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QUESTION 1

GoForBroke Investments has registered with the SEC to be a market maker in certain NASDAQ-listed securities. In order to be able to enter bid and ask quotes for the securities in which it is going to make a market, GoForBroke must subscribe to which level of NASDAQ?

- A. Level I
- B. Level II
- C. Level III
- D. Level IV

Correct Answer: C

Explanation: In order to enter bid and ask quotes, GoForBroke must subscribe to NASDAQ's Level II. Level I simply allows the user to view the highest bid and lowest ask price for a security, and Level II allows the user to view all the bid and ask quotes from all the market makers in a security, but only Level III allows the subscriber to enter quotes. There is no Level IV.

QUESTION 2

Sarah Bean is a registered representative with NewWave Investments, a family of mutual funds. She has recommended one of NewWave's funds to a client and given him a prospectus. The prospectus provides information about the fund's breakpoints and indicates that an investment of \$25,000 or more will lead to a reduced front-end load. The prospectus also clearly explains the details of a letter of intent. Sarah's client invests \$23,000 in the fund then and there without even opening the prospectus.

Has Sarah violated any of FINRA's rules of conduct?

- A. No. Sarah properly provided her client with a prospectus prior to selling him shares of the fund.
- B. Yes. Sarah is required to explain the concepts of breakpoints and letters of intent to her client.
- C. Yes. Sarah needed to tell her client that he would have to read through the prospectus to ensure he understood all aspects of the investment before she could take any money from him.
- D. Yes. Sarah is not permitted to accept funds from a client without the presence of her immediate supervisor.

Correct Answer: B

Explanation: Yes. Sarah is required to explain the concepts of breakpoints and letters of intent to her client and her failure to do so is a violation of FINRA's rules of conduct. A registered representative selling mutual fund shares is required to explain the salient facts contained in a fund's prospectus to a client before selling him the fund shares. Sarah's failure to do so is deemed "inconsistent with just and equitable principles of trade."

QUESTION 3

Under FINRA Rule 2830, a member firm and its associates are prohibited from selling shares of a mutual fund if the service fees disclosed in the fund prospectus exceed:

- A. 0.25% of the fund's average annual net assets.
- B. 0.50% of the fund's average annual net assets.
- C. 0.75% of the fund's average annual net assets.
- D. 1.00% of the fund's average annual net assets.

Correct Answer: A

Explanation: Under FINRA Rule 2830, a member firm and its associates are prohibited from offering to sell shares of a mutual fund if the service fees disclosed in the fund prospectus exceed 0.25% of the fund's average annual net assets.

QUESTION 4

Which of the following statements about the over-the-counter market is true?

- A. Only penny stocks are traded in the over-the-counter market.
- B. Trades in the over-the-counter market are conducted via the auction process.
- C. Only bonds and other debt instruments are traded in the over-the-counter market.
- D. Stocks that are listed on exchange floors are also traded in the over-the-counter market.

Correct Answer: D

Explanation: Stocks that are listed on exchange floors are also traded in the over-the-counter market. The term "third market" refers to over-the-counter trading of listed stocks. All types of securities—stocks, bonds, options, warrants, rights—trade over the counter. The over-the-counter market is a negotiated market, not an auction market.

QUESTION 5

Which of the following is not an advantage that an exchange traded fund (ETF) has over a traditional mutual fund?

- A. There are no fees (i.e., loads, commissions) associated with buying and selling ETFs.
- B. ETFs trade continuously throughout the day.
- C. Investors can use limit and stop orders when trading ETFs.
- D. All of the above are advantages that an ETF has over a traditional mutual fund.

Correct Answer: A

Explanation: The choice that does not represent an advantage that an ETF has over a traditional mutual fund is Choice A. While ETFs have no load charges, investors do pay commissions when buying or selling these funds. ETFs do offer the advantage of continuous trading, and investors can use limit and stop orders when trading ETFs, options that are not available when trading mutual funds.

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