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Uniform Securities State Law Examination

FINRA Series-63

Version Demo

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QUESTION NO: 1

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.

ANSWER: C

Explanation:

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 NO: 2

Nat Smart was employed as an investment adviser representative and sold many of his clients on a municipal bond fund of which he was fond, telling his clients that the returns earned on it were completely free from federal taxation. Unfortunately, he had some unhappy clients when, at the end of the year, they discovered that they had to pay federal tax on the capital gains earned by the fund when it sold some of the bonds it held. Nat was as surprised as they were.

Based on these facts, which of the following statements is necessarily true?

- I. Because Nat was as surprised as they were, he is guiltless.
 - II. Nat is subject to civil liability payments.
 - III. Nat will be subject to the criminal penalties for fraud and may spend time in prison.
- A. I only
 - B. II only
 - C. II and III only
 - D. III only

- E. Because Nat was as surprised as they were, he is guiltless.
- II. Nat is subject to civil liability payments.
- III. Nat will be subject to the criminal penalties for fraud and may spend time in prison.

ANSWER: B

Explanation:

Only Selection II is an accurate statement. In telling his clients that the returns earned on a municipal bond fund were totally tax-free, Nat misled the clients, whether intentionally or not. This constitutes fraud, and Nat is, at a minimum subject to civil liability payments, so this is “necessarily” true.

Whether or not Nat will be subject to criminal penalties for fraud and spend time in prison depends on his ability to prove that he had no knowledge that he was misleading his clients.

QUESTION NO: 3

As an agent, which of the following statements about the Securities Investor Protection Corporation (SIPC) can you legitimately make to your client?

- A. The SIPC is the FDIC of the stock and bond markets.”
- B. “The SIPC was established to restore funds to investors when the brokerage firm they have been using is bankrupt or in financial distress.”
- C. “The SIPC is a government agency created by an Act of Congress to combat fraud.”
- D. “The SIPC is a government agency that was created by an Act of Congress to protect investors against losses in the stock and bond market.”

ANSWER: B

Explanation:

The statement that you can legitimately make about the SIPC to your client is that it was established to restore funds to investors when the brokerage firm they have been using is bankrupt or in financial distress. The SIPC does not insure investors against losses in the stock and bond markets like the FDIC does bank deposits, and it does not combat fraud.

QUESTION NO: 4

A-2-Z Associates advertises itself as a full service brokerage firm that will buy and sell securities for its clients, as well as provide investment advice to them. Its brochure provides a variety of plans to which a client can subscribe. The basic plan is the cheapest and allows the client a maximum number of trades per month for a specified fee. Another, slightly more expensive, plan provides the client with the same maximum number of trades per month, but the client also receives a personalized quarterly review of his portfolio along with advice for restructuring his portfolio based on such factors as current market conditions and specific industry or company information. The most expensive plan is one in which the client is assigned to an individual portfolio manager, who will take total responsibility for the asset allocation of the client’s portfolio and will provide the client with monthly reports. Based on the services A-2-Z provides, it must register with the state as:

- A. a broker-dealer.

- B. an investment adviser.
- C. both a broker-dealer and an investment adviser.
- D. an investment adviser representative.

ANSWER: C

Explanation:

Based on the services A-2-Z provides, it must register with the state as both a broker-dealer and an investment adviser. It is receiving compensation as a broker-dealer for executing purchases and sales of securities for its clients under its basic plan, but it is receiving additional compensation for acting as an investment adviser under the two higher level plans.

QUESTION NO: 5

Once you have passed the Series 63 examination, which entity must then approve your application to sell securities?

- A. FINRA
- B. NASAA
- C. SEC
- D. the state administrator

ANSWER: D

Explanation:

Once you have passed the Series 63 exam, it is the state administrator who can approve or deny your registration. NASAA developed the Uniform Securities Agent State Law Examination and FINRA administers it. The SEC is not a party to the state registration process.

QUESTION NO: 6

When selling shares of an investment company to a client, an agent must provide the client with

- I. the fund's prospectus, which provides information on any loads or other fees as well as historical return information.
 - II. information about any breakpoints if it is a load fund along with an explanation of a letter of intent
 - III. information regarding the investment adviser used by the fund
 - IV. an explanation of the various loads and fees outlined in the fund's prospectus
- A. I, II, III, and IV
 - B. I, II, and III only
 - C. I and II only

D. I, II, and IV only

- E. the fund's prospectus, which provides information on any loads or other fees as well as historical return information.
- II. information about any breakpoints if it is a load fund along with an explanation of a letter of intent
- III. information regarding the investment adviser used by the fund
- IV. an explanation of the various loads and fees outlined in the fund's prospectus

ANSWER: D

Explanation:

When selling shares of an investment company to a client, the agent must provide the client with the fund's prospectus and provide the client with an explanation of the various loads and fees and any breakpoints that, if reached, will result in a lower load charge for the client, along with information on a letter of intent, which the client can execute. The agent need not provide any information regarding the investment adviser used by the fund although that information is contained in the prospectus as well.

QUESTION NO: 7

Registered agent Ina Scent has had her license suspended by the state Administrator prior to an administrative hearing on the order.

Which of the following statements is true regarding Ina's situation?

- A. Ina can sue the Administrator because she was not afforded a hearing before the suspension took place.
- B. Ina can make a written request that a hearing on the issue be scheduled within ten business days of her request and may continue working with clients while waiting for her day in court.
- C. Ina can make a written request that a hearing on the issue be scheduled within fifteen business days of her request and may not continue working with clients unless the Administrator vacates the order until final determination.
- D. Ina can immediately file an appeal of the suspension in a court of law.

ANSWER: C

Explanation:

When Ina receives notice of her license suspension, she can make a written request that a hearing on the issue be scheduled within fifteen business days of her request. She cannot continue working with clients unless the Administrator vacates the order until final determination because her license is still suspended pending final determination. If, after the hearing, the order still stands, Ina can file an appeal of the suspension with a court of law if she does so within 60 days.

QUESTION NO: 8

The 1988 Insider and Securities Enforcement Act indicates that a person convicted of insider trading can be subject to which of the following penalties?

- A. up to 10 years in prison and a fine of \$1 million or up to 3 times the amount of profits gained, or
- B. up to 3 years in prison, a \$5,000 fine, or both

- C. up to 5 years in prison and a fine of \$1,500,000 or both
- D. up to 7 years in prison and a fine equal to 200% of the amount of profits gained or losses avoided

ANSWER: A

Explanation:

The 1988 Insider Trading and Securities Enforcement Act increased the penalties for a person convicted of insider trading to up to 10 years in prison and a fine of \$1 million or up to 3 times the amount of profits gained, or losses avoided.

QUESTION NO: 9

The Uniform Securities Act (USA) is

- A. a body of laws governing the purchase and sale of securities within a single state.
- B. a set of guidelines for individual states to follow when formulating their own securities' laws.
- C. a group of laws requiring state-issued securities, such as municipal bonds, to be registered with.
- D. federal legislation that requires all states to adopt the same registration requirements for all.

ANSWER: B

Explanation:

The Uniform Securities Act (USA) provides a model for states to follow when formulating their own securities laws. It does not, itself, contain any laws.

QUESTION NO: 10

You execute a stock transaction for a client on Thursday, September 23rd. The settlement date on the order ticket will be

- A. Thursday, September 23rd.
- B. Monday, September 27th.
- C. Friday, September 24th.
- D. Tuesday, September 28th.

ANSWER: D

Explanation:

If you execute a stock transaction for a client on Thursday, September 23rd, the settlement date for that trade will be Tuesday, September 28th, which is T + 3, meaning three business days after the trade date.

QUESTION NO: 11

Which of the following is a security as defined by the Uniform Securities Act (USA)?

- A. a debenture
- B. a futures option contract on wheat
- C. a term life insurance policy
- D. Both A and B are securities as defined by the Uniform Securities Act.

ANSWER: D

Explanation:

Both a debenture and a futures option contract on wheat are securities as defined by the USA. A debenture is a long-term, unsecured debt instrument and is specifically listed as a security in the Act. Although commodity futures contracts are not considered to be securities as defined by the Act, options on commodity futures contracts are.

QUESTION NO: 12

Kevin has a pair of season tickets to the Boston Red Sox games. He and his wife can't attend all the games themselves, so Kevin has created "packages" of eight games each that he is listing for sale on Craig's List.

Do these "packages" meet the definition of securities, and, if so, does Kevin need to register them with the state before offering them for sale?

- A. If Kevin will be profiting from the sale of the packages, the packages are defined to be securities, but since he's selling the packages to only a few people, he will not have to register them with the state. (Kevin may, however, be guilty of violating ticket scalping laws.)
- B. Only if Kevin will be selling the packages at or below cost are the packages not considered to be securities, in which case Kevin will not have to register them with the state.
- C. The packages are not considered to be securities since each package is merely a purchase and sale agreement between Kevin and another person. There is no third party involved. Because they do not meet the definition of securities, Kevin does not need to register them with the state.
- D. Statements A and B are both true statements.

ANSWER: C

Explanation:

The packages are not considered to be securities since each package is simply a purchase and sale agreement between Kevin and another person, with no third party involvement; and since they are not securities, Kevin need not register them with the state. A buyer of one of the packages is not expecting to earn a profit on this investment "solely through the efforts of others," which is one of the defining characteristics of a security, as ruled by the U.S. Supreme Court in 1946.

QUESTION NO: 13

According to the NASAA Model Rules, which of the following institutions would not be considered a qualified custodian?

- A. a broker-dealer that is registered with the state
- B. a bank that is insured by a private, state-sponsored insurance company
- C. a foreign financial institution
- D. a savings institution that is insured by the FDIC

ANSWER: B

Explanation:

According to the NASAA Model Rules, a bank that is insured by a private, state-licensed insurance company would not be considered a qualified custodian. Registered broker-dealers, foreign financial institutions, and banks and savings institutions that are insured by the FDIC are on the list of qualified custodians.

QUESTION NO: 14

In which of the following instances is it permissible for an investment adviser to borrow money from a client?

- A. It is never permissible for an investment adviser to borrow money from a client.
- B. The investment adviser may borrow money from a client if the client is a bank.
- C. The investment adviser may borrow money from a client if the client is a close friend of the majority owner of the investment advisory firm.
- D. The investment adviser may borrow money in either of the scenarios described in B or C.

ANSWER: B

Explanation:

It is only permissible for an investment adviser to borrow money from a client if that client is in the business of loaning money, as would be the case if the client is a bank, but not if the client is merely a close friend of the majority owner of the investment advisory firm.

QUESTION NO: 15

Bootstraps, Inc. is a family-owned business that has experienced enormous growth in the last couple of years. The business needs more cash to support this growth and has decided to issue some promissory notes, each with a face value of \$5,000, for sale to the general public. The firm plans to hire three individuals to help them sell these notes. These individuals will earn a commission based on the notes they sell.

Given these facts, which of the following is true?

- A. The notes must be registered with the state, and the three individuals hired to sell the notes must be registered as agents with the state.
- B. The notes must be registered with the state, but the individuals hired to sell them are not required to be registered.

C. Neither the notes nor the individuals selling the notes need to be registered with the state.

D. Either the firm must register the notes with the state, or the individuals that are hired to sell the notes must be registered as agents with the state, but not both.

ANSWER: A

Explanation:

If Bootstraps hires three individuals to sell promissory notes to the public, both the notes and the three individuals hired to sell the notes must be registered with the state. The promissory notes are securities and, therefore, are required to be registered with the state before they can be offered for sale. The three individuals are working for the issuer, Bootstraps, to sell its securities to the public. This makes them agents, according to the Uniform Securities Act, and they must be registered as agents with the state.