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FINRA Uniform Securities Agent State Law Examination

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QUESTION 1

Alice Wonder called her broker on Tuesday, August 10th, with a market order to buy 10 calls on the stock of Abbott Laboratories. Under normal conditions, Alice will have to pay for the calls on:

- A. Wednesday, August 11th.
- B. Tuesday, August 10th.
- C. Friday, August 13th.
- D. Monday, August 16th.

Correct Answer: A

If Alice places a market order to buy call options on Tuesday, August 10th, she will have to pay for them on Wednesday, August 11th, the next business day. Options and U.S. government bonds settle on the day after the trade date, or T + 1.

QUESTION 2

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.

Correct Answer: A

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.

QUESTION 3

Assuming there is not a stop order or a proceeding pending, under the registration by coordination process a security's registration with the state becomes effective:

- A. only when it is approved by the state Administrator, regardless of whether it has been approved by the SEC.
- B. immediately after approval by the SEC as long as the registration statement has been on file for at least 20 days or the Uniform Securities Act has provided an exemption to this waiting period.
- C. immediately subsequent to approval by the SEC, regardless of how long the registration statement has been on file.
- D. only when it is approved by the state Administrator, who will review the registration documentation upon notification that SEC approval has been granted.

Correct Answer: B

Under the registration by coordination process, the security's registration with the state becomes effective immediately after approval by the SEC as long as the registration has been on file for at least 20 days or the Uniform Securities Act has provided an exemption to this waiting period. This assumes, of course, that there is not a stop order or a proceeding pending.

QUESTION 4

Which of the following is not a security, as defined by the Uniform Securities Act?

- I. an option contract
 - II. a futures contract on gold
 - III. a 401K plan
 - IV. a variable annuity
- A. None of the selections listed are securities.
- B. Only Selection III is not a security.
- C. Only Selections II and III are not securities.
- D. Selections II, III and IV are not securities.

Correct Answer: C

Only Selections II and III are not securities. Neither retirement plans nor commodity futures contracts are deemed to be securities by the Uniform Securities Act. A 401K plan may be invested in securities, but it is not a security itself. A gold futures contract is a contract between two parties for the delivery of the underlying asset, gold. The profits (or losses) are not dependent on the performance of an outside party, which is a critical element, based on a 1946 U.S. Supreme Court decision, which defines a security as "an investment of money. . . with profits to come solely from the efforts of others."

QUESTION 5

Which of the following are accurate statements regarding the minimum financial requirements for investment advisers according to the NASAA Model Rules?

I. Any investment adviser who has discretionary authority over a client's assets, but who does not have actual custody of client funds or securities, is required to maintain a minimum net worth of \$10,000 at all times.

II. An investment adviser who requires that a fee of more than \$500 from his clients be paid six months or more in advance must maintain a positive net worth at all times.

III.

Only an investment adviser who has actual custody of client assets is subject to a minimum net worth requirement, which the NASAA Model Rules specifies is \$10,000.

A.

I only

B.

I and II only

C.

II and III only

D.

III only

Correct Answer: B

Only Selections I and II are accurate statements of the NASAA Model Rules regarding minimum financial requirements for investment advisers. The NASAA rules stipulate that an adviser who has only discretionary authority, but does not take custody of a client's assets, must maintain a minimum net worth of \$10,000 at all times. Furthermore, any investment adviser who requires a fee of more than \$500 from his clients to be paid six months or more in advance must maintain a positive net worth at all times.

QUESTION 6

Which of the following would not fall under the classification of "institutional investor"?

A. Prudential Insurance

B. Chase Bank

C. Neuring Investment Advisers

D. Franklin Templeton Mutual Funds

Correct Answer: C

Nuering Investment Advisers would not fall under the classification of "institutional investor." Institutional investors are defined as banks, insurance companies, mutual funds, some pension plans, and broker-dealers registered under the Securities Exchange Act of 1934. Investment advisers are not part of this group.

QUESTION 7

Which of the following constitutes a non-punitive order?

- A. summary license suspension
- B. registration cancellation
- C. registration denial
- D. All of the above are punitive orders.

Correct Answer: B

Registration cancellation is a non-punitive order. The Administrator issues a cancellation order if a registered person dies, becomes mentally incompetent, is no longer in business, or is unable to be located.

QUESTION 8

Today's edition of the Wall Street Journal carried a front page story regarding a federal lawsuit that has been filed against a software manufacturer for monopolistic practices. The CFO of the company called his broker today and sold some of the shares he owns in the company.

Which of the following statements are true?

- I. The CFO is guilty of illegal insider trading.
- II. If the agent who effected the transaction for the CFO knew he was CFO of the software company, the agent is guilty of illegal insider trading.
- III.

The broker-dealer for whom the agent works may have its license suspended or revoked if its agent has knowingly executed this illegal insider trade for not having supervised the agent properly.

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

None of the statements is true.

Correct Answer: D

If the CFO called his broker and sold some of the shares he owns today, none of the statements is true. Insider trading is only illegal if the insider trades on information that the public does not yet have. In this case, the information has already been made publicly available, so no one has done anything illegal. Insiders to the company are allowed to buy and sell shares of their firm's stock as long as they are not acting on private information.

QUESTION 9

The current yield on a bond fund refers to

- A. the percentage increase in the fund's net asset value.
- B. the return that the fund earned because of the capital appreciation of the securities in the fund.
- C. the total return that the fund has earned over the most recent 12-month period.
- D. the return that the fund earned based only on the interest income it received.

Correct Answer: D

The current yield on a bond fund is the return that the fund earned from interest income only. The return from interest income plus the return due to the capital appreciation of the securities make up the total return earned by the fund. The investor's total return is equal to the return on the income received from the fund plus any change in the net asset value of the fund.

QUESTION 10

Cassie Clueless has recommended that a client purchase shares of a mutual fund prior to its ex-dividend date, so that the client will receive the dividends when they are distributed.

In which of the following situations might this recommendation be justifiable and not in violation of NASAA rules?

- I. The investor has refused to provide Cassie any information regarding his investment goals.
- II. The investor is a young professional with an investment goal of long-term capital appreciation.
- III.

The investor is a retiree in a low tax bracket and needs current income to augment her social security check.

- A.
I only
- B.
I and II only
- C.

III only

D.

It is always in violation of NASAA rules to recommend that a client purchase shares of a mutual fund prior to its ex-dividend date.

Correct Answer: C

If Cassie makes her recommendation based on the scenario described in Selection III, she is not violating any NASAA rules. It is advantageous for an investor who is a retiree in a low tax bracket and needs current income to augment her social security check to buy shares of a mutual fund before its ex-dividend date in order to receive the dividend income. The NASAA rule states only that an agent cannot indicate that the purchase of shares of a mutual fund prior to the ex-dividend date would be advantageous to the client "unless there are specific, clearly described tax or other advantages to the customer." It would be unethical for Cassie to recommend this strategy to an investor whose investment goals were unknown to her, as in Selection I, or to an investor who is looking for long-term capital appreciation and has no need for the dividend income--which will be taxable--as in Selection II.

QUESTION 11

An agent cannot tell a client that a mutual fund is "no load" if the fund has

I. a front-end load

II. a contingent deferred sales load

III.

12b-1 fees

A.

I, II or III

B.

I or II only

C.

I only

D.

I or III only

Correct Answer: B

If a fund has either Selection I or Selection II, an agent cannot tell a client it is "no load." If the fund has either a front-end load, a contingent deferred sales load, or both, the client must be told that the fund has a load. If the 12b-1 fees on a fund are 0.25% or less of the annual average net assets, it is not considered to be a load fund.

QUESTION 12

Which of the following describes an "exempt security," as defined by the Uniform Securities Act (USA)?

- A. An exempt security is any security that is being sold by an institutional investor, such as a bank, to another institutional investor, such as another bank or an insurance company.
- B. An exempt security is one that need not be registered in the state in which it is sold.
- C. An exempt security is any security being sold as a private placement.
- D. An exempt security is any security that is being sold in an isolated non-issuer transaction.

Correct Answer: B

As defined by the Uniform Securities Act, an exempt security is one that need not be registered in the state in which it is sold. Selections A and D describe exempt transactions. Although securities issued by financial institutions, such as banks, are exempt securities, not all securities that a bank purchases and sells qualify as exempt securities. Private placements may also be exempt transactions, but there are other stipulations that must be met.

QUESTION 13

Rich Quick is a broker-dealer registered in the state of Massachusetts. He occasionally trades on abnormalities he observes in bond yield spreads for his own account, short selling a bond that appears to be overpriced based on its yield and buying a bond that is identical in almost every respect except for the price, which is less than that of the other bond. He has been able to earn arbitrage profits 95% of the time when he does this. Rich Quick

- A. is in violation of securities laws. Arbitrage is a prohibited activity.
- B. is skilled if he is able to earn profits 95% of the time using this strategy.
- C. is trading on insider information, which is a violation of securities laws.
- D. engaged in a fraudulent activity.

Correct Answer: B

If Rich Quick is able to earn profits 95% of the time by trading on abnormalities he observes in bond yield spreads, he is skilled. There is nothing illegal in what he is doing. Arbitrageurs attempt to earn profits when they observe what they believe to be mispriced securities, and this is an accepted activity. Rich is not using insider information; bond yields are publicly available information.

QUESTION 14

Which of the following statements would not be in violation of NASAA rules regarding the sale of investment company shares?

- I. "Investing your money in shares of this money market mutual fund is identical to putting your money in a savings account at a bank, except the money market fund provides a higher return."
- II. "Our U.S. government bond fund is invested only in government bonds issued by the S. government and is, therefore, a risk-free investment."
- III.

"You are investing \$22,000 in this fund today. The fund has a 5% load at this investment level, but if you sign a letter of intent to invest another \$3,000 within the next 13 months, your load will be reduced to 4%. If something comes up and you can't invest the extra \$3,000 within 13 months, you will only need to pay the difference in the two loads."

A.

I only

B.

I and II only

C.

III only

D.

I, II, and III

Correct Answer: C

Only Selection III would not violate NASAA rules regarding the sale of investment company shares because it is the only true statement. If a fund has a breakpoint at \$25,000 that triggers a reduced front-end load and allows an investor to receive the reduced load charge if the investor signs a letter of intent stipulating that the additional investment will be made within 13 months, the only penalty to the investor who doesn't meet the breakpoint is payment of the difference in the two loads. Investing in shares of a money market mutual fund is not identical to putting money in a savings account at a bank. The bank account is insured by the FDIC in most cases; the money market mutual fund is not insured by the FDIC, and the investor can lose money (although, to date, money market mutual funds have covered any losses that they've experienced and not passed those losses onto their investors.) A U.S. government bond fund that is invested only in U.S. government bonds is free from default-risk, but it is still subject to interest rate risk. If interest rates increase, the value of the bonds in these funds-and therefore the fund itself-will decrease.

QUESTION 15

Mr. Bigwig, CEO of HiGrowth Corporation, meets with the president of BigFee Investment Bankers and arranges for BigFee to underwrite an Initial Public Offering (IPO) for the firm. When the IPO comes to market, GetErDone Broker-Dealers is part of the selling group, which handles the sale of the stock to the public. In this scenario, which party is the issuer?

A. HiGrowth Corporation

B. Mr. Bigwig

C. BigFee Investment Bankers

D. GetErDone Broker-Dealers

Correct Answer: A

HiGrowth Corporation is the issuer in this instance. Its stock will be sold, and HiGrowth will receive the proceeds from the sale-less BigFee's underwriting spread. Mr. Bigwig is merely HiGrowth's representative in this instance.

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