goal of capital preservation. Which of the following investments would be most suitable?

A. T-bills
B. T-notes
C. T-bonds
D. Blue Chip Stock

WHY: in general, don't be trying to jump in and out of the stock market in five years, certainly not when you also need your principal to be stable. A T-bond's maturity is at least twice as long as your investor's time horizon, so put him into a 5-year T-note. Couldn't you also just put him into T-bills and have him keep buying new ones every three or six months? Sure--but this is a test question. What does the test most likely want you to pick as the "right" answer?
ANSWER: B

9. If Marla fears an economic slowdown--as indicated by falling GDP--which of the following industries would be the most suitable for Marla to invest in?

A. steel
B. health care
C. transportation
D. automobiles

WHY: if the economy slows down, people still go to the doctor and buy their prescription drugs. On the other hand, people can put off purchasing a new automobile, which is a direct hit to the steel industry. The steel industry isn't booming because there isn't a lot of new construction or manufacturing going on. If manufacturing and construction are slowing down, there isn't as much need to transport goods all over the country, right? So, healthcare would be a "defensive industry," while the others here represent "cyclical industries." That's just fancy talk for the fact that healthcare will weather the recession better, while the other industries do well during an economic expansion but take it on the chin during a recession.
ANSWER: B

10. Your client's objective is maximum current income but she is not comfortable with excessive risk. Therefore, you would most likely recommend

A. Money market funds
B. Open end funds
C. High-yield bond funds
D. Investment-grade corporate bond funds

WHY: just keep eliminating choices until you're down to the one that's hardest to eliminate. Money market doesn't take care of "maximum income," and "high-yield" is too risky.
ANSWER: D

11. Your client's goal is to accumulate money for retirement. She has a good job and no debt beyond a modest mortgage payment. She is not risk-averse. Which of the following funds would you least likely recommend?

A. Money Market Fund
B. Aggressive Growth Fund
C. Overseas Opportunities Fund
D. Science and Technology Fund

WHY: the wording is tricky here, so read the question carefully. Our brains don't usually think in such a negative direction. . . least likely? Oh well. You have to ask yourself which of the four choices would be the worst recommendation to make. This investor needs to build a nest egg that grows faster than the rate of inflation. She's not a big wimp, so why put her in a safe, boring, low-yielding "investment" like the money market?
ANSWER: A

12. Johanna's investment objective is to match a particular stock index without paying a sales charge or high operating expenses. She would like to take advantage of intra-day movements in the markets and occasionally bet opposite of the market. Therefore, Johanna should consider investing in

A. ETF's
B. Open-End index funds
C. REITS
D. ADR's

WHY: wow, that one reads like a party game where people just keep giving clues until you finally say "E-T-F." If you chose "open-end index funds," you were almost right. They do track the index, but you can't take advantage of the intra-day movements. You can't buy low at 10 AM and then sell high at 11 AM. When you sell an open-end fund, you simply put in a redemption order and receive the NAV that is next calculated for the fund.
ANSWER: A

13. All of the following represent assets to an investor except

A. market value of a home
B. IRA balance
C. mortgage balance
D. checking account

WHY: is it a plus or a minus to you? A mortgage balance is what you owe the mortgage lender, a big minus reducing your net worth. Since the home is the biggest investment for most people, their entire net worth is wrapped up in the house. The

market value of the house (asset) minus the mortgage balance still owed (liability) is their net worth
ANSWER: C

14. All of the following represent an investor's liquid assets except
A. savings accounts
B. checking accounts
C. investment accounts
D. home

WHY: a home is definitely an asset, but it isn't liquid. A liquid asset is something you can withdraw or sell at a fair price immediately.
ANSWER: D

15. Which of the following types of mutual funds probably requires that the investor be able to withstand the largest amount of price volatility?
A. equity income
B. growth fund
C. value fund
D. intermediate-term bond fund

WHY: growth investing is not for everyone. Yes, it promises potentially huge returns, but it also involves many heartbreaks. You buy stocks at very high prices (compared to their earnings), and when these "growth companies" announce disappointing earnings one quarter, the enthusiasm propping up the stock evaporates and the stock falls 20-50%. A growth company has most of its success tucked frustratingly away in some perceived future. If the future doesn't look bright all of a sudden, the enthusiasm for the barely profitable company evaporates, and your stock is in serious trouble. In other words, you need an iron stomach and a long time horizon for this whole growth strategy.
ANSWER: B

16. Which of the following types of mutual funds is most suitable for an investor unable to withstand price volatility?
A. US Government Bond fund
B. Money Market fund
C. Conservative Growth Fund
D. Growth & Income Fund

WHY: in some ways, they all look like nice, conservative investments, largely because they all are. But government bonds drop in price when rates rise, and the other two are invested in the stock market, where even a conservative investment like Wal-Mart could be down 20% for the year. The money market is a "stable value" fund, with the share price at $1.
ANSWER: B

17. An investor works as an interior designer. She is a single parent with two children aged 5 and 9. Her objectives are to save for her children's education as well as her own retirement. Because her work load is sporadic, she would also like to take steps to deal with an inconsistent income stream. The investor's risk tolerance is moderate. Which of the following recommendations best addresses the investor's needs?

A. A conservative growth fund, as it would eventually provide enough capital to both fund the children's education and provide for the investor's retirement
B. 30% invested in STRIPS, 20% in a growth & income fund, 50% in an intermediate-term US Treasuries fund
C. A growth and income fund, as the growth would satisfy the needs for education and retirement while also providing supplemental income that can be depended on during work slowdowns
D. A U.S. Government Securities fund, as this investor's most pressing need is capital preservation

WHY: you have to analyze answers choices carefully. Yes, the US Gov't Securities Fund sounds about right, but is "capital preservation" her most pressing need? Does she actually have a bunch of capital to preserve? Maybe she needs some capital appreciation/growth to help build a retirement nest egg. We aren't doing emerging market funds or small cap aggressive growth funds with her moderate risk tolerance, but we can surely allocate a modest percentage to a growth & income fund. And, for her kids' education, she has Treasury STRIPS that WILL pay out the higher principal amount at maturity, and she has ½ her portfolio in intermediate-term US Treasuries. The 9-year-old will enter college in 9-years, so that's a good time horizon for T-notes/intermediate-term US Treasury Funds. Wow--you're supposed to think that hard just to get one test question right?
Only if you want to pass.
ANSWER: B

18. Susan's investment objective is capital preservation. If she is concerned about a rise in long-term interest rates, you would recommend that Susan invest in

A. T-bills
B. 15-year STRIPS
C. T-notes
D. T-bonds

WHY: all of the "T-s" are safe in terms of having no default risk. But when rates rise, long-term debt securities get smacked much harder than short-term. If she's worried about that, put her in short-term Treasuries and call it a day.
ANSWER: A

19. Joanna's investment objective is current income. If she also has a high risk tolerance and long time horizon, you would recommend

A. small cap stocks
B. aggressive growth mutual funds
C. non-investment-grade corporate bond funds
D. T-bonds

WHY: this type of question might seem frustrating at first—just start eliminating answer choices. Small cap stocks and aggressive growth funds don't offer much income, if any. T-bonds are too conservative for somebody in need of current income willing to take on risk. If you eliminate those, what are you left with?
The answer to the question.
ANSWER: C

20. Steven plans to invest in three mutual funds within the Feelgood Mutual Fund Family. Steven's anticipated holding period is 8-10 years. Therefore, you would most likely recommend

A. that Steven invest outside mutual funds
B. that Steven invest in A shares
C. that Steven invest in B shares
D. that Steven invest in C shares

WHY: the B-shares look tempting, until you realize that you're paying a much higher 12b1 fee for 6 or 7 years. As the assets of the fund grow, the 12b1 fee becomes a larger dollar amount, even if the percentage stays flat. No, no, no. You want compounded returns, where more money makes more money which makes more money. You don't want to be PAYING out compounded returns to the distributors of the fund. But the A-shares spread that front-end load over a long time period to make yourself feel better. You paid maybe a 3% sales charge, but divided by 8-10 years, that's not that big of a deal. And, if that doesn't cheer you up, consider how much you've saved by paying a MUCH lower 12b1 fee over 6 or 7 years compared to the B-shares.
ANSWER: B

21. An investor concerned with credit risk would least likely purchase

A. T-bills
B. Debenture rated BB-
C. T-notes
D. Debenture rated B

WHY: an investor concerned with credit risk would avoid the low-rated bond. Both BB- and B are junk bonds, but B is much junkier than BB-.
ANSWER: D

22. Which of the following generally has the lowest liquidity?
A. money market mutual funds
B. T-bills
C. large cap stock
D. municipal bonds

WHY: municipal bonds are often issued in tiny batches. A local school district recently raised $2 million by selling bonds. If the bonds are $1,000 par value, that's just 2,000 bonds. I bet 10 different investors or fewer snatched up all the bonds.
So, to whom do the 10 folks plan to sell their municipal bonds, and what the heck is a fair price on a bond that hasn't changed hands in 27 months?
Not a highly liquid secondary market. The other three choices are extremely liquid. I could liquidate my T-bills faster than I could get change for a twenty at the corner store. How hard would it be to sell shares of Wal-Mart, GE, or IBM? If I were logged into my account, it would take about 3 seconds. And nothing is more liquid than the money market mutual fund--you just cut a check and they redeem enough shares to cover it, at $1 per share.
ANSWER: D

23. Randall is a 38-year-old with a non-working spouse and two children, ages 2 and 5. Randall earns approximately $50,000. Which of the following likely represents Randall's most immediate need?
A. life insurance
B. capital appreciation
C. current income
D. tax-exempt income

WHY: since most of you are insurance agents, you would probably need to give us 50 pushups rather than the customary 25 if you missed this one. Even if you thought it was wrong, you should have stood up for your industry.
ANSWER: A

24. To which of the following investors would a registered representative most likely recommend an aggressive growth fund?
A. investor with a short time horizon
B. 55-year-old investor whose primary objective is income and secondary objective is growth
C. 47-year-old investor whose insurance needs are adequately met and who participates in a defined benefit pension plan
D. 45-year-old investor planning to purchase a home in the next 3-5 years

WHY: you don't invest in an aggressive growth fund unless your time horizon is long-term. There are two investors with short time horizons--eliminate them. Then, another investor wants income. Recommending a growth investment to an income investor is completely off the mark.
ANSWER: C

25. Which of the following likely represents the most significant risk to a holder of a Ginnie Mae (GNMA) pass-through security?

A. default risk
B. prepayment risk
C. liquidity risk
D. business risk

WHY: GNMA's don't have default risk. Just like a callable bond, these things are retired early when rates drop. Homeowners take out new mortgages to replace the ones backing your pass-through. You're done--here's the rest of your principal, go buy a new pass through offering a lower rate of return.
ANSWER: B

26. An investor who is not comfortable with the fluctuations of the stock market would least likely purchase which of the following funds?

A. money market
B. intermediate-term fixed-income
C. blend fund
D. US Treasury fund

WHY: the most common type of "blend fund" is a stock fund that invests in both "growth" and "value" stocks. A growth stock is in a hot company that the media just loves to death, trading at very high price-to-earnings multiples. A value stock is a company being trashed by the media and Wall Street, therefore, trading at low price-to-earnings multiples. Either way, the fund would be buying stocks, which is how you get the right answer here.
ANSWER: C

LESSON 5, PRODUCT INFORMATION: INVESTMENT COMPANY SECURITIES AND VARIABLE CONTRACTS (26 of 100 Questions on Series 6 Exam)

1. Which of the following represent(s) accurate statements concerning various share classes of mutual funds?

A. A-shares carry front-end sales charges and lower operating expenses compared to B- and C-shares
B. B-shares carry no front-end sales charges but do carry a declining back-end sales charge and higher operating expenses than A-shares
C. C-shares charge a 1% 12b-1 fee
D. all choices listed

WHY: three good things to know about A-, B-, and C-shares. A mutual fund that has all three classes would explain the difference very quickly in the prospectus under "fees and expenses of the fund."
ANSWER: D

2. Which of the following represent(s) accurate statements concerning term life insurance policies?

A. there is no cash value
B. younger investors typically find term more suitable than older investors
C. a Series 6 or 7 is not required to sell term insurance
D. all choices listed

WHY: term insurance costs more and more the older you get, so it's more attractive to younger investors who just want to make sure there is a death benefit should they die. After all, it would be rather rude to stick friends and family with your funeral bill.
ANSWER: D

3. Which of the following represent methods of redeeming/selling mutual fund shares?

A. by mailing a request to the transfer agent
B. by establishing a systematic withdrawal plan
C. by contacting the transfer agent via telephone
D. all choices listed

WHY: any mutual fund prospectus will explain how the investor can redeem shares of the fund.
ANSWER: D

4. Which of the following represents a true statement concerning a customer redemption order for a mutual fund investment?

A. customers receive the public offering price as next computed by the fund
B. customers receive the Asked price as next computed by the fund
C. customers receive the Net Asset Value as next computed by the fund, minus any back-end sales charges and/or redemption fees
D. customers receive the Net Asset Value as last determined by the fund

WHY: there really is no "asked" price for a mutual fund. The "POP" or public offering price would be similar, but still it would be the price an investor pays, not receives.
ANSWER: C

5. Which of the following terms describes the fact that an investor in a mutual fund owns a percentage of all securities held in the portfolio?

A. forward pricing
B. exculpability
C. undivided interest
D. fractional shares

WHY: it's not that some investors own the GE and others the GM. Each investor owns his or her percentage of all securities.
ANSWER: C

6. Which of the following represent(s) accurate statements concerning systematic withdrawal plans from mutual funds?

A. investors should not make further investments into the fund when a systematic withdrawal plan is in place
B. a fixed percentage withdrawal plan involves liquidating varying numbers of shares
C. a fixed share withdrawal plan pays out a varying amount of money to the investor
D. all choices listed

WHY: some investors like systematic withdrawal plans as opposed to selling everything at today's NAV. If we dollar-cost-average on the way in, we can use systematic withdrawal plans to dollar-cost-average on the way out.
ANSWER: D

7. Which of the following represent(s) methods of diversification for mutual fund portfolios?

A. a mutual fund purchases common stock in companies from a dozen different industries
B. a mutual fund purchases common stock in companies from several geographic areas
C. a mutual fund purchases common stock, preferred stock, and convertible debentures from two dozen issuers
D. all choices listed

WHY: the exam outline mentions that portfolios can be diversified by geographic region, types of securities, industries, and issuers. Even if you want to over-concentrate

in, say, the retail sector, you can diversify by purchasing stock in many different retailers: Wal-Mart, Kohl's, Home Depot, the Gap, etc.
ANSWER: D

8. Which of the following reflect(s) advantages of mutual fund investing compared to investing in common stock directly?

I. portfolio management
II. 12b-1 fees
III. redemption fees
IV. simplified tax reporting

A. I
B. I, IV
C. II
D. II, III

WHY: fees sure aren't an advantage to the investor. Mutual funds would collect dividends from maybe 50 different companies but send me just one 1099 DIV for the year. That's a lot easier than receiving 50 different 1099's, as I would if I owned common stock in each company.
ANSWER: B

9. All of the following represent the functions of a mutual fund's board of directors except

A. establishing dividend and capital gains distribution policy
B. managing the portfolio
C. overseeing the custodian and transfer agent
D. establish investment policy

WHY: the board hires an investment adviser to manage the portfolio. This is a company that manages money for a % of assets--their services are covered by the management fee that shareholders pay, along with 12b1 fees, and other operating expenses.
ANSWER: B

10. All of the following represent the functions of a mutual fund's portfolio manager except

A. deciding which securities to purchase
B. deciding when to sell particular securities
C. establishing 12b-1 fees
D. performing economic/portfolio analysis and conforming to US Tax regulations

WHY: 12b1 fees would be up to the board of directors and the shareholders.
ANSWER: C

11. Which of the following represent(s) accurate statements concerning the underwriter/sponsor of a mutual fund?

A. prepares sales literature
B. markets shares through a network of dealers
C. may sell shares directly to investors
D. all choices listed

WHY: the sponsor is the one with its name on the fund. They get the fund sold to investors by buying advertising in magazines, newspapers, radio and TV. They go around spreading the word to broker-dealers interested in sharing the sales charge and 12b1 fees investors pay. Of course, if they establish an 800-number and have folks call them directly, they can cut out the middleman.
ANSWER: D

12. Which of the following represent(s) accurate statements concerning the transfer agent and the custodian for a mutual fund?

A. the custodian performs payable/receivable functions
B. the transfer agent issues/redeems shares
C. the transfer agent disburses capital gains and dividend distributions to shareholders
D. all choices listed

WHY: the custodian keeps track of the assets of the portfolio--all the stocks, bonds, and cash. The transfer agent deals with the investors--issues and redeems shares, handles name changes when somebody inherits shares, for example, distributes reports and dividends/capital gains to investors.
ANSWER: D

13. Which of the following is/are mutual fund shareholders entitled to approve by voting their shares?

A. changes in investment objectives and policies
B. investment advisory contract
C. changes in fees
D. all choices listed

WHY: looks like a likely Series 6 question to me.
ANSWER: D

14. The Wilson Growth & Income Fund had a NAV of $10 at the beginning of the year, ending the year at $9. The fund distributed $1 in dividends and $.50 in capital gains. Therefore, the total return was

A. 25%
B. 5%
C. -25%
D. not enough information provided

WHY: although the NAV dropped $1, the fund did pay out $1.50, for a total "plus 50 cents." Plus 50 cents compared to (divided by) the $10 where we started is a "total return"

of 5%. This is what would be shown in the bar charts showing past performance of the fund in an omitting prospectus (advertisement) or the actual prospectus.
ANSWER: B

15. Which of the following funds typically has the lowest expense ratio?

A. aggressive growth
B. balanced
C. ETF
D. money market

WHY: believe it or not, many ETF's have operating expenses that are much less than a money market mutual fund. A typical money market mutual fund has an expense ratio of about .75%, with the maximum 12b1 fee of .25% (no load) included. An ETF such as the Spider or Viper would charge maybe .11%. That's a reduction of 85%!
Just don't forget the commissions you pay to buy and sell the ETF.
ANSWER: C

16. If an investor were reading sales literature profiling all of the mutual funds offered within a mutual fund complex, she would expect to see which of the following categorized as having the lowest price volatility?

A. growth
B. value
C. balanced
D. growth & income

WHY: the more you move away from stocks and into bonds, the lower your volatility and the better your sleep. A balanced fund keeps a large % of assets in the bond market . . .that's how they find the right "balance." The other three are either all equity/stock funds, or--in the case of growth & income--mostly stock funds.
ANSWER: C

17. Which of the following accurately compares balanced funds with growth & income funds?

A. both are suitable for investors seeking growth of capital and current income
B. the growth & income fund generally holds more stocks, which is why the volatility is generally higher
C. the balanced fund generally holds a much larger bond position
D. all choices listed

WHY: three things to know about growth & income versus balanced funds.
ANSWER: D

18. Which of the following mutual funds likely has the lowest volatility?

A. short-term US Treasury fund
B. intermediate-term US Treasury fund
C. long-term US Treasury fund
D. money market fund

WHY: even though Treasury's have no default risk, they do react to interest rates. so, even though the T-bonds held by the fund will pay interest and principal, when rates rise, the value of those bonds will drop. Meanwhile, the money market mutual fund has a stable value of $1 per share.
ANSWER: D

19. Which of the following clients would be the most suitable for the purchase of a bonus annuity?
A. a mother saving for the education of her 15-year-old daughter
B. a father saving for the education of his 14-year-old son
C. a 32-year-old advertising executive who has made his maximum 401(k) contribution
D. a couple in their late sixties planning to retire early next year

WHY: annuities, in general, should be considered only after maxing out all other retirement savings options. The bonus annuity requires a long time horizon, since the surrender period is longer.
ANSWER: C

20. The portfolio manager for which of the following funds would focus primarily on purchasing stocks trading below their estimated intrinsic value?
A. growth
B. ETF
C. value
D. short-term

WHY: just like all the shoppers lined up outside the local Wal-Mart at 6:58 AM, value investors are trying to buy stuff for less than it's really worth.
ANSWER: C

21. One of ABC's equity funds focuses on investing in stocks with solid fundamentals operating in sectors currently out of favor with investors. This fund is a(an)
A. growth fund
B. value fund
C. exchange-traded fund
D. sector fund

WHY: when the stock is out of favor but the company has strong fundamentals, a value investor is interested. For example, Krispy Kreme is a company whose stock has dropped by maybe 2/3 from where most folks bought it. Then again, it's up 80% this year, so a value investor who recognized the buying opportunity would be mighty pleased.
ANSWER: B

22. Which of the following types of mutual funds invests in companies whose sales and earnings are expected to increase greatly over the next 7 – 10 years?
A. value
B. growth
C. index
D. balanced

WHY: a good test-taker would get this one, whether he had studied or not.
ANSWER: B

23. All of the following represent operating expenses to a mutual fund except
A. management fees
B. board of director salaries
C. custodial services
D. sales charge

WHY: as you'll see in any mutual fund prospectus for a loaded fund, the sales charge is deducted directly from your investment. The other operating expenses are simply deducted from the fund's assets in an ongoing fashion.
ANSWER: D

24. Open- and Closed-end funds share all of the following characteristics except
A. clearly stated investment objectives
B. may invest in debt securities
C. trade on the secondary market
D. may be diversified

WHY: open-end fund shares are redeemed/sold back to the issuer. Closed-end funds trade among investors on the secondary market.
ANSWER: C

25. All of the following investments may charge a sales load except
A. Unit Investment Trusts
B. Face-Amount Certificates
C. Money Market Mutual Funds
D. Open-End Funds

WHY: a money market mutual fund must be "no load" per se, which means it can still get a .25% 12b1 fee.
ANSWER: C

26. All of the following statements are true of mutual funds except
A. may charge up to 9.0% of the POP as a sales charge
B. do not have to maintain diversified portfolios
C. must redeem shares within 7 days
D. do not trade on the secondary market

WHY: the maximum sales load is 8.5% of POP.
ANSWER: A

27. The NAV of a corporate bond fund has increased dramatically. The most likely reason is
A. investors have bought substantially more shares
B. interest rates have risen
C. bond prices have fallen
D. yields have dropped

WHY: make sure you understand concepts in order to avoid easily avoidable errors. If the question asks what made the Net Asset VALUE go up, and you chose that the reason must have been the VALUE of the bonds going down . . . that don't make no sense. Bond prices rise when rates/yields drop.
ANSWER: D

28. All of the following could cause a drop in NAV except
A. the fund pays a dividend distribution
B. a bond fund experiences a rise in interest rates
C. redemptions increase dramatically
D. securities held in the portfolio decrease in value

WHY: if they take in money by selling shares, the pie gets bigger but also cut into more slices. If they pay out money through redemptions, the pie gets smaller but also cut into fewer slices. Net assets change, but not net asset value per share.
ANSWER: C

29. Which of the following investments would be expected to have the lowest volatility?
A. small cap fund
B. mid cap fund
C. government bond fund
D. money market fund

WHY: okay, I'm overdoing this stable value nature of a money market mutual fund. If you promise to remember that, I promise to leave it alone from now on.
ANSWER: D

30. Which of the following investments would be expected to have the highest volatility?
A. small cap fund
B. medium cap fund
C. large cap fund
D. money market fund

WHY: the smaller the cap, the greater the risk/reward ratio.
ANSWER: A

31. All of the following are advantages of closed end funds over open end except
A. shares may be sold short
B. shares may sometimes be purchased at a discount
C. investor always receives NAV when selling
D. shares may sometimes be sold at a premium

WHY: there is a net asset value, but when you sell your closed-end shares, you'll receive the best bid price available. Could be higher or lower than the NAV. Supply and demand, baby, and welcome to the NFL.
ANSWER: C

32. A mutual fund that always invests in both stocks and bonds is called
A. a diversified fund
B. a non-sector fund
C. a balanced fund
D. a mixed fund

WHY: the "balance" is the balance between participating in both the stock and the bond markets. Often, when the stock market is hurting due to slower economic activity, interest rates drop and push up the value of bonds.
ANSWER: C

33. The New Discoveries Mutual Fund has a net asset value of $10 and a public offering price of $10.50. Therefore, the sales charge is
A. waived
B. 5.00%
C. 4.76%
D. 0.5%

WHY: the sales charge is what % of the $10.50 offering price? .50 divided by $10.50 = the right answer.
ANSWER: C

34. Which of the following investors may be combined for the purpose of receiving a quantity discount?
A. Mother and 33-year-old daughter
B. Investment clubs
C. Three college friends investing in separate accounts
D. Father and 7-year-old son

WHY: the child has to be a minor child in a custodial arrangement (UGMA, for example).
ANSWER: D

35. TRY Fund has a NAV of $10.00 and a POP of $9.50. XLZ Fund has a NAV of $9.00 and a POP of $9.50. Which of the following are true statements?

I. TRY is an open end fund
II. TRY is a closed end fund
III. XLZ is an open end fund
IV. XLZ is a closed end fund

A. I, III
B. II, III
C. I, IV
D. II, IV

WHY: if the POP is below the NAV, something ain't right. Open-end funds aren't purchased below NAV. The cheapest you can buy them is at the NAV, and that's for a no-load fund or a B-share. So, it's not an open-end fund if it's being purchased below NAV. Now, how do we know that the other one isn't a closed-end fund trading at a premium? We don't. But, as good test takers, we ask, "Now what's the point they're making here?" That only the closed-end fund could sell below NAV, because only the closed-end fund trades among investors based on supply and demand.
ANSWER: B

36. What is the maximum sales charge allowed over the life of a contractual plan?
A. 50%
B. 20%
C. 8.5%
D. 9%

WHY: any question on a contractual plan is a pure memorization question.
ANSWER: D

37. All of the following investments are non-managed except
A. UIT's
B. S&P 500 Index Fund
C. Total Market Index Fund
D. Money Market Fund

WHY: surprisingly, only the money market mutual fund here would be actively selecting assets. UIT's are non-managed, and index funds just buy and hold all the stocks/bonds in the index. The only time to sell something from an S&P500 index fund is when Standard & Poor's kicks one of the 500 stocks out and replaces it. Of course, if you worked at S & P and knew when this was about to happen, you could make quite a fortune buying puts on the stock about to be jettisoned and buying calls on the stock about to be included. That would also be insider trading which is bad, especially if you get caught.
ANSWER: D

38. James and Maria Hernandez are in their mid-50's. Both are highly paid professionals looking to reduce hours worked but still accumulate money for retirement, scheduled to commence in the next 8-10 years. Knowing that they are not high-risk investors, which of the following mutual funds would you most likely recommend?

A. Money Market Mutual Funds
B. Aggressive Growth Fund
C. Balanced Fund
D. S&P 500 Index Fund

WHY: the stock will promise the capital appreciation they'll need to retire, the bonds will provide the income they need in order to stop working so darned hard, and the balance provided by the balanced fund will take care of their rather low risk tolerance.
ANSWER: C

39. An investor sets up a contractual plan, agreeing to invest $200 per month. What is the maximum that may be deducted during the first year?

A. $100
B. $1,200
C. $18
D. none of the above

WHY: under the Act of 1940, front-end load contractual plans can take "only" HALF of the first year's payment into the plan. Over the life of the plan, the sales load needs to average out to a mere 9%.
ANSWER: B

40. Using the following breakpoint schedule, how many shares would your client be able to purchase with an initial investment of $50,000, with the NAV at $10.00?

Investment	Sales Load
$1,000 - $29,999	8.5%
$30,000 - $39,999	7.0%
$40,000 - $49,999	6.0%
$50,000 - $59,999	5.0%

A. 4642.52
B. 5000.00
C. 4410.39
D. 4750.00

WHY: what percentage of this investment goes into the fund, and what percent goes to the distributors? 95% goes into the fund at the NAV of $10. 95% of $50,000 is $47,500.
ANSWER: D

41. All of the following investment companies charge a management fee except
A. Face-amount certificate companies
B. Open-end funds
C. UIT's
D. Closed-end funds

WHY: UIT's do not actively manage the portfolio. Assets are selected and held. Since there is no active management, there is no management fee.
ANSWER: C

42. If an investor sees that the ABC Investment Company currently trades at a 22% discount from the NAV, the investor may conclude that
A. ABC is a mutual fund
B. ABC is a UIT
C. ABC is a closed-end fund
D. ABC is a REIT

WHY: the word "trades" means it's a closed-end fund right there, actually. If it sells below the NAV, it has to be a closed-end fund. For a quick look at closed-end funds visit www.nuveen.com.
ANSWER: C

43. XYZ Long-Term Opportunity Fund invests most of its capital in equities. Usually, the investment adviser (portfolio manager) for the fund invests in growth stocks. However, the adviser is now convinced that growth stocks will underperform the overall market for the next year or so. Given that assessment, which two of the following may the investment adviser do?
I. sell growth stocks short
II. buy defensive stocks
III. sell some stocks and place the proceeds in the money market
IV. buy government bonds on margin

A. I, II
B. I, III
C. II, III
D. II, IV

WHY: in general, mutual funds can not sell stock short, and they can't buy on margin. This portfolio manager would buy stocks that can weather the bad times and maybe hold a higher percentage of assets in cash. Of course, if you're a stock fund, you can't be parking huge chunks of your assets in the money market--that would be false advertising. People would get ticked paying the higher management fees on a stock fund if the manager is really turning it into a money market mutual fund.
ANSWER: C

44. Which of the following is a true statement concerning the distributor of a mutual fund?
A. The distributor buys shares at the NAV and holds them primarily for investment purposes.
B. The distributor acts as a consultant to both the board of directors and investment adviser on matters of investment strategy
C. The distributor purchases shares at the NAV and markets the shares to broker-dealers, who sell to clients.
D. none of the above

WHY: they're not consultants--they're promoters of the fund.
ANSWER: C

45. Which of the following sections of the prospectus would an investor check to see how the portfolio manager decides which securities to purchase?
A. Investment Objectives of the Fund
B. Investment Policies and Restrictions
C. Taxation of Fund Distributions
D. The Fund's Portfolio Manager

WHY: read a few mutual fund prospectuses and these questions will be easy for you.
ANSWER: A

46. Which of the following best describes an equity income fund?
A. a fund that invests in equities issued by companies earning above-average income
B. a fund that invests primarily in bonds
C. a fund that invests in equities with high dividend payout ratios
D. a fund that sells equity securities short

WHY: one other answer was tempting, but a company that earns lots of profits does not necessarily pay any part of them out as dividends. Oracle is wildly profitable. To date, it has paid dividends of approximately zero dollars per share. An equity income fund buys equity securities that pay income. Go figure.
ANSWER: C

47. When an investor redeems mutual fund shares, she receives
A. the current offering price
B. the offering price determined at the close of trading that day
C. the net asset value as determined the next time the fund computes it
D. her original purchase price plus a 12 b-1 fee

WHY: customers buy loaded funds at the POP and redeem them at the NAV. Investors buy no-load funds at the NAV and redeem them at the NAV. Notice how mutual fund shares are always redeemed at the NAV.
ANSWER: C

48. There are many ways to purchase mutual fund shares. If an investor invests the required minimum and then chooses to have $500 deducted from her checking account every month and used toward purchasing more shares, the main advantage of this method would be

A. locking in a minimum level of profitability
B. dollar cost averaging
C. buying shares at the NAV
D. tax deferral

WHY: can you make a case for any of the three other choices? Mutual funds offer no tax deferral. Why would she automatically buy at the NAV? Nobody "locks in minimum profitability." Eliminate three choices, and you win. Assuming you didn't eliminate the right answer.
ANSWER: B

49. Which of the following would an investor look at to determine the operating efficiency of a mutual fund?

A. total capital gains distributed
B. total return of the fund
C. expense ratio
D. 12 b-1 fees

WHY: the expense ratio shows how much of every dollar invested is eaten up by the operating expenses. For some funds, it could be 1.5 cents of every dollar (1.5% expense ratio.) For an index fund or ETF, it could be a fraction of one penny per dollar.
ANSWER: C

50. How is a contingent deferred sales charge paid by a mutual fund investor?

A. quarterly
B. semi-annually
C. deducted from NAV when shares are redeemed
D. deducted from POP when shares are purchased

WHY: break down the words "contingent deferred sales charge." The sales charge is deferred until you sell, and the amount is contingent upon when you sell. When you sell, you receive the NAV minus the back-end load. It might start at 5% and drop to zero after 7 years. A mutual fund prospectus for a fund with B-shares will show you the declining back-end load.
ANSWER: C

51. Mutual funds often discourage investors from short-term trading by

I. charging steadily declining contingent deferred sales charges
II. charging redemption fees
III. seeking court injunctions
IV. having investors sign a binding non-redemptive affidavit

A. I only
B. II only
C. I, II only
D. I, III, IV only

WHY: if you sell your B-share right away, you get nailed with the highest contingent deferred sales charge. If you wait a while, the back-end load declines. The SEC actually loves redemption fees, too. These are often charged if you redeem your shares within, say, 1 year. You might leave 1% behind to cover the pain-in-the-neck process of paying out redemptions. Mutual funds aren't supposed to be short-term holdings, anyway.
ANSWER: C

52. All of the following statements concerning contingent deferred sales charges are correct except

A. such charges are associated with B shares
B. such charges decline gradually and typically are eliminated within 6 - 8 years
C. such charges are synonymous with redemption fees that revert to the fund's portfolio
D. A confirmation for a fund that assesses a contingent deferred sales charge must disclose that a charge may be assessed upon redemption, even if the same disclosure is made in the prospectus.

WHY: sales charges go to the distributors, whether they're charged on the front end (A shares) or back end (B shares). A redemption fee is a little toll you pay to the fund portfolio for being a huge pain in the neck by jumping in an out of the fund so darned fast.
ANSWER: C

53. All of the following statements concerning redemption fees are true except

A. redemption fees are charged in order to discourage investors from frequent trading
B. frequent redemptions result in added expenses to the fund, burdening remaining shareholders
C. redemption fees are typically 2% or less
D. redemption fees revert to the underwriter/distributor of the fund

WHY: the underwriter gets the sales charge.
ANSWER: D

54. All of the following are associated with money market mutual funds except
A. investors pay no sales load
B. investors pay no management fees
C. commercial paper is a major component of the portfolio
D. liquidity

WHY: investors not only pay management fees in money market mutual funds, but also 12b1 fees, which is why the expense ratio can easily reach .75%.
ANSWER: B

55. 12b-1 fees are reviewed by the board of directors
A. annually
B. semi-annually
C. quarterly
D. at each board meeting

WHY: memorization point.
ANSWER: A

56. Which of the following represent(s) operating costs to a mutual fund?
I. management fees
II. 12b-1 fees
III. sales charges
IV. board of director salaries

A. I, and III only
B. I, II, IV only
C. III only
D. I, II, III, IV

WHY: many people fail to include board of director salaries in the operating expenses of the fund. I'm not sure where they think the $100,000+ per year for each member comes from . . . ?
ANSWER: B

57. An investor has received a prospectus for the Winthorp World-Class Equity Appreciation Fund. She notes that the fund offers both A shares and B shares. The main difference between the two types of shares, you would inform her, has to do with
A. amount of the management fee
B. investment objectives
C. method of paying sales charges
D. types of securities held in the funds' portfolios

WHY: you pay the sales charge on the front end for an A-share and on the back end (when you sell) for the B-shares. The other difference would be that the 12b1 fee is

higher on the B-shares than the A-shares. Other than that, there's no difference between the two. They're exactly the same, except for their inherent differences.
ANSWER: C

58. If the overall stock market has been rising the past year, one would expect most equity funds to see an increase in NAV. This morning, Joann Johnson notes that even though the overall market has increased substantially, the equity fund you sold her has seen a drop in NAV. Which of the following could explain this unfortunate phenomenon?

A. an unexpectedly large number of new fund shares were purchased by investors
B. an unexpectedly large number of shares were redeemed by investors
C. interest rates have peaked
D. the fund paid out large dividend and capital gains distributions to shareholders

WHY: the net asset value of a mutual fund share is just the value of the assets, minus the liabilities, divided by all the shares. One of the assets of the fund would be the cash that's been generated from holding dividend-paying stocks or interest-paying bonds. When the fund distributes that cash to shareholders, the assets go down while the number of shares stays the same. Net Asset Value per share drops by the amount of the distribution, as any prospectus will make clear.
ANSWER: D

59. An investor signs a letter of intent for $20,000 and initially invests $5,000 in the fund. Her account value then accumulates to $10,000. How much more must the investor invest to satisfy the LOI?

A. $15,000
B. $10,000
C. nothing, the LOI is already satisfied
D. $20,000

WHY: don't confuse rights of accumulation with a letter of intent. If you say you're putting in $20,000, the fund is looking for--get this--$20,000.
ANSWER: A

60. Many investors abhor volatility. An investor seeking to minimize price volatility would most likely purchase

A. growth funds
B. equity income funds
C. long-term government bond funds
D. short-term corporate bond funds

WHY: bond funds would certainly be less "abhorrent" for those investors who "abhor volatility." The bond fund with the least volatility would, naturally, be the one holding shorter-term bonds.
ANSWER: D

61. Joel Rothbardt believes that his investment portfolio should include a mixture of equity, bonds, and money market securities. However, a busy neurosurgeon, Joel does not have time to monitor the markets and make the necessary adjustments to the percentages committed to each of the three securities categories. You would, therefore, most likely recommend that Joel purchase

A. aggressive growth funds
B. growth & income funds
C. asset allocation funds
D. S & P 500 index funds

WHY: an asset allocation fund would be a type of balanced fund that maintains a mix of equity, fixed-income, and money market investments. The new retirement "target funds" do this and continuously switch from equity to fixed-income as the fund gets closer and closer to the target date, which is the date closest to your retirement date. If you buy the Target 2030 fund today, that's a time horizon of 24 years, so the equity percentage would be high. But, if you're in the Target 2010 fund, the allocation would be skewed heavily toward fixed-income.
ANSWER: C

62. All of the following may be deducted from the proceeds of a mutual fund redemption except

A. contingent deferred sales charge
B. redemption fee
C. backup withholding tax
D. management fee

WHY: management fees are a separate line item in the operating expenses.
No tricks here--the fund just tells us what % gets deducted for management fees.
ANSWER: D

63. An investor seeks high current return and low default risk. Therefore, you would recommend

A. money market mutual funds
B. high-yield bond funds
C. government bond funds
D. STRIPS

WHY: whether you like the answer or not, the only one you could make a case for here is government bond funds. They pay a higher yield than the money market in almost all cases, and they have no default risk. STRIPS don't pay income--you get a higher par value when the thing finally matures. If you chose "high-yield" for somebody who wants "low default risk," that would be like a customer ordering a German beer, and the bartender says, "Would you prefer Budweiser or Schlitz?"
Huh? I said GERMAN beer, dude.
Oh—German. How about a Heineken, then?
ANSWER: C

64. The NAV of a mutual fund is calculated

A. weekly
B. monthly
C. as stipulated in the prospectus
D. semi-annually

WHY: every day that the markets are open the fund recalculates NAV after the markets close for the day. The prospectus tells us how/when they value the NAV.
ANSWER: C

65. Your customer would like to purchase an insurance policy that does not require a scheduled premium payment. You would not recommend any of the following except

A. term life insurance
B. whole life insurance
C. variable life insurance
D. variable universal life insurance

WHY: the word "universal" means "flexible," so if you want a flexible premium, buy a policy with the word "universal" in it.
ANSWER: D

66. Your customer would like to purchase an insurance policy that offers a guaranteed minimum death benefit, but also offers the chance to increase cash value and death benefit amounts in relation to increases in the separate account maintained by the insurance company. You would recommend

A. term life insurance
B. whole life insurance
C. variable life insurance
D. variable universal life insurance

WHY: eliminate choices. There is no cash value on term insurance. Premiums go into the general--not separate--account for whole life. Now you're down to VLI and VUL. Assume that VLI has a minimum guaranteed death benefit, while VUL might offer that.
ANSWER: C

67. Your customer has built up $100,000 cash value in her life insurance policy. After holding the policy three years, she will be able to borrow?

A. $100,000
B. $75,000
C. $50,000
D. none of the above

WHY: after three years they can borrow 75% of the cash value that's built up--similar to how a homeowner can tap into the equity that's built up as the market value of the house has risen the past few years.
ANSWER: B

68. AIR is 4%. If the separate account achieves a 3.5% annualized rate of return, what will happen to cash value and death benefit in a variable life policy?

I. cash value increases
II. cash value decreases
III. death benefit increases
IV. death benefit decreases

A. I, III
B. I, IV
C. II, IV
D. II, III

WHY: AIR vs. actual returns is only relevant for the death benefit. Cash value increases when we see a positive return, period. 3.5% is a positive return, so cash value rises, just as a mutual fund share would. But, 3.5% is below the Assumed Interest Rate, so the death benefit drops, as an annuity unit would.
ANSWER: B

69. All of the following statements concerning Variable Life Insurance are true except

A. variable life insurance has a death benefit that may fluctuate
B. variable life insurance has a cash value that may fluctuate
C. variable life insurance is primarily an investment vehicle
D. variable life insurance is primarily an insurance vehicle

WHY: insurance is primarily an insurance vehicle. It might have features of an investment, such as the chance to lose a frightening amount of money really fast, but it's primarily to be marketed as an insurance product.
ANSWER: C

70. Selling which of the following products requires an NASD license?

A. variable life
B. whole life
C. term life
D. fixed annuity

WHY: because investors are exposed to the stock and bond market in variable products, you need a securities license to sell them.
ANSWER: A

71. An NASD license is required to sell all of the following except

A. variable annuity
B. fixed annuity
C. variable life
D. mutual funds

WHY: a fixed annuity, as with whole/term/universal life, would be an insurance product, so if you have an insurance license, you're good to go.
ANSWER: B

72. In a variable life insurance policy, the policy owner should know that

I. death benefit is calculated annually
II. death benefit is tied to AIR vs. actual performance of the separate account
III. cash value is tied to the general account performance
IV. cash value is calculated daily

A. I only
B. II only
C. I, II, IV only
D. I, II, III, IV

WHY: yes, the policyholder and anyone sitting for the Series 6 should know this much about variable life insurance. Remember that "variable" doesn't really go along with "general" account.
ANSWER: C

73. All of the following statements concerning life insurance are true except

A. The death benefit paid to the beneficiary would be reduced by any outstanding loans and unpaid premiums.
B. The death benefit paid to the beneficiary is federally taxable.
C. The death benefit is included in the estate for purposes of estate taxes.
D. The death benefit is guaranteed on a whole life policy.

WHY: remember that the beneficiary is not taxed on the death benefit. But, the value of the policy is included in the estate, which could trigger estate taxes.
ANSWER: B

74. All of the following statements concerning loan provisions for variable contracts are true except

A. If an annuitant in the accumulation phase takes a loan, the number of accumulation units is reduced.
B. If an annuitant in the accumulation phase takes a loan, the IRS considers it a distribution.
C. If the policy owner takes a loan against cash value in a VLI policy, this will have no effect on death benefit payable to a beneficiary.
D. Term life insurance offers no loan provisions.

WHY: if you take a loan against the value of your insurance contract, that reduces the cash value and death benefit. Often, you know that and don't care.
ANSWER: C

75. Which of the following statements are true concerning taxation of variable annuities and variable life insurance contracts?

I. Partial surrenders of cash value in a VLI policy will not be taxable up to the amount of net premiums paid because "principal first" rules apply.

II. In order to avoid taxation, the VLI policy owner must request and receive a specific IRS ruling.

III. A partial surrender of a variable annuity contract is not taxed the same way it would be taxed on a VLI policy.

IV. If a VLI policy owner does a partial surrender of cash value, any amount that exceeds the net premiums paid into the policy are tax deferred.

A. I only
B. III only
C. II, III, IV
D. I, III only

WHY: remember that annuities and variable life are not taxed the same way when the contract owner wants to tap the funds a little early. For an annuity, the IRS considers all money coming out to be part of the taxable earnings; for insurance, you can take out what you put in without paying taxes. If you take out more than the net premiums paid into the policy, that excess would be taxable, not tax-deferred.
ANSWER: D

76. If a policy owner stops paying premiums, his VLI policy will lapse. However, the cash value of the policy must be made available due to the
A. minimum cash value guarantee
B. non-forfeiture provision
C. policy loan provision
D. exchange privilege

WHY: did you pick "minimum cash value guarantee," even when you know there is no such thing as a minimum cash value guarantee? Hmm. What'd you go and do a thing like that for?
ANSWER: B

77. Which of the following represents a true statement concerning VLI policies?
A. Obtaining a Series 6 license eliminates the need for the representative to obtain an insurance license in order to sell these contracts.
B. Death benefit could, hypothetically, fall to zero due to poor performance of the separate account.
C. The insurance company may increase the premiums due to poor performance of the separate account.
D. Cash value could, hypothetically, fall to zero due to poor performance of the separate account.

WHY: there is a minimum guaranteed death benefit but no minimum cash value. Of course, the rep needs both an insurance and securities license to sell these policies.
ANSWER: D

78. All of the following are guaranteed except
A. cash value on a VLI policy
B. death benefit on a VLI policy
C. payment of principal and interest on a Treasury bond
D. rate of return on a fixed annuity

WHY: cash value is tied to the stock and bond market, so choose your allocations carefully and welcome to the NFL.
ANSWER: A

79. All of the following products would involve the investment of at least some of a client's net premiums into the insurance company's separate account except
A. Fixed Annuity
B. VUL
C. Combination Annuity
D. Variable Annuity

WHY: fixed/guaranteed payments are covered by the general account.
ANSWER: A

80. All of the following are true of variable life insurance contracts except
A. There is neither a minimum nor maximum cash value.
B. A partial surrender of cash value reduces the face amount of the policy.
C. There is neither a minimum nor maximum death benefit.
D. The policy owner may choose to invest part of net premiums in common stock as a hedge against purchasing power risk.

WHY: there is a minimum death benefit, because--after all--these are insurance policies. It would be downright rude to take somebody's premiums for 25 years and then tell the beneficiaries there's no money for a proper burial now that the markets have tanked.
ANSWER: C

81. Barbara Bernsen, a single parent of three small children, needs the discipline of forced savings and wants to provide for her children in the event of her untimely death. She is not comfortable with the ups and downs of the stock and bond markets. Therefore, you would most likely recommend
A. Term Life
B. Whole Life
C. VUL
D. VLI

WHY: some questions eliminate three answer choices for you. If she doesn't want to invest in the stock and bond markets, eliminate anything with the word "variable" in it.

Since she wants forced savings, eliminate term insurance, which has no cash value. Now, some people are confused over the meaning of "savings." They think that buying term insurance versus whole life is a form of "savings." Not. See, if you spend, say, $300 a year less on term vs. whole life, you are not "saving" money. You are just spending less money on insurance. After 10 years, whole life would build up cash value (savings) that you could use to buy a house or renovate the one you already own.
What do you have to show for your term life purchase after 10 years?
Not a darned thing.
ANSWER: B

82. If a client prefers fixed/scheduled payment of premium, she should purchase

I. VLI
II. VUL
III. Whole Life
IV. Universal Life

A. I, III
B. II, IV
C. I, IV
D. II, III

WHY: equate the word "universal" with "flexible premium." For variable life or whole life, the premium will be fixed and you absolutely need to stay on the little schedule unless you want the policy to lapse.
ANSWER: A

83. Which TWO of the following statements concerning taxation of insurance policies are true?

I. death benefits are taxable to the beneficiary
II. death benefits are not taxable to the beneficiary
III. death benefits are included in the insured's estate
IV. death benefits are not included in the insured's estate

A. I, III
B. I, IV
C. II, III
D. II, IV

WHY: I wouldn't keep bringing up these two points if I weren't convinced you'll need to know them for the exam.
ANSWER: C

84. Which of the following payout options typically offers the largest monthly payment to the annuitant?

A. life with 10-year period certain
B. straight life
C. joint with last survivor
D. life with 15-year period certain

WHY: the insurance company's risk is that the annuitant will live longer than he was supposed to. That's enough mortality risk to deal with, but when you want to lock them into a period certain or have them cover you and then your daughter's life expectancy, they have to lower the monthly payout. So, straight life is the most generous monthly payout, since the payments cease when the annuitant ceases.
ANSWER: B

85. AIR is a factor in determining value for

I. Death benefit in a variable life policy
II. Cash value in a variable life policy
III. An accumulation unit
IV. An annuity unit

A. I, II, III, IV
B. II, IV only
C. III, IV only
D. I, IV only

WHY: these questions drive students absolutely nuts, and I'm not sure why. When you're invested in the market (accumulation unit, cash value), all you need is a positive return. But, when you're talking about the money that comes out (annuity unit, death benefit), now things get a little tricky and we start babbling about AIR.
ANSWER: D

86. If your client would like to purchase an annuity that covers her daughter and grand-daughter, you would most likely recommend

A. Life with period certain
B. Joint and last survivor
C. Straight life
D. Whole life

WHY: don't miss the rare two-inch putt this course will give you.
ANSWER: B

87. A mutual fund and a variable annuity separate account are similar in all the following ways except

A. professional management of the portfolio
B. voting rights
C. tax deferral
D. investor assumes investment risk

WHY: as I may have mentioned a few dozen times before, no tax deferral is offered by a mutual fund in and of itself.

ANSWER: C

88. If a variable annuity has an AIR of 3% and the separate account grows at an annualized rate of return equal to 6%, this appreciation

A. is taxable only to the separate account
B. is taxable as ordinary income to an annuitant in the accumulation phase
C. will increase the amount received by annuitants in the pay-out phase
D. is taxable as a long-term capital gain to an annuitant in the accumulation phase

WHY: as usual, you just need to start eliminating answer choices. You don't pay capital gains rates, so that eliminates one choice. If you got taxed during the accumulation phase, where the heck is the tax-deferral? Eliminate that one. Then you see a choice that says only the separate account gets taxed, not the individuals who own units of it? Huh? Eliminate that one and you're done.

ANSWER: C

89. On March 1, 2000, your client purchased a variable life policy. On February 15, 2002, he decides he'd like to switch to a traditional whole life policy. Which of the following is true in this situation?

A. You should tell the client that he must hold the policy a full three years before making such a switch.
B. Your client will be able to make this switch after providing further proof of insurability.
C. You should advise your client that this type of 1035 exchange is illegal.
D. Your client will be able to make this switch without providing further proof of insurability.

WHY: they have 24 months to switch back to whole life without doing the little cheek swab again. Notice how a smart aleck test writer like me tries to confuse you with other things you have studied concerning insurance--isn't there something about a 1035 and something about three years you're supposed to know?
Yes--what exactly is it that you're supposed to know, though? The NASD would like to know that you know what you're supposed to know.
You know?

ANSWER: D

90. Which of the following correctly describe(s) accumulation units and annuity units?

I. the number of accumulation units varies
II. the value of accumulation units varies
III. the number of annuity units is fixed
IV. the value of annuity units is tied to AIR and varies

A. I, III
B. II, IV
C. III
D. I, II, III, IV

WHY: there are many ways this sort of question can be asked, but I am 100% confident you'll get at least one--maybe two--versions of it on your exam.
ANSWER: D

91. All of the following accurately represent types of annuities except
A. single payment immediate annuity
B. periodic payment deferred annuity
C. single payment deferred annuity
D. periodic payment immediate annuity

WHY: how about if I start paying $50 a month, and you guys start sending me annuity checks for $75 a month. Yeah, we'll call it a periodic payment immediate annuity. Not.
ANSWER: D

92. Certain fees are deducted from the premium when an investor purchases a variable annuity. Which of the following is/are deducted from the subaccount values after being allocated to the separate account?
A. mortality risk fee
B. expense risk fee
C. management fee
D. all choices listed

WHY: another memorization question.
ANSWER: D

93. Which of the following is/are deducted from the premium paid into a variable contract?
A. state premium tax
B. sales charges
C. administrative fee
D. all choices listed

WHY: something else to memorize.
ANSWER: D

94. Which of the following statement(s) is/are true of fixed and variable annuities?
A. a Series 6 or 7 license is required in order to sell them
B. both guarantee a minimum rate of return known as AIR
C. net premiums are allocated to the general account for a fixed annuity, the separate account for a variable annuity
D. both offer protection of purchasing power

WHY: try to eliminate answer choices. Why would you need a securities license to sell an insurance product called a fixed annuity? Gone. How could a fixed payment protect you from inflation? Gone. You're now sitting 50-50. AIR is not a rate of return, and it sure as heck isn't guaranteed on a VARIABLE annuity. Eliminate that one, and what are you left with? The answer to the question. The right answer, even.
ANSWER: C

95. Which of the following mutual funds invests in stocks of both foreign companies and domestic companies?
A. short-term fixed-income funds
B. intermediate-term fixed-income funds
C. global equity funds
D. international funds

WHY: don't confuse a global fund with an international fund. The difference is that a global fund includes the entire world, whereas an international fund includes the entire world except for your home country.
ANSWER: C

96. One of your investors calls at 1PM quite upset that when he logged onto his mutual fund account, he was unable to see the current value of his investment in the Greene & Ingerson Growth & Income Fund. Which of the following statements would be accurate concerning this situation?
A. the exchange and over-the-counter markets must be closed
B. the S&P 500 has altered its composition by removing 3 companies and adding 3 new ones
C. mutual funds recalculate net asset value (NAV) at the end of the trading day
D. if the investor enters a purchase order now, he can be assured of paying the NAV as of last evening

WHY: this reality is partly why I invest in common stock primarily. I can't stand the fact that I can't see the current value of my mutual fund during the day.
Oh well. I probably shouldn't be checking the value so often.
ANSWER: C

97. A mutual fund family offered a growth fund and a value fund for the first seven years of operation. If they now want to offer a fund that combines both investment styles, they would launch which of the following types of funds?

A. intermediate term fixed income
B. growth and income
C. blend
D. balanced

WHY: check out the Morningstar categories for mutual funds. Stock funds are growth, value, or blend.
The "blend" fund is just a stock fund that can't make up its mind as to whether they like "growth" or "value" investments.
ANSWER: C

98. Which of the following types of mutual funds takes extra steps to shield investors against loss of capital?

A. balanced fund
B. equity income fund
C. principal-protected fund
D. specialized fund

WHY: a good test-taker would get this question right, whether he knows what he's doing or not. They are protecting your principal. But, that means they charge more expenses, the protection doesn't kick in for maybe five years, and they have to buy a bunch of safe income-producing securities to cover their risk.
ANSWER: C

99. If a client is considering the purchase of a principal-protected mutual fund, her registered representative should disclose which of the following?

I. there is a greater potential for loss
II. only accredited investors may purchase principal-protected funds
III. the protection may require a 5 to 10-year "lockup period"
IV. the principal protection carries additional costs to the investor

A. I
B. II
C. III, IV
D. I, III, IV

WHY: a few things to know about principal-protected mutual funds.
ANSWER: C

100. If a client is considering an investment in a fund of hedge funds, her registered representative must discuss which of the following features?

A. FDIC insurance
B. principal protection
C. potential illiquidity
D. tax-deductible contributions

WHY: hedge funds are investment partnerships for accredited investors. They are high-risk, very expensive, and they force you to hold your investment usually for a year or two, even if you want to sell.

ANSWER: C

LESSON 6, OPENING AND SERVICING CUSTOMER ACCOUNTS (12 of 100 Questions on Series 6 Exam)

1. According the Federal Reserve Board's Regulation T, in order to purchase shares of stock listed on the NYSE, the customer in a new margin account must deposit

A. at least 10% of the current market value
B. 50% of the current market value
C. 25% of the current market value
D. 100% of the current market value

WHY: not sure if the exam would ask about margin accounts, but it’s possible. So, the answer to a question like this about buying on margin would be "50% of market value, or at least $2,000."
ANSWER: B

2. Under the NASD's Code of Arbitration Procedure, which of the following statements accurately describes the ramifications of a member's refusal to honor an arbitration award?

A. awards are honored on a discretionary basis only
B. this is a matter for civil courts and not a violation of NASD rules
C. this is considered conduct inconsistent with just and equitable principles of trade and, therefore, a violation of NASD Rule 2110
D. payment would be required only if the SEC or federal courts intervened

WHY: failure to abide by the Code of Arbitration Procedure is a violation of member conduct rules. That makes it a violation of the first commandment: a member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.
ANSWER: C

3. Which of the following customer requests would be considered a discretionary order?

A. Buy 1,000 shares of ORCL this afternoon.
B. Sell 1,000 shares of ORCL this afternoon
C. Buy as much ORCL as I can afford
D. Sell 1,000 shares of ORCL at the best price you think we can obtain today

WHY: if the customer lets the rep/firm choose the amount of shares, the activity (buy or sell) or the asset (which stock/bond?), that requires discretionary authorization. If the customer gives the rep/firm an order for a specific number of shares, however, the rep/firm can choose the time or price at which to execute the order.
ANSWER: C

4. A customer's account is frozen for 90 days under Regulation T. Which of the following statements is correct?

A. The customer may not make any transactions under any circumstances.
B. The customer may make purchase transactions only if the full purchase price is in the account before the order is executed.
C. The customer may make purchases but not sales.
D. The customer may make sales but not purchases.

WHY: if the account is "frozen," that just means that credit has been cut off to this customer for 90 days. Fool us once, shame on you. Fool us twice . . . well, not for another 90 days at least.
ANSWER: B

5. A broker-dealer delivers a trade confirmation to a customer. The trade confirmation indicates that the firm acted in a "dealer" capacity. Therefore, the firm acted as a(an)

A. fiduciary
B. independent
C. broker
D. principal

WHY: a "broker-dealer" either acts for the accounts of others (agent/broker) or they take the other side of the transaction for their own account and act as a dealer/principal.
ANSWER: D

6. Which of the following would protect an investor against missing assets due to the failure of her broker-dealer firm?

A. FDIC
B. FRB
C. Anti-Embezzlement Protection Corporation
D. SIPC

WHY: SIPC protects customer assets when the creditors of the broker-dealer try to seize them. SIPC, remember, is not FDIC insurance. Investors are always subject to market loss, which is what makes investing so much fun.
ANSWER: D

7. Juan Ramirez has a special cash account with $390,000 in securities and $110,000 in cash. He and his wife, Marta, also have a JTWROS account with securities worth $450,000 and $60,000 cash. What is the total SIPC coverage for these accounts?

A. $1,020,000
B. $1,000,000
C. $500,000
D. $990,000

WHY: basic SIPC coverage is $500,000 total, of which no more than 100K of cash is covered. In the first example, the account has more than 100K cash, and in the second example, the account is worth more than $500,000, which is what makes the question tricky. I know you'd like more clarification, but that's actually enough for you to go back and figure this one out.
ANSWER: D

8. A registered rep working for Broker-Dealer XYZ wants to start an investment account with Broker-Dealer PDQ. If both firms are NASD members, which of the following correctly describes the steps that need to be taken?

A. the account may not be opened
B. the account may be opened upon the signing of a notarized affidavit
C. Broker-Dealer PDQ must receive written permission from XYZ
D. Broker-Dealer PDQ must notify XYZ in writing and send duplicate trade confirmations upon request

WHY: for NASD members, notification is required and duplicate trade confirmations and other account records are provided to the employer upon request, not automatically.
ANSWER: D

9. Heather is associated with an NASD member firm. Several of her clients are high-net-worth individuals with a relatively large appetite for risk. When Heather's sister-in-law decides to open a cafe, she asks Heather if she can help find investors willing to purchase 5% ownership stakes of the cafe for $10,000 each. Which of the following represent accurate statements concerning this situation?

A. the ownership stakes would not meet the definition of "investment contract" as determined by the Howey case
B. the state where Heather works has no authority of the offer/sale of these ownership stakes, as Heather's firm is an NASD member firm
C. if Heather offers/sells these securities without informing her employer, she has committed a violation of NASD conduct rules called "selling away"
D. because of the small size of the investment, Heather may offer/sell these securities without employer notification

WHY: the Howey decision tells us that an investment of money in a common enterprise whereby the investor hopes to profit solely through the efforts of others = an investment contract, which was already listed as a "security" under the Securities Exchange Act of 1934 and the Uniform Securities Act. Unless we think that these rich folks plan to wash dishes, wait tables, or cook your hashed browns scattered, smothered, and covered, it's pretty clear that these investments fit the definition of a "security."
ANSWER: C

10. Under Regulation S-P a customer must be provided with a broker-dealer's statement of privacy policy

A. at the time the customer establishes a business relationship with the firm
B. within 30 days of the third transaction with the firm
C. either choice listed
D. neither choice listed

WHY: very simple concept. When he becomes a customer, the firm provides a statement on how they will protect his privacy. It would be sort of late if they waited until 30 days after the third transaction.
ANSWER: A

11. In which of the following cases must a member firm file a currency transaction report to FinCEN?

A. a customer deposits $2,000 in cash
B. a customer deposits $50,000 in bearer bonds
C. a customer purchases $12,000 of stock with cash
D. a customer writes a check for $12,000 to a mutual fund company

WHY: cash transactions > 10K require a Currency Transaction Report.
ANSWER: C

12. A client deposits $6,000 at 10 AM. If the client deposits $5,000 at 4:00 PM, your firm would file

A. no report at this time
B. a currency transaction report
C. a suspicious activity report
D. a Reg T extension request

WHY: cash transactions > 10K require a Currency Transaction Report.
ANSWER: B

13. A suspicious activity report (SAR) should be filed with FinCEN:

A. only if the broker-dealer has actual knowledge of criminal activity
B. only after receiving a court order
C. only if the parties are on the OFAC list
D. for most types of suspicious activity, depending on the facts/circumstances

WHY: if the activity looks suspicious, file a Suspicious Activity Report.
ANSWER: D

14. As a registered representative of Abel Broker-Dealers, you notice that a client has executed a series of transactions that are inconsistent with his objectives. If you suspect that the trading is linked to criminal activity, your firm must file an SAR when the transactions equal or exceed

A. $10,000
B. $5,000
C. $2,500
D. $1,000

WHY: yet another number to memorize.
ANSWER: B

15. What must a firm do if it discovers that one of its clients is on the OFAC list of suspected terrorists?

A. notify the SEC
B. notify the NASD
C. notify federal law enforcement authorities immediately
D. initiate an internal investigation forthwith

WHY: let's hope your first customer is not on this list. If so, let's hope he doesn't hold a grudge.
ANSWER: C

16. Under NASD Rule 2830, the distributor of a mutual fund must

A. only sell shares to other member firms
B. only sell shares to member firms with whom there exists a written sales agreement
C. refrain from distributing shares that involve excessive sales charges
D. all choices listed

WHY: as always, make sure you get all the easy questions right.
ANSWER: D

17. Under NASD Rule 2820, which of the following forms of non-cash compensation may a registered representative accept for selling variable contracts?

A. securities
B. electronics equipment valued at $300
C. $200 gift certificate in exchange for reaching a sales target
D. none of the choices listed

WHY: the rep may not accept securities, period. The gift needs to be no more than $100, and if there is compensation or even a so-called "seminar" involved, it had better not be awarded based on achieving a certain sales target.
ANSWER: D

18. Arbitration is binding in which of the following disputes?
I. member versus another member
II. member versus transfer agent
III. member versus registered representative
IV. customer versus member

A. II, III
B. I
C. I, II, III
D. I, II, III, IV

WHY: arbitration is binding. If you use the arbitration process, you're bound by the decision reached.
ANSWER: D

19. Arbitration is mandatory in which of the following disputes?
I. member versus another member
II. member versus transfer agent
III. member versus registered representative
IV. customer versus member

A. II, III
B. I
C. I, II, III
D. I, II, III, IV

WHY: few firms would even consider opening an account until the customer signs the pre-dispute arbitration agreement. But, if the customer has not signed an arbitration agreement with the firm, the customer is still free to sue the firm's behind off in civil court, filing appeal after appeal. Also, since the exam is obviously in a bad mood these days, remember that a customer could still join a class action suit against the firm, even if they had signed the arbitration agreement.
Just to keep things nice and simple.
ANSWER: C

20. A registered representative pursues a matter in arbitration and loses the decision. She may appeal this decision to
A. DOE
B. NAC
C. SEC
D. None of the above

WHY: she may appeal this decision to her favorite bartender, or she may rent several large vats of gourmet ice cream and watch chick flicks all weekend with three of her best friends. But, as far as a formal appeal process . . . there is none.
ANSWER: D

21. Because of Regulation S-P, a broker-dealer must provide a description of its policies regarding client privacy to:
A. All consumers at the time they first transact business with the firm
B. Anyone who requests it in writing
C. All customers at the time they first establish a relationship with the firm
D. Only government regulators or SRO’s, such as the NASD

WHY: the law distinguishes a "consumer" from a "customer." When they're just a consumer filling out paperwork, the firm is running credit checks. Once the firm opens the account, the other party is their customer, which is when the privacy statement must be made available.
ANSWER: C

22. Frank is planning to open an account at Zappa Securities. Zappa Securities must furnish Frank with a privacy notice:
A. Only if Zappa plans to disclose any of Frank's private information to nonaffiliated third parties
B. At the time Frank opens the account
C. Before Frank enters his first order
D. By the end of the year in which the account is opened and annually thereafter

WHY: when Frank opens the account, he becomes a customer and must receive the privacy statement.
ANSWER: B

23. One of your customers deposits $7,000 cash at 11AM and $4,000 at 3:45 PM. Therefore:
A. your firm must immediately contact OFAC
B. the second deposit must be dated for the next day
C. your firm must file FinCEN Form 104 (Currency Transaction Report)
D. your firm must file a SAR with NASD

WHY: cash transactions > $10,000 in the same day require a Currency Transaction Report.
ANSWER: C

24. Beau Teek has a dress shop down the street from your branch. He does a cash business and periodically deposits less than $1,000 at your branch. You would be suspicious of his behavior if he:

I. Begins selling stock short
II. Starts to deposit much larger sums
III. Wires funds to a foreign bank
IV. Opens a joint account with his sister-in-law

A. I and II only
B. II and III only
C. I, II, and IV only
D. I, II, III, and IV

WHY: if the deposits suddenly balloon, that's suspicious. Wiring money to a foreign bank, say in the Cayman Islands or Switzerland, would tend to raise some red flags, too.
ANSWER: B

25. If an investor wishes to open a cash account in her name only and allow her husband to make trading decisions as well as withdraw cash and securities, she must instruct her broker/dealer to open a

A. margin account
B. cash account with limited power of attorney
C. cash account with full power of attorney
D. cash account

WHY: limited power of attorney would allow the husband to enter orders only; full power of attorney would allow him to do that and also tell the firm to send checks and/or certificates to his wife.
ANSWER: C

26. A customer has indicated that she would like to take automatic reinvestment of dividend and capital gains distributions from her recent purchase of the Vesper Value Fund. Which of the following statements is, therefore, accurate?

A. Taxation will be deferred on these distributions.
B. The customer’s proportionate ownership in the fund will be lowered each time a distribution is made.
C. Customers no longer have this option as of Tax Year 2006.
D. The customer will be allowed to reinvest her distribution without paying a sales charge.

WHY: the advantage of automatic reinvestments is that you avoid the sales charge, and you get the full effect of "compounding." In other words, those total return figures published in the prospectus and other communications would accurately reflect your own experience in the fund. You would not be losing proportional ownership in the fund, which is what happens to investors who cash the check and go shopping. You would also not be deferring taxation by reinvesting dividends and capital gains distributions. You'll

get a 1099 DIV, which will show you the amount of taxable income you received, whether you cashed the check or reinvested into more shares.
ANSWER: D

27. NASD Rule 3110(f), Pre-dispute Arbitration Agreements mandates that
A. the agreement be delivered at the time of signing.
B. the agreement be delivered no later than the confirmation date of the first trade in the account.
C. the receipt of the agreement is acknowledged by the customer orally.
D. the acknowledgement of receipt of the agreement is not required so long as it is delivered in a timely fashion.

WHY: the NASD wants the investor to know exactly what she is signing—arbitration does not allow for appeals, decisions do not have to be explained, some of the arbitrators are real friendly with the folks in the industry who prefer not to pay any money to customers. Deliver the agreement to the customer, get it signed, and get her acknowledgment of receipt in writing.
ANSWER: A

28. The Pre-dispute Arbitration Agreement disclosure required by NASD Rule 3110 includes clauses that explain which of the following?
A. Arbitration is nonbinding and rulings are often reversed in a court of law.
B. All parties to the agreement are giving up the right to sue each other in court.
C. The arbitrators' award must include all factual findings and legal reasoning that justify the award.
D. All choices listed.

WHY: civil court is too time consuming and costly, so the industry prefers arbitration. There are no appeals to arbitration awards, which are binding. The arbitrators do not have to provide explanations for their decisions.
ANSWER: B

29. Some customers prefer paying commissions per transaction, while others prefer to pay fee-based compensation, as a percentage of assets. The NASD stipulates which of the following to members who offer fee-based services?
A. it is a violation to place a customer in an account with a fee structure that reasonably can be expected to result in a greater cost than an alternative account offered by the member that provides the same services and benefits
B. members must have reasonable grounds to believe that such an account is appropriate for that particular customer
C. if a member discloses that an alternative account would be cheaper but the customer opts for the fee-based structure, the firm may open the fee-based account
D. all choices listed

WHY: the firm should put the customer into the billing structure that makes the most sense for the customer. If they explain that a fee-based billing would be cheaper but the customer says that's okay, I'd rather go with fee-based billing, the firm would just make

note that the customer was informed and made her own decision. Why would a customer choose fee-based billing? Maybe she likes knowing that when her account balance drops, so does the income of the firm. That tends to discourage the time-honored practice of pitching crappy stocks to people who don't know no better.
ANSWER: D

30. The NASD has requested copies of books and records regarding transactions of a particular client and has asked you to testify to provide additional information. All of the following statements are accurate EXCEPT:

A. you and your firm must provide testimony to the NASD
B. you and your firm must provide copies of books and records requested
C. you and your firm are not required to provide books and records regarding a particular client during routine examinations; only after a formal complaint has been filed
D. you could be barred and your firm expelled if you engaged in destruction of the books and records requested

WHY: a real good rule of thumb is to always cooperate with the NASD.
ANSWER: C