Investment Company and Variable Contracts Products Representative Qualification Examination (IR)

[FINRA Series-6]

Version Demo

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QUESTION NO: 1

Ms. Mix always assures her clients that she will be calling them with quarterly recommendations for rebalancing their portfolios if there are any changes that she feels are appropriate. This has worked out well for her pocketbook since she has always been able to tweak each of her clients' investment portfolios a little each quarter by recommending that they redeem their shares in one fund that hasn't performed as well in the last quarter and use the proceeds to invest in another that has. Her clients feel cared for since she is in such regular contact with them.

Is Ms. Mix violating any securities regulations with this policy of hers?

A. No. Ms. Mix is merely providing good service to her customers.

B. Yes. Mutual funds are not designed to be short-term investments.

C. It depends. There is no violation as long as her clients' portfolios are increasing in value.

D. Yes. Any recommendation that benefits a registered representative is deemed to be in violation of FINRA's rules regarding fair dealing.

ANSWER: B

Explanation:

Yes. Mutual funds are not designed to be short-term investments, and Ms. Mix should not be calling her customers quarterly with rebalancing recommendations. Even if one fund has outperformed another in a particular quarter, there is no guarantee that this will happen in the next quarter. This violation falls under FINRA's rules regarding the trading of mutual fund shares, even if the trading results in an increase in the clients' portfolio values. Ms. Mix can certainly call her clients each quarter to see if they have any questions or concerns or to say hello; her clients will still feel cared for. It is not a violation for a registered representative to make a recommendation that benefits her as well as her clients as long as the recommendation is made to benefit the client first and foremost.

QUESTION NO: 2

Marshall's employer offers a 403(b) plan, and Marshall must decide into which of several mutual fund alternatives the contributions will be invested.

Regardless of other factors, which of the following would clearly not be a good choice?

A. a municipal bond fund

B. a fund that invests in stocks that are expected to experience high growth

C. a fund that invests almost exclusively in high-tech stocks

D. a fund that invests in both foreign and domestic stocks

ANSWER: A

Explanation:

A municipal bond fund is clearly not a good investment choice for a 403(b) plan. Earnings in a 403(b) plan grow tax-deferred, so Marshall would not be receiving the tax-free income benefits offered by a municipal bond fund. All he would be receiving is a lower return on his investment.

QUESTION NO: 3

Joan is a customer of GetErDone Broker-Dealers. Her twin sister, Jean, has accompanied her to GetErDone's office and has gathered some information regarding opening an account with the firm, giving it her contact information at the same time.

Under Regulation S-P, which of the following statements regarding GetErDone's handling of Joan's and Jean's personal information is true?

A. GetErDone must provide Joan with a notification of its privacy policies annually and provide her with information on how to mandate that it not share her nonpublic personal information with nonaffiliated third parties.

B. GetErDone can disclose any information that Jean provided them to nonaffiliated third parties since Jean is not a customer of the broker-dealer.

C. GetErDone is required to have provided Jean with a copy of its privacy policy when she inquired about opening an account with the broker-dealer.

D. All of the above are true statements.

ANSWER: A

Explanation:

Since Joan is a customer of GetErDone, GetErDone must provide her with a notification of its privacy policies annually and provide her with information on how to mandate that it not share her nonpublic personal information with nonaffiliated third parties. GetErDone may not disclose any information about Jean, who is not yet a customer of the firm, unless the broker - dealer has provided Jean with its privacy policy and given her the opportunity to opt out of its ability to share her information with nonaffiliated third parties. GetErDone is not required to have provided Jean with a copy of its privacy policy when she inquired about opening an account, but it will need to provide her with one when/if she becomes a customer.

QUESTION NO: 4

What did the Howey Decision?

A. provided for fixed annuities to be excluded from the definition of a security.

B. defined an investment contract as any investment of money in a common enterprise with the expectation of earning a profit from the efforts of others.

C. stipulated that all general partnerships were investment contracts and, therefore, securities, as defined by the Securities Exchange Act of 1934.

D. determined that certificates of deposit issued by a bank and insured by the FDIC did not qualify as securities, as defined by the Securities Exchange Act of 1934.

ANSWER: B

Explanation:

The Howey Decision defined an investment contract as any investment of money in a common enterprise with the expectation of earning a profit from the efforts of others. General partnerships do not fall under the definition of investment contracts since the general partners are actively involved in the business operations. Although both fixed annuities and bank CDs are excluded from the definition of a security, this was not part of the Howey Decision.

QUESTION NO: 5

Jake's Uncle Zeke gave Jake and his new bride 100 shares of the stock of Southwest Airlines (LUV) when they got married. Uncle Zeke had paid $16.60 for the stock several years earlier, but it was selling for only $12.10 on the day of the wedding. Jake and his bride are unimpressed with the stock's performance a few months later and decide to sell it for $11.00, its market price at that point.

What are the tax consequences of the sale for the newly wedded couple?

A. Jake and his bride will have a long-term capital loss of $110 to offset other income.

B. Jake and his bride will have a long-term capital loss of $560 to offset other income.

C. Jake and his bride will have a short-term capital loss of $560 to offset other income.

D. Jake and his bride will have neither a taxable gain nor a capital loss to declare.

ANSWER: A

Explanation:

If Jake and his bride sell the stock of LUV for $11.00 when it was selling for $12.10 on the day that they received it, they will have a long-term capital loss of $110 to offset other income. In this situation, the relevant cost basis is the value of LUV on the day of the wedding. Therefore, the loss is calculated as ($11 - $12.10) x 100 = -$110. The holding period is based on the holding period of the donor, so the loss is considered to be a long-term capital loss. In a gift situation, there are two cost bases. In the case of an asset that has depreciated in value, as in this instance, if the recipient sells the gifted property for less than its market value on the day he received it, the cost basis is considered to be the market price on the day the gift was received. If, on the other hand, the property has appreciated in value and the gift recipient sells the gifted property for more than the cost basis of the donor, then his gain is based on the cost basis of the donor, not the price at which the property was selling on the day the gift was received. If the selling price is somewhere between the two values, there is neither a taxable gain nor a taxable loss for the gift recipient to declare.

QUESTION NO: 6

Your client is trying to choose between a variable annuity and a fixed annuity. You can tell him that:

I. the fixed annuity will make guaranteed monthly payments, but has more purchasing power risk than a variable annuity.

II. he can expect higher monthly payments from his fixed annuity during a bear market than he would get from a variable annuity.

III. the earnings on both variable and fixed annuities grow tax-deferred.

A. I only

B. I and II only

C. I and III only

D. I, II, and III

E. the fixed annuity will make guaranteed monthly payments, but has more purchasing power risk than a variable annuity.
II. he can expect higher monthly payments from his fixed annuity during a bear market than he would get from a variable annuity.
III. the earnings on both variable and fixed annuities grow tax-deferred.

ANSWER: C

Explanation:

Only Statements **I** and **III** are accurate. When your client is trying to choose between a variable annuity and a fixed annuity, you can tell him that the fixed annuity will make guaranteed monthly payments, but has more purchasing power risk than a variable annuity, and that the earnings on both variable and fixed annuities grow tax-deferred. You cannot tell him that he can expect higher monthly payments from his fixed annuity during a bear market than he would get from a variable annuity. This will depend on various factors, such as the amount of the fixed annuity payment, the assumed interest rate, and the actual returns earned on the variable annuity investment portfolio.

QUESTION NO: 7

Fidelity Investments has two money market funds that is available to most investors. The Fidelity Cash Reserves fund (FDRXX) is currently yielding 0.10% while its Fidelity Municipal Money Market fund (FTEXX) is yielding 0.01%. One reason for this significant difference is that:

A. the Municipal Money Market fund pays interest that is free from state and local taxes.

B. the Municipal Money Market fund pays interest that is free from federal taxes.

C. interest earned on the Cash Reserves fund is subject to the alternative minimum tax.

D. the Municipal Money Market fund is insured by the FDIC, and this is not true of the Cash Reserves fund.

ANSWER: B

Explanation:

One reason for the significant difference between the returns on Fidelity's Cash Reserves fund and its Municipal Money Market fund is that the Municipal Money Market fund pays interest that is free from federal taxes. The interest earned is not necessarily free from state and local taxes, and the Municipal Money Market fund is not insured by the FDIC.

QUESTION NO: 8

The mortality guarantee of a variable annuity contract:

A. guarantees a fixed death benefit amount will pay to your beneficiaries upon your death.

B. guarantees that you can receive a monthly check of a specified amount as long as you live.

C. guarantees that both you and a person you specify as your beneficiary will continue to receive payments as long as one of the two of you is alive.

D. None of the above is a true statement about the mortality guarantee of a variable annuity contract.

ANSWER: D

Explanation:

None of the choices provided is a true statement about the mortality guarantee of a variable annuity contract. The mortality guarantee guarantees that you can receive a monthly check for as long as you live, but it does not guarantee that the check will be for a specified amount.

QUESTION NO: 9

On which of the following items do mutual fund shareholders get to vote?

I. any change in the investment objective of the fund

II. the election of a new investment adviser

III. the renewal of the fund's 12b-1 fee

IV. the purchase or sale of real estate by the fund

A. I, II, III, and IV

B. I, II, and IV only

C. I, II, and III only

D. I, III, and IV only

E. any change in the investment objective of the fund
II. the election of a new investment adviser
III. the renewal of the fund's 12b-1 fee
IV. the purchase or sale of real estate by the fund

ANSWER: D

Explanation:

Mutual fund shareholders get to vote on any change in the investment objective of the fund, the renewal of the fund's 12b-1 fee, and the purchase or sale of real estate by the fund. They do not elect the fund's investment adviser; they only vote to approve the investment adviser's contract.

QUESTION NO: 10

Upon receiving approval via a majority vote of its shareholders, a mutual fund is permitted to:

A. change from a diversified company to a non-diversified company.

B. engage in margin transactions.

C. retain any dividends and capital gains that it earned on its portfolio rather than paying them out to the shareholders.

D. issue preferred stock.

ANSWER: A

Explanation:

Upon receiving approval via a majority vote of its shareholders, a mutual fund is permitted to change from a diversified company to a non-diversified company. The fund is not allowed to engage in margin transactions, fail to make dividend and capital gain distributions, or issue preferred stock under any circumstances.

QUESTION NO: 11

Paul is 36 years old and is married with two children, ages eight and ten. Paul lays carpet for a living, working as an independent contractor, and earns about $35,000 a year. His wife, Paula, is 33 years old, drives a school bus and earns only $18,000 a year, but her job provides the family with low-cost health insurance. They live conservatively and barely make ends meet. Paula recently inherited $180,000, however, and the couple would like to invest it, with the goal that they can both retire when Paul turns 62. The inheritance also included an educational endowment for their children, so they will not have to worry about saving for their children's college educations.

Which of the following would not be a suitable recommendation for the allocation of their investment monies?

A. municipal bond fund

B. aggressive growth stock fund

C. Roth IRA

D. life insurance

ANSWER: A

Explanation:

Given that their combined income is only $53,000, Paul and Paula's marginal tax rate is low, so a municipal bond fund would not be a good recommendation for the allocation of their investment monies. Municipal bonds offer lower returns, and the couple would get little or no benefit from the tax-free interest income that these bonds provide. Their investment horizon is long enough (26 years) for them to invest some of their money in an aggressive growth stock fund, which has higher risk but also provides the higher expected returns that they may need to be able to retire when Paul turns 62. A Roth IRA is preferred over a traditional IRA in their situation. Although the traditional IRA would allow them to deduct their contributions, they already pay little or no taxes. Contributions to a Roth IRA are made out of after-tax income, but the contributions themselves can be withdrawn at any time without penalty if Paul and Paula run into some unexpected expenses, and the earnings grow tax-deferred and will be completely tax-free if they make no withdrawals until the age of 59 ½. Given the ages of their children, a life insurance policy that will help provide for them if one or both of the parents die, should be strongly recommended.

QUESTION NO: 12

On Monday, August 2nd, the Board of Directors of Baldor Electric (BEZ) announced that the firm would pay a dividend of $0.17 a share. Payment will be made on Friday, October 8th to shareholders of record as of Friday, September 17th.

In order to receive this dividend check, an investor would have to purchase shares of Baldor Electric before which day?

A. Monday, August 2nd.

B. Wednesday, September 15th.

C. Friday, September 17th.

D. Friday, October 8th.

ANSWER: B

Explanation:

In order to receive the dividend check, an investor would have to purchase shares of Baldor Electric before Wednesday, September 15th, the ex-dividend date. The ex-dividend date of a stock is two business days prior to the date of record.

QUESTION NO: 13

Which of the following statements about the over-the-counter market is true?

A. Only penny stocks are traded in the over-the-counter market.

B. Trades in the over-the-counter market are conducted via the auction process.

C. Only bonds and other debt instruments are traded in the over-the-counter market.

D. Stocks that are listed on exchange floors are also traded in the over-the-counter market.

ANSWER: D

Explanation:

Stocks that are listed on exchange floors are also traded in the over-the-counter market. The term "third market" refers to over-the-counter trading of listed stocks. All types of securities-stocks, bonds, options, warrants, rights-trade over the counter. The over-the-counter market is a negotiated market, not an auction market.

QUESTION NO: 14

Simple Simon owns 1,000 shares in the Pasty Pie Corporation, which has just declared a stock dividend of 5%. Just prior to this announcement, Pasty Pie was selling for $10 a share. This announcement will:

A. increase Pasty's shares outstanding and reduce Simple's proportionate ownership in the firm.

B. increase the number of shares that Simple owns to 1,050, which will increase the market value of the shares that he owns from $10,000 to $10,500.

C. increase the number of shares that Simple owns to 1,050, but this will not affect the market value of Simple's holdings.

D. increase Simple's cash by the amount of the dividend paid: 0.05 x $10 = $0.50 x 1,000 shares = $500.

ANSWER: C

Explanation:

If Simple Simon owns 1,000 shares of Pasty Pie Corporation when Pasty declares a 5% stock dividend, the stock dividend will increase his number of shares to 1,050, but it will not affect the market value of Simple's holdings since the market price per share will also decrease proportionately. The aggregate market value of the firm stays the same, but the number of shares outstanding increases, resulting in a lower market value per share. Simple's proportionate ownership remains the same because his shares increased in the same percentage as the shares outstanding of the firm did. A stock dividend does not result in any cash payments to the shareholders.

QUESTION NO: 15

The American Funds family of funds offers numerous funds to investors. Among these are a U.S. government bond fund, a high-yield corporate bond fund, a diversified emerging markets fund, and a large stock growth fund. Of these four, the one that would expose the investor to the most social and political risk is its:

A. U.S. government bond fund.

B. diversified emerging markets fund.

C. large stock growth fund.

D. high-yield corporate bond fund.

ANSWER: B

Explanation:

An investor will be most exposed to social and political risk in American's diversified emerging markets fund. This fund invests, by definition, in securities offered by firms located in developing countries, whose economies are in transition. Often, the political and social environment of these countries is very unstable.