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QUESTION 1

Upon receiving a complaint about one of its member firms, FINRA may: I. require any person associated with the member firm to provide information to FINRA and to testify under oath.

II. inspect and copy the books, records and accounts of the member firm.

III.

share information obtained from its investigation of a member firm with a foreign regulatory agency.

A.

II only

B.

I and II only

C.

II and III only

D.

I, II, and III

Correct Answer: D

Explanation: Upon receiving a complaint about one of its member firms, FINRA may require any person associated with the member firm to provide information and to testify under oath; it may inspect and copy the books, records, and accounts of the member firm; and it may share information obtained from its investigation of a member firm with a foreign regulatory agency. The foreign regulator must agree to treat the information confidentially, and the agreement with the foreign regulator is predicated on two requirements: "(A) the other regulator party to the agreement must have jurisdiction over common regulatory matters; and (B) the agreement must require the other regulator to reciprocate and share with FINRA information of regulatory interest or concern to FINRA."

QUESTION 2

Which of the following would not be required to display prominently the name of the member firm issuing it?

I. sales literature distributed to an institutional investor

II. correspondence by a registered representative with her client

III.

an advertisement to recruit new registered representatives

A.

I only

B.

I and II only

C.

III only

D.

I, II, and III

Correct Answer: C

Explanation: Only an advertisement to recruit new registered representatives is not required to display prominently the name of the member firm issuing it.

QUESTION 3

Giant Investments, a family of mutual funds, is introducing a new fund. Giant has recently filed a registration statement for the new fund with the SEC and is waiting for the SEC to declare the registration statement effective. While it does so, Giant may:

I. place advertisements in financial publications that announce that a new fund is expected to be available soon, along with Giant's contact information.

II. mail preliminary prospectuses to existing and prospective clients.

III.

mail existing clients who have been pre-screened to determine that the fund's objectives are in line with their investment objectives with information on the price they can lock in today to purchase the shares once the registration statement is deemed effective.

A.

I only

B.

I and II only

C.

I and III only

D.

I, II, and III

Correct Answer: B

Explanation: While Giant is waiting for the SEC to declare its registration statement effective, it may engage only in the activities described in Selections I and II. It may place advertisements in financial publications that announce that a new fund is expected to be available soon, along with its contact information-i.e., a tombstone advertisement; and it may mail

preliminary prospectuses to existing and prospective clients. It may not make any offer to sell the securities to clients, prescreened or otherwise, prior to the effective date of the registration statement.

QUESTION 4

Which of the following activities are permitted during the “cooling off” period associated with a new offering?

- I. A preliminary prospectus may be provided to prospective investors.
- II. The security can be registered in any states in which it will be sold.
- III. The management of the issuing firm may give interviews in which they discuss the market for their products and future revenue expectations.
- IV.

The underwriter of the issue may run a tombstone advertisement in the Wall Street Journal to announce the upcoming offering.

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

Correct Answer: C

Explanation: Only the activities described in Selections I, II, and IV are permitted during the “cooling off” period associated with a new offering. A preliminary prospectus can be provided to prospective investors; the security can be registered in any states in which it will be sold, and the underwriter of the issue can run a tombstone advertisement in the Wall Street Journal, or any other publication for that matter. The management of the issuing firm may not, however, give interviews in which they discuss future revenue expectations, among other things.

QUESTION 5

NewWave Investments, a family of mutual funds, hires the star of a new motion picture about the workings of Wall Street to provide a testimonial as part of NewWave’s new television ad campaign. The actor’s financial adviser has, in fact, invested some of the actor’s monies in NewWave’s funds. NewWave provides the actor with a script in which the actor explains the concept of dollar cost averaging to the viewers. At the conclusion of the actor’s explanation, the viewers are informed that the actor has been paid for his testimonial, that his experience may not be representative of that of other clients, and that past performance is no guarantee of future performance. Based on these facts:

- A. NewWave has violated no rules; it has complied with all of FINRA’s disclosure requirements.

B. NewWave has violated a FINRA rule stipulating that testimonial providers can receive no payment for their testimonies.

C. NewWave has violated a FINRA rule that prohibits testimonials of public figures from being used advertisements.

D. NewWave has violated a FINRA rule requiring that any testimonial that contains a technical aspect related to investing must be given by someone who has both the knowledge and experience to hold a valid opinion on the topic.

Correct Answer: D

Explanation: When NewWave hires an actor who is unlikely to have the knowledge to understand fully the concept of dollar cost averaging to explain it, it has violated a FINRA rule requiring that any testimonial that contains a technical aspect related to investing must be given by someone who has both the knowledge and experience to hold a valid opinion on the topic. The use of testimonials is not prohibited by FINRA, and providers are allowed be paid for their services.

QUESTION 6

Your client has recently heard about “principal-protected funds” and has asked your advice. You should tell her that:

I. the majority of principal-protected funds guarantee the investor's initial investment, less any front-end load, even if the stock market falls.

II. it would not be a good investment if she thinks she will need the money within the next five to ten years.

III. it will beat the returns she could earn on an S&P 500 Index fund in most years.

IV.

if she sells her shares at any time other than the maturity date specified, she could lose money if the price per share has fallen.

A.

I only

B.

I and II only

C.

I and III only

D.

I, II, and IV only

Correct Answer: D

Explanation: Only Statements I, II and IV are true. You can legitimately tell your client that the majority of principal-protected funds guarantee the investor's initial investment, less any front -end load, even if the stock market falls (i.e. Selection I), but that there is a lock-up period involved. Therefore, it would not be a good investment if she thinks she will need the money within the next five to ten years (Selection II) because the principal guarantee will likely be voided, and she might be subject to a penalty for early withdrawal. You should also warn her that if she sells her shares at any

time other than the maturity date specified, she could lose money if the price per share has fallen (Selection IV) since the guarantee is only valid on the maturity date of the fund in most instances. You should not tell her that the returns on a principal-protected fund will beat the returns she could earn on an S&P 500 Index fund in most years (Selection III). Although this may happen in a bear market year, it will definitely not be true during bull markets.

QUESTION 7

Which of the following bonds will experience the greatest percentage change in price for a given change in interest rates?

- A. a bond with 5 years to maturity that pays a 5% coupon
- B. a bond with 10 years to maturity that pays a 5% coupon
- C. a bond with 5 years to maturity that pays a 7% coupon
- D. a bond with 10 years to maturity that pays a 7% coupon

Correct Answer: B

Explanation: The bond that will experience the greatest percentage change in price for a given change in interest rates is the bond with 10 years to maturity that pays a 5% coupon. Bonds with longer durations experience greater changes in price, and the long maturity, low coupon bonds have longer durations.

QUESTION 8

Which of the following relationships regarding shares of common stock are necessarily true?

- I. shares outstanding > issued shares
- II. authorized shares ? issued shares
- III. issued shares = treasury shares
- IV.
issued shares ? shares outstanding

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

Correct Answer: B

Explanation: Only Selections II and IV are necessarily true. The number of authorized shares must always be greater than or equal to the number of shares that the firm offers to the public, which are the issued shares. The number of issued shares will be equal to the number of shares outstanding as long as the firm doesn't buy back any of its outstanding shares. Otherwise, the number of issued shares will exceed the number of shares outstanding since $\text{issued shares} = \text{shares outstanding} + \text{treasury shares}$. The issued shares would only be equal to the treasury shares if the firm repurchased all its shares outstanding.

QUESTION 9

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.

Correct 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 10

A table providing detailed information on the various fees and expenses charged by a mutual fund can be found in the fund's:

- A. Statement of Additional Information (SAI).
- B. prospectus.
- C. financial statements.
- D. annual report.

Correct Answer: B

Explanation: A table providing detailed information on the various fees and expenses charged by a mutual fund can be found in the fund's prospectus. The other choices provide a wealth of information regarding such items as investment strategies, fund holdings, and financial statements, however.

QUESTION 11

Phil Anthropy wrote his cousin a \$15,000 check to pay for medical bills the cousin had accumulated. He also distributed \$5,000 checks to three nephews who were in college, and gave his mother a check for \$12,000.

Have Phil's actions triggered any gift taxes?

- A. Yes, \$19,000 of his total distributions is subject to the gift tax.
- B. Yes, \$2,000 of his total distributions is subject to the gift tax.
- C. Yes, \$7,000 in distributions is subject to the gift tax.
- D. No. None of Phil's distributions is subject to the gift tax.

Correct Answer: B

Explanation: Yes. If Phil gives his cousin a \$15,000 check, three nephews \$5,000 checks, and his mother a check for \$12,000, \$2,000 of his total distributions is subject to the gift tax. The current annual gift tax exclusion is \$13,000 per person, and he has exceeded that by \$2,000 with the check he wrote to his cousin. Had Phil written the check directly to his cousin's medical care provider, no gift taxes would have been due on any of that amount either.

QUESTION 12

Mr. Investor has purchased 100 shares of the common stock of the Everyman Corporation. As such, which of the following is not a right that Mr. Investor has?

- A. the right to receive dividends, if declared
- B. the right to vote on the members of Everyman's board of directors
- C. the right to vote on any proposed changes to the corporate bylaws
- D. the right to vote on the purchase of a major piece of property that Everyman is considering

Correct Answer: D

Explanation: Mr. Investor does not have the right to vote on the purchase of a major piece of property that Everyman is considering or any decision involving business operations. He does have the right to receive dividends, if dividends are declared, based on his proportionate ownership of the firm. He also has the right to vote on the members of the firm's board of directors and to vote on any proposed changes to the corporate by laws.

QUESTION 13

Which of the following describes a difference between a Roth IRA and a traditional IRA?

- I. Anyone with earned income can contribute to a traditional IRA, but not everyone with earned income can make contributions to a Roth IRA.
- II. The contributions made to a traditional IRA may be tax deductible, but the contributions made to a Roth IRA are never tax deductible.
- III. Contributions made to a Roth IRA may be withdrawn without penalty at any time whereas contributions to a traditional IRA may only be withdrawn without penalty when the contributor reaches 59 ½ or if the contributor meets some specific requirements (e.g., becomes disabled.)

IV.

When a contributor to a traditional IRA turns 70 ½, he must begin making mandatory withdrawals, but there are no mandatory withdrawals with a Roth IRA.

A.

II and III only

B.

I, II, and III only

C.

II, III, and IV only

D.

I, II, III and IV

Correct Answer: D

Explanation: All four selections describe differences between a Roth IRA and a traditional IRA. Only those below a stipulated income level may contribute to a Roth IRA, which is not the case with a traditional IRA although with the traditional IRA, the contributions will not be tax deductible if the contributor's income is above a certain level. Contributions made to a Roth IRA are never tax deductible and may be withdrawn without penalty at any time. Even non-tax-deductible contributions made to a traditional IRA may not be withdrawn early without penalty. There is a minimum distribution requirement associated with a traditional IRA when the contributor turns 70 ½, but there is no such requirement associated with a Roth IRA.

QUESTION 14

Which of the following are included in the expense ratio of a fund?

I. 12b-1 fees

II. brokerage costs incurred by the fund when it buys and sells securities

III. redemption fees

IV.

management fees

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: A

Explanation: Of the selections, only 12b-1 fees and management fees are included in the expense ratio of the fund. Brokerage costs that the fund incurs when it buys and sells securities are not included (which is why a fund's turnover ratio is important to consider.) Redemption fees are paid by the shareholder to the fund, so it would not be included in a fund's expense ratio since it is not an expense of the fund.

QUESTION 15

Ms. Mix always assures her clients that she will be calling them with quarterly recommendations for rebalancing their portfolios if there are any changes that she feels are appropriate. This has worked out well for her pocketbook since she has always been able to tweak each of her clients' investment portfolios a little each quarter by recommending that they redeem their shares in one fund that hasn't performed as well in the last quarter and use the proceeds to invest in another that has. Her clients feel cared for since she is in such regular contact with them.

Is Ms. Mix violating any securities regulations with this policy of hers?

A. No. Ms. Mix is merely providing good service to her customers.

B. Yes. Mutual funds are not designed to be short-term investments.

C. It depends. There is no violation as long as her clients' portfolios are increasing in value.

D. Yes. Any recommendation that benefits a registered representative is deemed to be in violation of FINRA's rules regarding fair dealing.

Correct Answer: B

Explanation: Yes. Mutual funds are not designed to be short-term investments, and Ms. Mix should not be calling her customers quarterly with rebalancing recommendations. Even if one fund has outperformed another in a particular quarter, there is no guarantee that this will happen in the next quarter. This violation falls under FINRA's rules regarding the trading of mutual fund shares, even if the trading results in an increase in the clients' portfolio values. Ms. Mix can certainly call her clients each quarter to see if they have any questions or concerns or to say hello; her clients will still feel cared for. It is not a violation for a registered representative to make a recommendation that benefits her as well as her clients as long as the recommendation is made to benefit the client first and foremost.

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