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QUESTIONS & ANSWERS
DEMO VERSION
(LIMITED CONTENT)

Question 1

Question Type: MultipleChoice

A broker-dealer will be found guilty of churning an account if the account has a turnover ratio of

Options:

- A- four.
- B- five.
- C- eight.
- D- There is no specified turnover ratio assigned to the prohibited practice of churning.

Answer:

D

Explanation:

There is no specified turnover ratio assigned to the prohibited practice of churning since some investors are simply more frequent traders than others.

Question 2

Question Type: MultipleChoice

You are an investment adviser to Mr. Crochety, an elderly man who lives solely on his social security income although he managed to accumulate an investment portfolio worth about \$100,000 over the years. Mr. Crochety recently got his hands on a business publication and read about the tax-free interest paid by municipal bonds. He calls you and instructs you to sell his other investments and invest all his money in a municipal bond portfolio, so that "the government doesn't get any more of my hard-earned money." You tell Mr. Crochety that you don't believe this is a wise move because he's in such a low tax bracket that municipal bonds are not a good investment for him, but he is insistent. Based on these facts, you should

Options:

- A- ignore Mr. Crochety's instruction since it is not in his best interest.

B- require Mr. Crochety to sign an affidavit of liability waiver, indicating that you will not be held responsible for any adverse consequences of this decision.

C- have Mr. Crochety sign a statement of investment policy that indicates that this transaction is being executed on the client's instructions and that you have advised the client against it.

D- call Mr. Crochety's relatives and suggest they have him examined for mental instability.

Answer:

C

Explanation:

Given that you have advised Mr. Crochety that this is not a wise move and he still insists on it, you should protect yourself by getting it in writing. In no case, however, can you require a client to sign an affidavit of liability waiver, nor can you refuse to follow his adamant instructions.

Question 3

Question Type: MultipleChoice

Mr. Sailor is cruising through the Bahamas when he learns that a healthcare company in which he owns stock is being sued by former patients, doctors, nurses, and even the federal government. He doesn't have his broker's number handy, and he doesn't have internet access, so he calls his son and tells him to call the broker and instruct the broker to sell his shares. As a registered agent for his broker, you take the call.

Should you execute this transaction?

Options:

A- Yes. This is a legitimate request from a client, and you are required to follow the client's instructions.

B- No, not unless you and your broker-dealer have a written document that gives Mr. Sailor's son the power-of-attorney to trade on his account.

C- Yes, as long as the son presents proper identification that proves his relationship to Mr. Sailor, such as a birth certificate.

D- Yes, as long as the son is at least 21 years old and not a minor child.

Answer:

B

Explanation:

No, you cannot execute this transaction unless you and your broker-dealer have a written document that gives Mr. Sailor's son the power-of-attorney to trade on his account. Otherwise, you will be executing an order from an unauthorized third party, which is a prohibited practice, and you can lose your license for doing so.

Question 4

Question Type: MultipleChoice

Ken Con is an agent with Blue Sky Broker-Dealers. He gets up early each morning so that he can study any late-breaking news that may affect the markets and figure out ways to incorporate this news into conversations with select clients in order to pressure them to restructure their portfolios by selling holdings they have in one particular industry to invest the money in another particular industry.

Ken has been very successful with this strategy and executes more trades for his clients than any other agent with the firm, but is he in danger of losing his license?

Options:

- A- Yes. Ken is engaging in churning, a prohibited practice and can have his license revoked or suspended.
- B- It depends. If his clients have lost money, Ken may lose his license; but if a review indicates that his clients' accounts earn profits, then his license is safe.
- C- Yes. Ken is guilty of the prohibited practice of "tailgating."
- D- No. Ken is just a successful sales person who is working harder than the other agents in the firm.

Answer:

A

Explanation:

Yes. If Ken is getting up each morning in order to collect news that he can use to pressure his clients to buy and sell their securities, Ken is engaging in churning and can have his license revoked or suspended for this prohibited practice. A lot of the news might have a short-term effect on a particular industry, but any profits gained by trying to time the market will often not be sufficient to cover the commissions that the investor had to pay on the transactions and the taxes they may have to pay on the short-term capital gains they realized when they sold securities. Regardless, it doesn't matter whether his clients' accounts show a profit or not.

Question 5

Question Type: MultipleChoice

Stu Pede is an agent with broker-dealer Cavalier. A customer calls with a request to establish a classic IRA and asks for Stu's advice regarding where the money in the IRA should be invested. Stu suggests a municipal bond fund, explaining to his client that the interest income earned on it will be tax-free at the federal level, and some of it may even be tax-free at the state and local levels.

Has Stu engaged in any prohibited practices?

Options:

- A- Yes. Stu is an agent with a broker-dealer. He is not an investment adviser representative and is not allowed to make recommendations regarding investments to the firm's clients.
- B- No. Although Stu has given investment advice, it was solicited by the client, and Stu received no additional compensation for the advice.
- C- Yes. Municipal bonds are not suitable investments for a classic IRA, and Stu can have his license revoked or suspended.
- D- No. Although municipal bonds are not suitable investments for a classic IRA, Stu obviously didn't know this and is merely guilty of stupidity.

Answer:

C

Explanation:

Yes. When Stu recommends an investment in municipal bonds for a classic IRA account, he has made an unsuitable recommendation, which is a prohibited practice, and he can have his license revoked or suspended. Municipal bonds are not suitable investments for a classic IRA because municipal bonds pay interest that is at least free from federal taxation, so they offer a lower yield than fully taxable bonds of similar risk. The money in a classic IRA grows tax-free anyway, so the client is getting a lower yield with no benefit.

Question 6

Question Type: MultipleChoice

Mr. and Mrs. Cleaver are nearing retirement and have made an appointment with Mr. Eddie, an investment adviser representative who works for Haskell Investment Advisers, to get advice on how they can better structure their investments to meet their retirement goals. Their son, Theodore, who has recently graduated college and has a great job as a software writer for a video game company, accompanies them. Mr. Eddie explains that the main goal of any plan is diversification and recommends that Mr. and Mrs. Cleaver spread their investment monies equally among six load mutual funds that Mr. Eddie can sell them. He suggests that Theodore follow suit and invest any monies he has equally among the same ten funds.

Has Mr. Eddie done anything wrong?

Options:

- A- Yes. Mr. Eddie has advised his clients to invest in load funds when no load funds are clearly better investments.
- B- No. Diversification should, in fact, be the goal, and he has advised a well-diversified plan for his clients.
- C- Yes. Clients who are ready to retire have different investment needs than a client who is just entering the work force. The recommendation that both Theodore and his parents have the same asset allocation is clearly unsuitable.
- D- Yes. Mr. Eddie is guilty of misappropriation, a prohibited practice.

Answer:

C

Explanation:

Yes. In recommending that Mr. and Mrs. Cleaver and their son allocate their assets in identical fashions, Mr. Eddie has made an unsuitable recommendation since investors with different investment time horizons have different investment needs. Making unsuitable recommendations is a prohibited practice, and Mr. Eddie could have his license suspended or revoked.

Question 7

Question Type: MultipleChoice

Noah Aull is an investment adviser representative with Canto Investment Advisers. A client has called and told Noah that he heard about a firm that had recently completed an IPO at a party he had attended that weekend and instructed Noah to purchase shares of the company, which was now trading on the OTC Bulletin Board. Noah did some research and felt the company was far too risky an

investment for this client, so he did not execute the trade. This turned out to be fortunate for his client since the firm became insolvent within six months of its IPO.

Has Noah done anything wrong?

Options:

- A- Yes. Noah is guilty of misappropriation and could have his license revoked.
- B- No. Noah did what he is hired to do-manage his clients' accounts to the best of his ability.
- C- Yes. Noah is guilty of not following a client's instructions and could have his license revoked.
- D- Yes. Noah is guilty of making an unauthorized transaction and could have his license revoked.

Answer:

C

Explanation:

Yes. Noah is guilty of not following a client's instructions and could have his license revoked. A refusal to act on a client's legitimate order is a prohibited practice, even if the client would have lost money after-the-fact.

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