FINRA-SERIES-63 Q&As

FINRA Uniform Securities Agent State Law Examination

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QUESTION 1

Desi Genuos is an agent with Broker-Dealer CanDo. A client has asked Desi to recommend a mutual fund that does not have a sales charge. Desi recommends a fund that has no front-end load although it does have a deferred sales load if the investor redeems his shares within the first three years of ownership, but the client has informed Desi that he is looking at this as a long-term investment. Based on these facts, Desi:

A. is in violation of NASAA rules regarding investment company shares.

B. is not in violation of any rules since the fund has no front-end load and the deferred sales load will not apply to this client, given his indication that this is meant to be a long- term investment.

C. will not be in violation of any NASAA rules as long as he has his client sign a "letter of intent."

D. is not in violation of any rules because he is an agent of a broker-dealer and is not affiliated with the fund he has recommended in any manner.

Correct Answer: A

If Desi recommends a mutual fund that has a deferred sales load to a client who requests a mutual fund with no sales charge, he is in violation of NASAA rules regarding investment company shares. The NASAA rules specify that it is prohibited for an agent to state or imply that the investment has no sales charge if there is a deferred sales load involved. It doesn\\'t matter if, in fact, the deferred load may never have to be paid by the client. A letter of intent involves a statement of intent by the investor to invest an amount that will meet a breakpoint that will entitle him to a lower load charge. This is not pertinent to this specific question.

QUESTION 2

Which of the following describes a prohibited practice in the sale of shares of investment companies?

I. Sandy Slacker hands her client the fund\\'s prospectus and tells him that the prospectus will provide him all that he needs to know about loads and fees associated with the fund.

II. Elliot Eager tells a client who has an investment objective that includes current income that a certain bond fund has a current yield of 8% and provides the client with a prospectus so that the client can peruse the average annual returns that the fund has generated in past years when the client has the time.

III.

After explaining all the fees and loads involved in two different bond funds as well as the difference between current yield and total return, Patty shows the client the data on the average annual returns that the two bond funds provided. She explains to the client that the municipal bond fund has a lower yield than the similar-risk corporate bond fund because the interest income the client will receive from the municipal bond fund will be free from federal taxation, while the interest income on the corporate bond fund is fully taxable.

A.

All the choices describe prohibited practices in the sale of shares of investment companies.

B.

I only

C.

I and II only

D.

I and III only

Correct Answer: C

Only the scenarios described in Selections I and II represent prohibited practices. The NASAA rules state that it is not enough to hand a client a prospectus, but that the agent must fully explain all sales charges and also to explain the difference between current yield and total return to the client and present that client with the fund\\'s most recent average annual returns over the past year, 5-year, and 10-year periods. Sandy and Elliot have not done this in the scenarios described. In Selection III, Patty has done so and has also provided the client with accurate and useful information regarding why a municipal bond offers a lower yield than a corporate bond fund.

QUESTION 3

Joe Treader is the owner of a small, state-registered investment advisory firm that is on the verge of becoming insolvent. One of his clients who has become like a mother to him is aware of his financial difficulties and has offered to sell off some of the assets that he manages for her and loan him the money to get him through this period of economic uncertainty until he is able to get on his feet again.

Can Joe take her up on her offer?

A. Yes. Based on the facts presented, it is an unsolicited offer and, as such, Joe can (and should) accept it.

B. Yes, but only if Joe draws up a formal loan agreement with a fair interest rate, based on the going market rates, stated in the agreement as well as a firm date for principal repayment.

C. No. As the client\\'s investment adviser, he has a fiduciary relationship with the client. Entering a loan agreement with this client could lead to conflicts of interest.

D. Both A and B are true.

Correct Answer: C

No, Joe cannot take his client\\'s offer of a loan because it could lead to a conflict of interest- -if not today, perhaps in the future--and as a fiduciary Joe will be expected to put this client\\'s welfare ahead of his own. If it takes him a lot longer than expected to get on his feet again, he may be tempted to act in his own best interest.

QUESTION 4

Blue Sky Laws are designed to:

A. protect investors from fraud in their securities market transactions.

B. protect agents, broker-dealers, and investment advisers and their representatives from spurious allegations of fraudulent activity.

C. enhance the tourism industry within a state.

D. favor investment in companies that engage in environmentally friendly practices.

Correct Answer: A

The main purpose of Blue Sky Laws is to protect individual investors from fraud in their securities market transactions. Requiring the registration of new security issues and theregistration of those persons who advise individual investors as well as those involved in the purchase and sale of securities to the public are just some of the regulations designed to do this. There are no provisions designed to protect agents, broker-dealers, or investment advisers and their representatives in any regard.

QUESTION 5

According to the NASAA Model Rules, a broker-dealer is not permitted to allow a customer to engage in margin transactions unless

A. the broker-dealer already has a margin agreement signed by the client in hand.

B. the broker-dealer receives a margin agreement signed by the client promptly after the client\\'s first margin transaction.

C. the client has a net worth of at least $500,000.

D. the client has been a customer of the firm for at least 6 months.

Correct Answer: B

A broker-dealer is not permitted to allow a customer to engage in margin transactions unless the broker-dealer receives a margin agreement signed by the client promptly after the client\\'s first margin transaction.