FINRA-SERIES-6 Q&As

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

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QUESTION 1

SuperDOT is:

A. an electronic communication network (ECN).

B. an electronic system whereby trades are executed on NASDAQ.

C. an electronic system used to place orders on the NYSE.

D. both A and C.

Correct Answer: C

Explanation: SuperDOT is an electronic system used to place market and limit orders on the NYSE whereby the orders are routed directly to the specialist in the assigned stocks. It is not an ECN, which is an electronic network that is designed to allow buyers and sellers to interact directly with each other, thereby bypassing the middlemen.

QUESTION 2

Your cousin has recently attended a seminar on the benefits of diversification. Based on what he learned, he decided to sell the shares he had in a large stock growth fund and put 50% of his money in hotel stocks and 50% in airline stocks. Based on this information, you can tell him:

A. that he\\'s wise beyond his years.

B. that he\\'s less diversified than he was before.

C. that he\\'s less diversified than he was before, but can expect a higher rate of return.

D. none of the above.

Correct Answer: B

Explanation: If your cousin sold his shares in a large stock growth fund and put 50% of his money in hotel stocks and 50% in airline stocks, you can tell him that he\\'s less diversified than he was before. The large stock growth fund was invested in many more industries than two-industries whose returns are less likely to move together than stocks in the hotel and airline industries. His expected return will not necessarily be higher and may even be lower; he\\'s just exposed to more risk. The return that can be expected from an investment is based on its non-diversifiable, or market, risk. An investor cannot expect a higher return by putting all his eggs in one (or in this case, two) baskets.

QUESTION 3

Paul is 36 years old and is married with two children, ages eight and ten. Paul lays carpet for a living, working as an independent contractor, and earns about $35,000 a year. His wife, Paula, is 33 years old, drives a school bus and earns only $18,000 a year, but her job provides the family with low-cost health insurance. They live conservatively and barely make ends meet. Paula recently inherited $180,000, however, and the couple would like to invest it, with the goal that they can both retire when Paul turns 62. The inheritance also included an educational endowment for their children, so they will not have to worry about saving for their children\\'s college educations.

Which of the following would not be a suitable recommendation for the allocation of their investment monies?

A. municipal bond fund

B. aggressive growth stock fund

C. Roth IRA

D. life insurance

Correct Answer: A

Explanation: Given that their combined income is only $53,000, Paul and Paula\\'s marginal tax rate is low, so a municipal bond fund would not be a good recommendation for the allocation of their investment monies. Municipal bonds offer lower returns, and the couple would get little or no benefit from the tax-free interest income that these bonds provide. Their investment horizon is long enough (26 years) for them to invest some of their money in an aggressive growth stock fund, which has higher risk but also provides the higher expected returns that they may need to be able to retire when Paul turns 62. A Roth IRA is preferred over a traditional IRA in their situation. Although the traditional IRA would allow them to deduct their contributions, they already pay little or no taxes. Contributions to a Roth IRA are made out of after-tax income, but the contributions themselves can be withdrawn at any time without penalty if Paul and Paula run into some unexpected expenses, and the earnings grow tax-deferred and will be completely tax-free if they make no withdrawals until the age of 59 ½. Given the ages of their children, a life insurance policy that will help provide for them if one or both of the parents die, should be strongly recommended.

QUESTION 4

After having been divorced for several years, Mrs. Blended has remarried a man with three children of his own. She has set up a revocable trust in which she deposited funds that she inherited when her mother died, so that the monies will go uncontested to her two biological children in the event of her own death. These two adult children are the only beneficiaries of the trust. Mrs. Blended has no plans to touch any of the money in the trust unless circumstances demand it in the future. The trust is invested in a mutual fund that paid $500 in dividend income and distributed $3,000 in long-term capital gain income to the trust this year.

Which of the following statements is true regarding the tax treatment of these distributions?

A. The distributions will not be taxed at this point; they will be taxed only when Mrs. Blended or her beneficiaries make withdrawals from the trust.

B. Assuming her two adult children are equal beneficiaries, each one is responsible for paying tax on 50% of the income to the trust, or $1,750.

C. Mrs. Blended must pay taxes on the $3,500 in distributions.

D. The distributions will not be taxed at this point; they will be taxed as part of the estate upon Mrs. Blended\\'s death.

Correct Answer: C

Explanation: If Mrs. Blended established a revocable trust that invested in a mutual fund that distributed $3,500 total in dividend and capital gain income this year, Mrs. Blended is responsible for paying taxes on the distributions. Whether or not any monies or assets are withdrawn from a revocable trust, the grantor of the trust-in this case, Mrs. Blended-- is responsible for any taxes due.

QUESTION 5

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.