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QUESTION 1

Harry Lange manages the investment portfolio for the Fidelity Magellan Mutual Fund. Mr. Lange is a(n)

- A. broker-dealer.
- B. agent.
- C. investment adviser.
- D. investment company.

Correct Answer: C

If Harry Lange is managing the investment portfolio of Fidelity Magellan Mutual Fund, he is an investment adviser. He is making the investment decisions and receives a percentage of the assets under management as his compensation. He is not selling the mutual fund or the fund's investors anything, which is the job of a broker-dealer or an agent. Fidelity Magellan is the investment company.

QUESTION 2

The state of Massachusetts has issued a general obligation (G.O.) bond that pays 3% interest. As an agent selling this bond, you can legitimately tell the investor that

- A. the bond is guaranteed by the state of Massachusetts and is, therefore, a risk-free investment.
- B. the interest income the investor receives from the bond will be free from federal taxation.
- C. all state general obligation bonds are also guaranteed by the federal government.
- D. all of the above statements are true.

Correct Answer: B

An agent selling a Massachusetts general obligation bond can legitimately tell the investor that the interest income he receives from the bond will be free from federal taxation. It is not, however, a risk-free investment. States may default on their bond issues, and bonds issued by states are not guaranteed by the federal government.

QUESTION 3

Which of the following are examples of the prohibited practice of manipulation in the securities markets?

- I. Broker-Dealer Joker is unhappy with its investment in the stock of a speculative firm and engages another broker-dealer to purchase a large number of shares from it, with the unofficial agreement to buy back those shares, offer more shares which the second broker-dealer will purchase, and so on.
- II. Broker-Dealer Joker has a large short position in the stock of a certain corporation. Joker offers a bonus to its agents who effect sale transactions in the stock.
- III.



A client calls Broker-Dealer Joker with a request to purchase 20 bonds issued by Massachusetts Institute of Technology (MIT.) The bonds are currently selling for their par value of \$1,000. Knowing this, Joker offers to sell the client the bonds for \$120 per \$100 of par, or \$1,200 per \$1,000 bond.

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

Correct Answer: B

Only Selections I and II are examples of manipulation in the securities market. It is considered to be manipulation if one firm engages another firm to make a series of purchases and sales that will make it appear that there is very active trading in the security; it is also considered manipulation if a broker-dealer encourages its agents to solicit sales of a security in which it has a short position since that broker-dealer is hoping that the sales will drive the price of the security down, thereby making the firm's position profitable. Although the offer to sell a client bonds at a much higher price than their market price is illegal, it is not an example of price manipulation.

QUESTION 4

An investment adviser representative with Capital Investment Advisors, Inc. advised his client to invest \$5,000 in bonds of a firm that the adviser claimed was an investment "almost as risk-free as investing in U.S. government bonds; maybe even more so, given the magnitude of the government deficit these days." The client paid a total of \$200 for this advice. The bonds paid interest at the rate of 6%, with semiannual payments, and the client received \$300 in interest payments before the firm went belly-up at the end of a year, and its bonds were deemed worthless. The client has filed suit, and its attorneys' fees and court costs are expected to be \$1,000. When the investment is a bond, the state has recently been assessing an interest rate equal to the interest rate paid by the security as an equitable interest payment guideline in civil penalties.

The maximum the client can expect in civil penalties is

- A. \$5,900.
- B. \$6,200.
- C. \$5,200.
- D. \$6,000.

Correct Answer: B

The maximum amount the client can expect in civil penalties in this case is \$6,200. In civil court, the client is awarded the cost of the investment plus any attorneys' fees and court costs, plus any interest that the state deems appropriate, less any income earned on the investment. In this instance, the only income is the interest that the client earned, which



is identical to the interest that the Administrator mandates the investment adviser pay, so that is a wash. The investment advisory fee is included as part of the investor's cost, so the client can sue for the recovery of his original investment of \$5,000 plus the \$200 he paid for the investment advice plus the court costs and attorneys' fees of \$1,000, or \$6,200 total.

QUESTION 5

Once a person has filed an application with the Administrator, and in doing so has truthfully disclosed every material fact, how long does the Administrator have after the effective date of the registration to commence a proceeding to deny, suspend, or revoke that person's license based on those facts?

- A. 30 days.
- B. 60 days.
- C. 90 days.
- D. one year.

Correct Answer: C

If a person has appropriately and truthfully disclosed every material fact on its application for registration, the Administrator has 90 days after the registration becomes effective to commence a proceeding to deny, suspend, or revoke the license. If the Administrator has known about the fact for longer than this, he may not begin a proceeding against that person according to the Uniform Securities Act.

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