FINRA-SERIES-6 Q&As

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

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QUESTION 1

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

Correct 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 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

Correct 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 3

Which of the following statements regarding a mutual fund\\'s expenses are true?

A. A mutual fund that has a front-end load cannot also charge 12b-1 fees.

B. A mutual fund\\'s record maintenance fees cannot exceed 0.25% of average net assets.

C. The expense ratio of a mutual fund cannot exceed 1.0%.

D. A mutual fund family is prohibited from charging a fee when an investor exchanges his shares of one of its funds for another.

Correct Answer: B

Explanation: The true statement regarding a mutual fund\\'s expenses is that a mutual fund\\'s record maintenance fees cannot exceed 0.25% of average net assets. Mutual funds are permitted to have both front-end loads and charge 12b-1 fees, and the expense ratio of a mutual fund can exceed 1.0% (although a common recommendation is to select a fund with an expense ratio ? 1.0%.) Mutual fund families have the option of charging an "exchange fee" when an investor switches between their funds.

QUESTION 4

The Slippery Fund is a high-yield bond fund, which means it invests a substantial amount of its money in:

A. investment-grade bonds.

B. high-quality bonds.

C. junk bonds.

D. bonds with an AAA rating.

Correct Answer: C

Explanation: As a high-yield bond fund, Slippery invests a substantial amount of its money in junk bonds. High yield = high risk. Junk bonds have a rating below BBB.

QUESTION 5

Which of the following securities would be exempt from SEC registration requirements?

I. a 15-year bond issued by the state of Colorado

II. an issue of preferred stock that has an aggregate par value of $5 million

III.

an issue of commercial paper that has a 5-month maturity

A.

I only

B.

III only

C.

I and III only

D.

I and II only

Correct Answer: C

Explanation: Only Selections I and III are exempt from SEC registration requirements. The bond issued by Colorado is exempt because bonds issued by a government body are exempt from registration. The issue of commercial paper is exempt because securities with less than 270 days to maturity are exempt from registration.

QUESTION 6

Which of the following would not be a characteristic associated with stocks in which a growth fund might invest?

A. high earnings growth

B. high price-earnings (P/E) ratio

C. high cash dividends

D. beta > 1.0

Correct Answer: C

Explanation: The choice that would not be a characteristic of stocks in which a growth fund might invest is high cash dividends. Growth stocks offer returns in the form of capital appreciation (aka price increases.) In order to achieve this growth, the firms reinvest their earnings in their firms rather than distributing the earnings as dividends. Growth firms are those that are experiencing high earnings growth, and as a result, investors who are expecting great things from these firms are paying even higher prices, resulting in high P/E ratios. Growth firms are usually riskier than the average stock and have a beta greater than 1.0 to reflect this.

QUESTION 7

Given the same maturity, which of the following debt instruments would you expect to offer the highest yield-to-maturity?

A. a debenture issued by Abbott Laboratories

B. a bond issued by the Federal Home Loan Bank Board

C. a general obligation bond issued by the state of Massachusetts

D. a U.S. Treasury bond

Correct Answer: A

Explanation: Given the same maturity, the debenture issued by Abbott Laboratories would be expected to offer the highest yield -to-maturity. It is unsecured debt offered by a corporation and is the riskiest of the four choices. Bonds issued by the U.S. government and by U.S. government agencies are considered to be free of default-risk and would have lower yields to reflect this. The general obligation bond offered by the state of Massachusetts pays interest that is free from federal taxation and will have a lower yield because of this feature.

QUESTION 8

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

Correct 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 9

Which of the following statements regarding the “rights of accumulation” is true?

A. All mutual funds that have front-end loads are required to allow their shareholders rights of accumulation.

B. Reinvested dividends and capital gain distributions count toward reaching a breakpoint under the rights of accumulation.

C. A breakpoint must be reached within a 13-month period, at which point the accumulation period begins anew.

D. A letter of intent must be signed to activate the rights of accumulation.

Correct Answer: B

Explanation: The true statement is that reinvested dividends and capital gain distributions count toward reaching a breakpoint under the rights of accumulation. The rights of accumulation are not something that all mutual funds with front-end loads must offer. There is no time limit on the accumulation period. The rights of accumulation and the letter of intent are two separate animals; neither has anything to do with the other.

QUESTION 10

The Securities Exchange Commission consists of:

A. 6 members, elected by member firms.

B. 5 members, appointed by the President of the U.S., with Senate approval

C. 7 members, appointed by FINRA.

D. 5 members, appointed by the Secretary of Treasury of the U.S.

Correct Answer: B

Explanation: The Securities Exchange Commission consists of 5 members, appointed by the President of the U.S., with

Senate approval.

QUESTION 11

Rank the following entities with regard to the priority of their claims on a firm-from the highest priority to the lowest priority-in the event of bankruptcy.

I. common shareholders

II. preferred shareholders

III. secured bondholders

IV.

debenture holders

A.

III, II, IV, I

B.

II, III, I, IV

C.

III, IV, II, I

D.

IV, III, II, I

Correct Answer: C

Explanation: Choice C correctly ranks the entities with regard to the priority of their claims on the firm in the event of bankruptcy, from the highest priority to the lowest priority. Secured bondholders get paid first, then debenture (unsecured bond) holders, followed by preferred shareholders. Common shareholders come in last.

QUESTION 12

Which of the following statements regarding the taxes associated with a variable life insurance policy is false?

A. Earnings on a variable life insurance policy grow tax-free.

B. Payments to beneficiaries upon the death of the policyholder are taxed as ordinary income.

C. One variable life policy can be exchanged for another variable life policy without triggering any consequences under Section 1035 of the tax code.

D. If a policyholder withdraws some of the cash value associated with the policy, taxes need only be paid on the amount that exceeds the total amount of the premiums paid to date.

Correct Answer: B

Explanation: The statement that payments to beneficiaries upon the death of the policyholder are taxed as ordinary income is false. When a policyholder dies, the death benefit received by the beneficiaries is tax-free. The death benefit will, however, be included in calculating any estate taxes that might be due. All the other choices are true statements. Unlike the tax treatment of variable annuities, the IRS uses first -in, first out (FIFO) accounting when determining whether the withdrawals have come from earnings or premium payments; therefore, when a policyholder withdraws some of the policy\\'s cash value, it is assumed to be a withdrawal of premiums first, and that amount of the withdrawal is tax-free.

QUESTION 13

Which of the following must be true for a fund to be called a “no load” fund?

I. The fund can have no front-end load.

II. The fund can have no contingent deferred sales charge.

III. The fund can charge no 12b-1 fees.

IV.

The fund cannot charge investors an exchange fee.

A.

Only I and II must be true.

B.

I, II, and III must all be true.

C.

Only I must be true.

D.

I, II, III, and IV must all be true.

Correct Answer: A

Explanation: Only Statements I and II must be true for a fund to be called a “no load” fund. The fund can have no front-end load, and it can have no contingent deferred sales charge. It can, however, charge 12b-1 fees, as long as the 12b-1 fees do not exceed 0.25% of the fund\\'s average net assets, and it can charge investors an exchange fee when they elect to switch their monies from one fund to another.

QUESTION 14

Under FINRA\\'s rules regarding proper supervision, member firms must:

I. have clear written procedures to supervise the activities of its principals, registered representatives, and other associated persons.

II. designate as an office of supervisory jurisdiction (OSJ) any office of the member that engages in maintaining custody of the funds and/or securities of the member\\'s customers.

III. prohibit the use of any electronic communication method, including personal electronic devices, for business-related communications unless the use of the devices can be properly supervised and the communications retained.

IV.

regularly evaluate the effectiveness of its supervisory policies.

A.

I and IV only

B.

I, II, and IV only

C.

I, III, and IV only

D.

I, II, III and IV

Correct Answer: D

Explanation: Under FINRA\\'s rules regarding proper supervision, member firms must engage in the activities described in all four statements, including prohibiting the use of personal electronic devices for business-related communications unless the devices can be properly supervised and the communications retained.

QUESTION 15

Mandatory guidelines for the prospectuses of which of the following are dictated by the Investment Company Act of 1940?

I. mutual funds

II. closed-end investment companies

III. unit investment trusts

IV.

variable contracts

A.

I and II only

B.

II only

C.

I, II, and III only

D.

I, II, III, and IV

Correct Answer: D

Explanation: Mandatory guidelines for the prospectuses of all of the selections are dictated by the Investment Company Act of 1940.