

Test Alert!
to Accompany the 2nd Edition LEM

8/16/07

series 6

The information included in this release, in addition to your other Kaplan Financial materials, is designed to assist you in preparing for concepts that your exam may include. We urge you to read it carefully and take time to review the sample questions and rationale.

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Introduction

Since the completion of the Series 6 3rd edition for publication, the SEC has approved the creation of the Financial Industry Regulatory Authority, or FINRA, a consolidation of NASD and NYSE Regulation, Inc. The move is intended to end much regulatory duplication and strengthen the competitiveness of US securities markets. FINRA has completed the preliminary work necessary for this historic consolidation, but many months of harmonization of rules, manuals, and other documents remain. As the transition progresses, and over time, the name *NASD* will disappear from both securities licensing examinations and the texts that help students prepare for them.

This *TestAlert!* comprises information regarding changes in rules and regulations that were approved between the publication of the Series 6 2nd and 3rd editions, as well as changes to the text and Drill & Practice materials. These changes have been incorporated into the 3rd edition license exam manual and the student notebook.

New Topics or Changes in Emphasis

1. **NASDAQ Market designation changes.** Nasdaq stock quotes now fall under three market designations.
 - **The NASDAQ Global Select Market** This includes companies of global scope that meet the most stringent listing requirements.
 - **The NASDAQ Global Market** This replaces the Nasdaq National Market and includes corporations of global scope that are not included in the Global Select Market.
 - **The NASDAQ Capital Market** This replaces the Nasdaq SmallCap Market, and includes corporations that may be of interest to investors seeking growth and/or value. Those included in this market are of domestic as well as global scope.
2. **Contractual plans** These are no longer sold, but are still on the exam, because there are many plans still in effect.
3. **Taxation of returns from variable contracts** There is more emphasis on taxation of variable contracts. Three different situations that have tax consequences should be reviewed.
 - **Contract surrender** If a contract is turned in for cash, the annuitant or insured is responsible for income tax on any growth in the account. He must also pay a 10% penalty on any growth if he is not yet 59½.
 - **Scheduled annuity payment** During the payout phase of an annuity, part of each payment will count as return of principal and not be taxed; the rest will be counted as growth and will have income tax payable on it. This holds during the annuitant's life expectancy. If he survives beyond it, his cost base is considered to be used up, and payments become 100% taxable.
 - **Death benefit** If an annuitant dies during the accumulation phase of a variable annuity, his beneficiary will receive either the value of the account or the total amount invested, whichever is greater. The beneficiary will be responsible for income tax on any amount above that which the annuitant invested. If a death benefit is paid on variable life insurance, the beneficiary will owe no taxes, but the death benefit will be considered part of the insured's estate for estate tax purposes.
4. **Insider Trading and Securities Fraud Enforcement Act of 1988** The penalties under this act have been increased from \$1 million or 300% of profits made or loss avoided to \$5 million or 300% of profits made or loss avoided. The maximum prison sentence has been increased from 10 to 20 years.
5. **Currency exchange questions** There is additional emphasis on the consequences of changes in currency exchange rates. It is important to remember that when two currencies are compared, if currency A is strengthening with respect to currency B, one could just as accurately state that currency B is weakening with respect to currency A. Money flowing into a country will strengthen that country's currency. Money flowing out will weaken it.

Quick Quiz

1. Clocks of the World, a small American import company, has just ordered 5,000 British alarm clocks. The company will pay for the clocks in British pounds. Which of the following events, taking place after the price was agreed upon, would increase the profits of Clocks of the World?
 - I. More tourists than usual visit the British Isles.
 - II. British companies invest heavily in foreign enterprises.
 - III. Interest rates rise in the United States.
 - IV. Interest rates fall in the United States.
 - A. I and III
 - B. I and IV
 - C. II and III
 - D. II and IV
2. Sanderson Manufacturing is a new company in the United States. It is small but is thought to have excellent growth potential. If its securities trade over the counter, where might you expect to find them quoted?
 - A. The Nasdaq Capital Market
 - B. The Nasdaq Global Select Market
 - C. The Nasdaq Global Market
 - D. The Nasdaq National Market
3. An investor was warned about a pending lawsuit against the Smith and Hodgeson Corporation. The warning was given to him by a friend who sat on the board of the corporation bringing the suit. The investor quickly sold off a large block of Smith and Hodgeson common stock for \$8 million. When the suit was finally brought, Smith and Hodgeson stock dropped 75% in value. If the investor faces a monetary penalty, on what amount will the penalty be based?
 - A. \$8 million
 - B. \$6 million
 - C. \$5 million
 - D. \$2 million
4. One of your customers has just surpassed his life expectancy. Years ago, he purchased a variable annuity through your company and selected straight life as his payout option. This month, if he receives an annuity check of \$1,500, on how much of it must he pay income tax?
 - A. Annuity payments cease upon attainment of life expectancy.
 - B. Only that portion that corresponds to cost base is still taxable.
 - C. The payments now become tax free.
 - D. He must pay tax on the whole \$1,500.
5. Your customer, who is in the 28% tax bracket, has decided to borrow \$40,000 from his variable life insurance account. His contract now has a cash value of \$100,000, and over the years, he has paid \$45,000 in premiums. What will be his tax liability?
 - A. It depends on whether he borrows from cost base or growth
 - B. He will owe no tax
 - C. \$28,000
 - D. \$11,200

Answers to Quick Quiz:

1. **C** Importers must purchase foreign currency to settle their orders. Hence, their profits go up if their own currency strengthens (or, conversely, if the foreign currency weakens). The American importer in this case would like the dollar to strengthen, or the pound to weaken. Rising interest rates would invite investment money into the United States and would strengthen the dollar, while British companies investing in foreign companies would weaken the pound.
2. **A** Sanderson is apparently a small, domestic, over-the-counter company of interest to investors seeking growth and/or value. This places it within the Nasdaq Capital Market.
3. **B** Because the stock dropped 75% in value, the investor avoided a loss of 75% of \$8 million, or \$6 million. This is the amount on which a monetary penalty will be based.
4. **D** When the annuitant reaches life expectancy, his account is theoretically precisely exhausted. The insurance company must go on paying him under the straight life option, so additional payments are all over and above cost base and are 100% taxable.
5. **B** A cash value loan, like any loan, is not a taxable event.

To submit comments or suggestions, please send an email to errata@kaplan.com.

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