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

FINRA Series-6

Version Demo

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QUESTION NO: 1

The MaxCharge fund has a 5% front-end load and a 12b-1 fee that is 0.25% of its average net assets. Under these conditions, any rear-end load, it may have, is limited to:

A. 2.00%.

B. 4.25%.

C. 4.75%.

D. 3.25%.

ANSWER: D

Explanation:

Since the MaxCharge fund has a 5% front-end load and a 12b -1 fee that is 0.25% of its average net assets, any rear-end load, it may have, is limited to 3.25%. The maximum sales charge that is allowed is 8.5%, and this includes the front-end load, rear-end load, and 12b-1 fee. Since MaxCharge has a front-end load and a 12b-1 fee that totals 5.25%, its rear-end load is limited to 8.5% - 5.25% = 3.25%.

QUESTION NO: 2

Steel Dynamics (STLD) has a convertible bond issue that matures in four years. The bond has a face value of $1,000 and pays a coupon of 5.125%, with interest paid semiannually. The conversion ratio is 56.9801. If the stock of Steel Dynamics is currently priced at $15 a share, what is the conversion value of this bond, to the nearest cent?

A. $854.70

B. $569.80

C. $175.50

D. Until it matures, the conversion value of the bond is equal to its face value of $1,000

ANSWER: A

Explanation:

The conversion value of this bond $854.70. It is equal to its conversion ratio of 56.9801 times the current market price of its stock, $15. Thus, 56.9801 x $15 = $854.70.

QUESTION NO: 3

Which of the following would be required to register as an investment company?

I. a non-diversified management company

II. a unit investment trust

III. a face-amount certificate company

A. I, II, and III

B. II only

C. II and III only

D. I and II only

E. a non-diversified management company
II. a unit investment trust
III. a face-amount certificate company

ANSWER: A

Explanation:

All three choices must register as an investment company since all meet the definition of an investment company under the Investment Company Act of 1940. A management company refers to either a closed-end or an open-end investment company, both of which must register, regardless of the diversification of their investments.

QUESTION NO: 4

Which of the following is not required to be included in a management company's prospectus?

A. the various fees charged by the company

B. the potential risks to which the company's investors are exposed

C. a statement of the investment objective of the company

D. the financial statements of the company

ANSWER: D

Explanation:

The financial statements of the investment company are not required to be included in a management company's prospectus. Management companies, otherwise known as closed-end or open-end investment companies, are required to have a "statement of additional information," however, that would include the financial statements of the company.

QUESTION NO: 5

Tex Payor purchased his shares of Invest4U Mutual Fund 30 days prior to its ex-dividend date. In order for any dividends he receives from the fund to be qualified, Tex cannot sell his shares until:

A. one day after the fund's ex-dividend date.

B. thirty-one days after the fund's ex-dividend date.

C. six months after the settlement date of his purchase.

D. twelve months after the settlement date of his purchase.

ANSWER: B

Explanation:

In order for any of the dividends Tex receives from the fund he purchased 30 days prior to its ex-dividend date to be considered qualified, Tex cannot sell his shares until thirty-one days after the fund's ex-dividend date. To treat any fund dividends as qualified, a shareholder has to have held the shares for more than 60 days during a 121-day time frame that begins 60 days before the ex-dividend date stipulated by the fund. So, if Tex bought the shares 30 days prior to Invest4U's ex-dividend date, he needs to hold the shares for at least another 31 days after the fund's ex-dividend date for any distributed dividends to be considered qualified dividends.

QUESTION NO: 6

NASDAQ market makers provide investors with assurance that:

A. there is a market for the listed security.

B. the investor will be able to buy or sell the security at a price he desires.

C. the investor will be investing in a high quality investment with relatively low risk.

D. NASDAQ market makers provide investors with no assurance whatsoever. It is "buyer beware."

ANSWER: A

Explanation:

NASDAQ market makers provide investors with assurance that there is a market for the listed security by posting bid and ask prices for it. There is no guarantee, however, that the investor will be able to buy or sell the security at the price he desires or that the investment is high quality and low risk.

QUESTION NO: 7

A fund's 12b-1 fees may not be used to pay which of the following?

A. printing prospectuses

B. compensating brokers who sell shares of the fund

C. mailing sales literature to existing and prospective customers

D. administrative expenses of the fund's investment adviser

ANSWER: D

Explanation:

A fund's 12b-1 fees may not be used to pay the administrative expense of the fund's investment adviser. This would be part of the fund's management fees. SEC rule 12b-1 authorizes a fund to pay for distribution costs out of a fund's assets only if the fund has adopted a 12b-1 plan. The SEC defines these distribution costs to include the costs of marketing and selling the fund shares, including compensating brokers who help to sell the shares, and printing and mailing prospectuses and sales literature to existing and prospective customers.

QUESTION NO: 8

After three warnings, Honest Broker-Dealer was forced to terminate Sly Conman, one of its representatives, for making inaccurate statements when offering its mutual fund products to customers.

After his registration is terminated:

A. Mr. Conman can apply for reinstatement of his license after 12 months.

B. Mr. Conman remains under the jurisdiction of FINRA for a period of 1 year.

C. Mr. Conman remains under the jurisdiction of FINRA for a period of 2 years.

D. Mr. Conman can apply for reinstatement of his license after 6 months, but will have to pay any applicable fees and retake a test.

ANSWER: C

Explanation:

After his registration is terminated, Mr. Conman remains under the jurisdiction of FINRA for a period of 2 years. During this time, FINRA is able to file complaints against Mr. Conman for actions he made prior to his termination.

QUESTION NO: 9

Which of the following correctly describes a difference between closed-end and open-end investment companies?

A. Open-end investment companies have a fixed number of shares; closed-end companies can create new shares if there are more buyers than sellers.

B. Open-end investment company shares will never be offered at a price below the net asset value per share of the fund; this is not true of closed-end companies.

C. Open-end companies may invest in non-diversified portfolios; closed-end companies are required to invest only in diversified portfolios.

D. Shares of open-end companies sell on exchange floors; shares of closed-end companies are bought and sold through the company itself.

ANSWER: B

Explanation:

A difference between closed-end and open-end investment companies is that open-end investment company shares will never be offered at a price below the net asset value of the fund; this is not true of closed-end companies. The shares of open-end investment companies (mutual funds) are bought (and sold) through the company itself at net asset value or net asset value plus a load charge.

Therefore, the offer price will always be greater than or equal to the fund's net asset value per share.

Closed-end company shares are bought and sold on exchange floors, and the price is set by supply and demand, so closed-end shares may sell for less than the net asset value of the fund. Closed-end companies have a fixed number of shares. Open-end companies can create new shares if there are more buyers than sellers. Both types of management companies can be either diversified or non-diversified in their holdings.

QUESTION NO: 10

Jack is an investment adviser representative employed by Giant Investments, a family of mutual funds. Jack has recently read an article posted on the web that he thinks explains some consequences of some tax law changes that are being considered extremely well, and he e-mails his existing retail customers with a summary of the salient facts of the article. Given these facts:

A. Jack has violated FINRA rules if he did not first have a principal of Giant approve his e -mail prior to hitting the send button.

B. Jack must submit a copy of the e-mail to a principal of the company, but he did not need to do so prior to sending the e-mail.

C. a copy of the e-mail must be submitted to FINRA within 10 days of Jack's hitting the send button.

D. Both A and C are true statements regarding this situation.

ANSWER: B

Explanation:

When Jack e-mails some of his existing retail clients with a summary of the tax article, he must submit a copy of the e-mail to a principal of the company, but he does not need to do so prior to sending the e-mail. Since this was sent to Jack's existing retail customers, it falls under the category of "correspondence," which does not need to be approved by a principal beforehand, but is subject to review and supervision requirements.

QUESTION NO: 11

Which of the following statements regarding the required distribution of income by a regulated investment company are true?

A. Both short-term and long-term capital gains earned by the company can be distributed only once a year.

B. Under current tax laws, qualifying dividends distributed to the company's investors are taxable to those investors at a preferential rate-i.e., either 0% or 15%, depending on the investor's marginal tax rate.

C. If an investor in the investment company has elected to reinvest his dividend and capital income in the company rather than receiving a check, then the investor is not required to pay taxes on the reinvested funds.

D. Both A and B are true statements.

ANSWER: B

Explanation:

The statement regarding the required distribution of income by a regulated investment company that is true is that under current tax laws, qualifying dividends distributed to the company's investors are taxable to those investors at a preferential rate-i.e., either 0% or 15%, depending on the investor's marginal tax rate. This preferential treatment is due to expire on Dec. 31, 2010 unless it is extended. Only long-term capital gains earned by the company can only be distributed once a year. Short-term capital gains are generally distributed along with dividends-usually once a quarter. Even if an investor elects to reinvest dividend and capital gain income rather than receiving a check, the investor must still pay taxes on the income he would have received had he not made the election.

QUESTION NO: 12

After having been divorced for several years, Mrs. Blended has remarried a man with three children of his own. She has set up a revocable trust in which she deposited funds that she inherited when her mother died, so that the monies will go uncontested to her two biological children in the event of her own death. These two adult children are the only beneficiaries of the trust. Mrs. Blended has no plans to touch any of the money in the trust unless circumstances demand it in the future. The trust is invested in a mutual fund that paid $500 in dividend income and distributed $3,000 in long-term capital gain income to the trust this year.

Which of the following statements is true regarding the tax treatment of these distributions?

A. The distributions will not be taxed at this point; they will be taxed only when Mrs. Blended or her beneficiaries make withdrawals from the trust.

B. Assuming her two adult children are equal beneficiaries, each one is responsible for paying tax on 50% of the income to the trust, or $1,750.

C. Mrs. Blended must pay taxes on the $3,500 in distributions.

D. The distributions will not be taxed at this point; they will be taxed as part of the estate upon Mrs. Blended's death.

ANSWER: C

Explanation:

If Mrs. Blended established a revocable trust that invested in a mutual fund that distributed $3,500 total in dividend and capital gain income this year, Mrs. Blended is responsible for paying taxes on the distributions. Whether or not any monies or assets are withdrawn from a revocable trust, the grantor of the trust-in this case, Mrs. Blended-- is responsible for any taxes due.

QUESTION NO: 13

Mr. R. Retired recently turned 61 and has decided to annuitize a variable annuity contract in which he had been investing. When he does so:

A. he will have to pay a 10% penalty for annuitizing the contract before he turned 62 ½.

B. his accumulation units will be converted into a fixed number of annuity units.

C. the value of his annuity units becomes fixed.

D. Both B and C are true statements.

ANSWER: B

Explanation:

When Mr. R. Retired decides to annuitize his variable annuity contract at the age of 61, his accumulation units will be converted into a fixed number of annuity units. The value of these units will depend on the actual returns earned by the account and the actuarially-determined assumed interest rate; it is not fixed. Mr. Retired will not be subject to a 10% penalty since he is over 59 ½ years old.

QUESTION NO: 14

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: 15

A retirement plan under which the benefit to be paid upon retirement is specified when an employee is signed up for the plan is known as a:

A. 401(k) plan.

B. SIMPLE-IRA.

C. defined benefit plan.

D. defined contribution plan.

ANSWER: C

Explanation:

A retirement plan under which the benefit to be paid upon retirement is specified when an employee is signed up for the plan is known as a defined benefit plan. The 401(k) plan and the SIMPLE-IRA are types of defined contribution plans.