

Series 66 Practice Test

1. Which of the following is true regarding types of risks related to a client's portfolio?

- a. The level of unsystematic risk will decrease as more securities are added to the portfolio
- b. The level of systematic risk will decline as more securities are added to the portfolio
- c. Unsystematic risk can be measured by a portfolio's beta
- d. Default risk is an example of systematic risk

2. The Securities and Exchange Commission requires foreign private issuers to file which of the following forms annually?

- a. 10-K
- b. 11-K
- c. 20-F
- d. 20-K

3. Which statement regarding quick ratios and current ratios is true?

- a. The current ratio measures a company's long-term liquidity while a quick ratio measures a company's short-term liability
- b. A company's quick ratio is a more conservative measurement than the current ratio
- c. In general, it's better for a company to have a lower quick ratio
- d. A company with a current ratio under 1 is likely to receive an investment grade rating on a new bond issue

4. Which statement(s) regarding derivatives are true?

- I. A derivative derives its value from the value of some underlying security
 - II. Derivatives provide investors with an opportunity for hedging
 - III. Derivatives provide investors with an opportunity for increased leveraging
 - IV. A convertible bond is an example of a derivative security
- a. I only
 - b. I and IV only
 - c. I, II and III only
 - d. I, II, III, IV

5. A futures contract agreement specifies which of the following terms?

- I. Place of delivery
 - II. Quality of the commodity
 - III. Unit Price
 - IV. Time of delivery
- a. III only
 - b. II, III and IV only
 - c. I, III and IV only
 - d. I, II, III and IV

6. Tom believes that the market is efficient to the point at which any technical or fundamental analysis is already reflected in the price of the market. However, Tom also believes there is added value to insider information, and that this information, since not readily available to the public, is not reflected immediately in the price of the market. Based on these beliefs, which form of Efficient Market Hypothesis would Tom support?

- a. Based on this information, Tom does not believe the market is efficient
- b. Weak form
- c. Semi-strong form
- d. Strong form

7. With a fixed annuity insurance product, investment risk...

- a. is non existent
- b. lies with the insured
- c. lies with the insurer
- d. is split between the insured and insurer

8. Theodore, age 62, owns a variable annuity. At the beginning of this year, he began receiving monthly payments from the annuity to supplement his income during retirement. Theodore wants to know the tax consequences of such payments. Which of the following is true?

- a. If the variable annuity was a qualified account such as an IRA, Theodore will not owe any income tax on the payments he receives
- b. Since Theodore is over the age of 59 ½, he will not owe any income tax on the payments received from the annuity
- c. Theodore's tax will be determined using an exclusion ratio which establishes his cost basis in the annuity relative to the benefits he expects to receive
- d. Theodore's annuity will use the LIFO accounting method to determine taxation on withdrawals. Since this is the first year he is taking distributions, he probably won't owe any income tax

9. Amanda is considering purchasing life insurance coverage. Her risk tolerance is very low, so she wants a product with a guaranteed death benefit. Her main purpose for the insurance policy is to pay off her mortgage in the event of her premature death. There are 20 years remaining on her mortgage until it is paid off. She would like the lowest premiums possible for a policy that meets all of her needs. Which type of insurance policy would best suit Amanda's needs?

- a. Universal life
- b. Renewable term
- c. Whole life
- d. Variable Universal

10. Which component of an option is not considered fixed?

- a. Premium
- b. Expiration
- c. Strike price
- d. Size of contract

11. In a limited partnership, which statement best describes the exposure to liability for a general partner and a limited partner?

- a. Both limited and general partners are liable for all debts incurred by the partnership
- b. Only limited partners are liable for debts incurred by the partnership
- c. Limited partners are not liable for any debts incurred by the partnership
- d. Limited partners are liable for debts incurred by the partnership, but only to the extent of their original investment

12. All of the following are true regarding S-Corporations except...

- a. S Corps avoid double taxation by passing income, losses and deductions to individual shareholders
- b. an S-Corp may have more than one class of stock
- c. individual shareholders pay taxes on flow-through income at their individual income tax rates
- d. there may be no more than 100 shareholders

13. The maximum number of members of a Limited Liability Corporation is...

- a. 1
- b. 3
- c. 100
- d. there is no maximum number

14. You are a financial adviser meeting a new client for the first time. Which of the following are important and appropriate non-financial investment considerations to discuss with the client?

- I. Values
 - II. Attitude
 - III. Experience
 - IV. Demographics
- a. I and II only
 - b. I, II and III only
 - c. III only
 - d. I, II, III and IV

15. You are a financial adviser meeting a new client for the first time. The client would like to invest \$100,000 in a mutual fund, but refuses to discuss some of his personal financial information, such as his tax situation or existing investments. As best practice, you should...

- a. invest the client's money as they desire
- b. place the trade and try to get the information from the client later
- c. explain to the client you cannot help him without having an understanding of his current financial information
- d. ask the client to sign a letter stating that you tried to obtain such information from him, and then go ahead with the trade

Answer Key and Explanations

1. A: The level of unsystematic risk will decrease as more securities are added to the portfolio. Unsystematic risk is the risk associated with a specific security, such as a union strike to a car company. It can be decreased through diversification of one's portfolio. As more securities are added, the portfolio's unsystematic risk declines. Examples of unsystematic risk include financial risk, business risk, default risk, political risk, and country risk. Systematic risk, measured by beta, is the risk that comes with investing in the general market. Sources of systematic risk range from domestic interest rates to foreign wars. It's also known as non-diversifiable risk because it can't be avoided through diversifying a portfolio. Systematic risk includes interest rate risk, market risk, purchasing power risk, reinvestment risk and exchange rate risk.

2. C: 20-F. Securities and Exchange Commission (SEC) Form 20-F is used by private foreign issuers to report annually to the SEC, pursuant to Sections 13 or 15(d) of the Act. 20-F filers must submit their annual reports within six months of the end of their fiscal years. Form 10-K is for domestic companies' annual reports, due within 60 days of the end of their fiscal years. Form 11-K is used by companies to report employee stock purchase, savings and similar plans. There is no SEC Form 20-K.

3. B: A company's quick ratio is a more conservative measurement than the current ratio. While both the quick and current ratios measure a company's short-term ability to meet debt obligations, the quick ratio is a more conservative measure because its formula excludes inventory from current assets. The quick ratio is calculated as: $\text{Current Assets} - \text{Inventories} / \text{Current liabilities}$. The current ratio does not subtract a company's inventory from the numerator, thus expressing a less conservative ratio. The higher the ratio, the more liquidity in the company, which is generally preferred, thus a company with a ratio below 1 would be unlikely to receive an investment grade rating for a new bond issue.

4. D: I, II, III, IV. A derivative derives its value from the value of an underlying investment, with a convertible bond being a prime example since it derives its value from the stock into which it is convertible. The most common types of derivatives are options, warrants, and futures. Benefits to investors include an opportunity for hedging and for additional leverage. However, derivatives can also create additional risk to investors because of such features.

5. D: I, II, III and IV. Futures are a type of derivative investment in which two parties agree to terms as outlined in a futures contract to make or take delivery of a certain commodity, of certain quality, at a future time, place and price. Thus, the contract will include all such details of the agreement. In each contract, there is only one buyer and one seller. Futures contracts trade on exchanges and are mostly written on commodities and financial assets.

6. C: Semi-strong form. Tom supports the semi-strong form of the Efficient Market Hypothesis, in which both technical and fundamental analysis information is reflected efficiently in the price of the market. The semi-strong form suggests that analysts cannot consistently outperform the market, because the market reflects all available public information. However, insider information that is not publicly available would not be currently reflected in the price of the market.

7. C: Investment risk lies with the insurer. The insurer carries the investment risk in a fixed annuity because the instrument pays out a consistent, fixed payment regardless of the market performance of the insurer's investments. The fixed annuity is considered to be a very safe

investment for the insured, more conservative than a variable annuity, precisely because it avoids the risk of market downturns.

8. C: Theodore's tax will be determined using an exclusion ratio which determines his cost basis in the annuity relative to the benefits he expects to receive. Since Theodore owns a variable annuity, the exclusion ratio will be used to determine the taxable consequences of any withdrawals made. The exclusion ratio divides the cost basis of the annuity by the expected benefits. Tax is owed at the standard rate for payments received in excess of the exclusion amount. Since Theodore is past age 59 ½, there will be no penalties associated with the income, but there are still tax consequences. The same is true if the annuity is part of an Individual Retirement Account.

9. B: Renewable term. Since Amanda's insurance needs are considered temporary (to provide funds to pay off her mortgage), temporary term coverage is appropriate. Term insurance also fits with her desire to keep premiums as low as possible and to receive a guaranteed death benefit. Whole, universal, and variable are all permanent forms of coverage, which Amanda did not specify she needed. In addition, because coverage never lapses, premiums are higher for those products than for term policies.

10. A: Premium. In options trading, the premium is the variable factor, while expiration date, strike price and size of contract are always fixed.

11. D: Limited partners are liable for debts incurred by the partnership, but only to the extent of their original investment. Limited partnerships consist of both general and limited partners. General partners retain all management control and have unlimited liability for all debt incurred by the partnership. Limited partners, however, have no management authority and are responsible for debt incurred by the partnership, but only to the extent of their original investment.

12. B: An S-Corp may have more than one class of stock. An S Corporation is one that is organized under subchapter S of the Internal Revenue Code. It is established for small businesses. An S Corporation is not permitted to have more than one class of stock, however it can have two or more types within a class. It may have both voting and non-voting common stock, for instance. S-Corps are considered "pass-through tax entities," in which income, losses, deductions and credits are passed on to shareholders who then report such items on their personal federal tax returns. Shareholders pay tax on the flow-through income based on their own individual tax rates. The maximum number of shareholders permitted in an S Corporation is 100.

13. D: There is no maximum number. A Limited Liability Corporation (LLC) is a type of business structure, allowed by state statutes, in which owners have limited personal liability over the debt and actions of the corporation. They also allow for a more flexible management structure than a corporation, and the pass-through of taxes to the owners, who are called members. LLCs can have an unlimited number of members, including corporations as well as individuals. In most cases, banks and insurance companies cannot be LLCs.

14. D: I, II, III and IV. All of these variables – values, attitude, experience and demographics – are important non-financial investment considerations that should be discussed with a new client, since they frame the client's views on investing. A new client's risk tolerance is also an important non-financial consideration that is appropriate to discuss before making any investment recommendations.

15. C: Explain to the client you cannot help them with the investment without having an understanding of their current financial information. As best practice, you should have all