

# Test Alert!

## to Accompany the 2nd Edition LEM

6/4/07

series 7

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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As always, we strive to provide you with the most current test preparation information. If you have any questions about this or any other Kaplan Financial study material, please call AnswerPhone at 1-800-621-9621, ext. 3598 between the hours of 8 AM and 6 PM CT, Monday through Friday.

**KAPLAN** FINANCIAL

The information in this TestAlert! is designed to update Kaplan Financial's Series 7 License Exam Manual, 2nd Edition, to match the newly published 3rd edition. In addition to the issues that highlight special or unusual information and amplify important points, you will also see Quick Quizzes, which will ensure that you understand and retain the material covered in that particular section. Quick Quizzes are a quick, interactive review of what you just read. Answers to Quick Quizzes appear at the end of this *TestAlert!*

## I. EQUITY—REITS

### INSERT—PAGE 33

#### REITS

Under the guidelines of Subchapter M of the Internal Revenue Code, a REIT can avoid being taxed as a corporation by having at least 75% of total investment assets in real estate, deriving at least 75% of gross income from rents or mortgage interest and distributing 90% or more of its net investment income to its shareholders.

#### Test Topic Alert under REITs:

- 75% of total investment assets in real estate
- 75% of gross income from rents or mortgage interest

## II. MUNICIPAL SECURITIES, REVENUE NOTES—GRANT ANTICIPATION NOTES (GANs)

### INSERT—PAGE 119

#### Grant Anticipation Notes (GANs)

GANs are short-term municipal revenue notes issued with the expectation of receiving grant money from the federal government.

#### QUICK QUIZ 1

1. A municipality that has issued GANs (short-term municipal notes) does so in expectation that the debt service will be paid by the receipt of funds attained
  - A. from future tax revenue
  - B. from both tax and other anticipated revenue
  - C. through the issue of long-term bonds
  - D. via grants from the federal government

### III. OPTIONS—AUTOMATIC EXERCISE

#### INSERT—PAGE 222

##### Automatic Exercise

Contracts that are in-the-money by at least .05 at expiration are automatically exercised as a service to the customer unless other instructions have been given. The in-the-money amount, determined by OCC, applies to both customer and institutional accounts.

#### PAGE 223

Amended graphic in conjunction with OCC automatic exercise

#### QUICK QUIZ 2

2. Automatic exercise will occur for equity options at expiration that are in-the-money by at least
  - A. .01
  - B. .05
  - C. 1/8 of a point
  - D. 1/4 of a point

### IV. RETIREMENT PLANS—ROTH 401(K)

#### INSERT—PAGES 471 AND 472

##### Roth 401(k) Plan

A qualified distribution for a Roth 401(k) is the same as for a Roth IRA. For tax-free withdrawals to occur, the plan owner must be at least age 59½ and the distribution must occur at least five years after the participant's first contribution.

### V. DIRECT PARTICIPATION PROGRAMS—RENEWABLE ASSETS

#### INSERT—PAGE 512

##### Renewable Assets

Recognize that some assets cannot be depreciated (building) nor depleted (oil or gas). For example, farm crops are included in this category and are generally known to be renewable assets.

#### QUICK QUIZ 3

3. An investor wanting to know about the tax consequences of a direct participation program (DPP) should know which asset types can be depleted or depreciated. Which of the following asset types CANNOT be depleted or depreciated?
  - A. Oil
  - B. Gas
  - C. Crops
  - D. Buildings

## **VI. ETHICS, RECOMMENDATIONS, AND TAXATION— BORROWING AND LENDING**

### **INSERT—PAGE 571**

#### **Take Note**

#### **Borrowing and Lending**

Generally, before borrowing from or lending to a customer, a representative must advise his firm in writing and receive written permission. However, notice and approval are not needed if the loan is between immediate family members, and approval is not needed if the customer is a lending institution and the loan is on standard commercial terms.

## **VII. US GOVERNMENT AND STATE RULES AND REGULATIONS— INSIDER TRADING AND SECURITIES FRAUD ENFORCEMENT ACT**

### **INSERT—PAGE 615**

#### **Insider Trading and Securities Fraud Enforcement Act**

- Criminal penalties up to 20 years in jail
- Fines up to \$5 million

#### **QUICK QUIZ 4**

4. Civil penalties under the Insider Trading and Securities Fraud Enforcement Act of 1988 may include
  - A. 200% of any profits realized
  - B. the greater of \$5 million or 300% of the profits made or losses avoided
  - C. no more than \$1 million
  - D. any monetary penalty deemed appropriate and up to 20 years in jail

## **VIII. OTHER SEC AND SRO RULES AND REGULATIONS—ANNUAL COMPLIANCE REVIEW**

### **INSERT—PAGE 634**

#### **Annual Compliance Review**

NASD requires that each registered representative and principal receive compliance training on an annual basis. The purpose of the meeting is to discuss compliance matters relevant to the activities of the registered person. The meeting delivery method can be individually or in groups, regionally or at a central location, in person or by Webcast, which can be either live or on demand (recorded). NASD requires certain safeguards to be in place. For example, firms must be able to ensure that registered personnel attend the entire meeting and have an opportunity to ask questions or engage in dialogue with presenters either live or electronically.

**QUICK QUIZ 5**

5. A broker/dealer informs registered personnel that to satisfy the annual compliance meeting requirements, it has recorded a Webcast that individuals can view at their own convenience. A Webcast of this type would be
- A. allowed for principals only
  - B. allowed for registered representatives but not for principals
  - C. allowed for all registered personnel if informed of the opportunity to submit questions and receive answers in a timely fashion
  - D. prohibited because it is recorded and not a live Webcast

**IX. OTHER SEC AND SRO RULES AND REGULATIONS—CENTRAL REGISTRATION DEPOSITORY (CRD)****INSERT—PAGE 636****Take Note****Central Registration Depository (CRD)**

The Central Registration Depository (CRD) maintains information on the disciplinary history of all persons currently registered. A customer can access this information toll free through the CRD's Broker Check.

**X. OTHER SEC AND SRO RULES AND REGULATIONS—MINOR RULE VIOLATION (MRV)****PAGE 638****Minor Rule Violation (MRV)**

Maximum fine: \$2,500

**QUICK QUIZ 6**

6. Under the Code of Procedure, the maximum fine for a minor rule violation (MRV) is
- A. \$1,000
  - B. \$2,500
  - C. \$7,500
  - D. \$10,000

**XI. OTHER SEC AND SRO RULES AND REGULATIONS—PREDISPUTE ARBITRATION AGREEMENT****INSERT—PAGE 640****Predispute Arbitration Agreement**

Today, virtually all new account forms contain a predispute arbitration clause that must be signed by customers before opening an account. Thus, assuming the customer has signed the arbitration agreement or the new account form containing the predispute arbitration agreement, unresolved customer complaints must be mediated under the Code of Arbitration.

**QUICK QUIZ 7**

7. NASD's Code of Arbitration procedure would be mandatory to settle disputes between
- I. a member and a registered clearing corporation
  - II. a member and one of its associated persons
  - III. an associated person with a statutory discrimination claim against a member
  - IV. a member and a client who has signed a predispute arbitration clause
- A. I and II
  - B. I, II and IV
  - C. II, III and IV
  - D. II and IV

**XII. OTHER SEC AND SRO RULES AND REGULATIONS—CORRESPONDENCE****INSERT—PAGE 644****Correspondence**

In addition to any written or electronic communication prepared for a single customer, the definition of correspondence also includes group correspondence. Group correspondence includes form letters and group email sent to both existing and prospective retail customers. Prior principal pre-use approval is not required for correspondence, including group correspondence, unless it makes financial or investment recommendations or promotes a product or service and is sent to 25 or more existing or prospective retail customers within any 30-calendar-day period. It should be noted that this type of correspondence need not be filed with NASD.

**XIII. OTHER SEC AND SRO RULES AND REGULATIONS—RESEARCH ANALYST CONFLICTS OF INTEREST****INSERT—PAGE 652****Research Analyst Conflicts of Interest**

The Sarbanes-Oxley Act required SROs to establish research analyst conflict of interest rules for its members. NASD Rule 2711 and NYSE Rule 472 also address research analyst conflicts of interest, specifically the improvement of objectivity and reliability of research.

**QUICK QUIZ 8**

8. A brokerage firm's research department has issued a buy recommendation on XYZ Corporation common stock. The report must contain all of the following information EXCEPT
- A. that the firm was the managing underwriter in a recent public offering of the stock
  - B. that the firm was part of the selling group in a recent public offering of the stock
  - C. that the partners of the firm hold options to purchase the stock
  - D. that the firm makes a trading market in the stock

## ANSWERS TO QUICK QUIZZES

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1. **D.** Grant anticipation notes (GANs) are short-term municipal notes issued in anticipation of funds via grants that the municipality is expecting from the federal government.
2. **B.** Automatic exercise will occur for equity options at expiration that are in-the-money by at least .05, unless specific instructions are given by the customer not to do so.
3. **C.** Oil and gas are examples of asset types that can be depleted, whereas buildings are a depreciable asset. Farm crops are considered to be renewable assets.
4. **B.** Under the Insider Trading and Securities Fraud Enforcement Act of 1988, civil penalties can be the greater of \$5 million or 300% of the profits made or losses avoided; only criminal penalties can carry a jail term.
5. **C.** Use of a recorded Webcast for the annual compliance meeting is allowed for all registered personnel as long as certain safeguards are in place. One such safeguard is the opportunity to ask questions and receive answers in a timely fashion and that the firm's registered individuals are made aware of that opportunity.
6. **B.** According to the NASD Code of Procedure, the maximum fine for a minor rule violation is \$2,500.
7. **B.** Disputes between anyone in the industry, including registered clearing corporations, must go to arbitration, with the exception of statutory discrimination claims, which are claims alleging sexual harassment or discrimination on the basis of, among other things, age, sex, or ethnicity. Such claims may be taken to court instead of arbitration. When a client has signed a predispute arbitration agreement, arbitration is mandatory.
8. **B.** Disclosure of participation as a selling group member is not required.

To submit comments or suggestions, please send an email to [errata@kaplan.com](mailto:errata@kaplan.com).

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