



Series 7 Practice Questions

1. In order for an issue to be exempt from federal registration when sold intrastate which of the following is true?
 - A. 75% of the purchasers must be in the state
 - B. 75% of the revenue must be from in the state
 - C. 100% of the purchasers must be from the state and a significant portion of the proceeds must be used in the state
 - D. 60% of the purchasers must be from another state

2. FINRA's rules related to research reports include all of the following except:
 - A. Analysts' compensation must not be tied to the firm's investment banking revenues
 - B. Research reports must disclose when, within the last 12 months, that firm has received any fees from investment banking services from the company that is the subject of the report
 - C. Firms are not required to disclose their proprietary rating systems
 - D. Analysts must disclose whether they or any member of their household have a financial interest in the subject security

3. Silke owns a house on a golf course. She paid \$150,000 for it 30 years ago. As of the date of Silke's death the house had a fair market value of \$500,000. Her daughter Jacquelyn inherited the house. Six months after Silke's death, Jacquelyn sells the house for \$510,000. Assuming this inherited house is not Jacquelyn's primary residence, what are the tax consequences of this sale?
 - A. Jacquelyn owes taxes on \$10,000, at long-term capital gains rates
 - B. Jacquelyn owes taxes on \$360,000, at long-term capital gains rates
 - C. Jacquelyn owes taxes on \$360,000, at short-term capital gains rates
 - D. Jacquelyn owes taxes on \$260,000, at long-term capital gains rates

4. A member must test and verify supervisory policies and procedures in which of the following areas:
 - I. Safeguarding of customer funds and securities
 - II. Maintaining books and records
 - III. Transmittal of funds or securities from customers to third party accounts; from customer accounts to locations other than a customer's primary residence; and between customers and registered representatives
 - IV. Changes of customer account information, including address and investment objectives changes and validation of such changes
 - A. I, IV
 - B. II, III
 - C. II, IV
 - D. I, II, III, IV



5. Systematic risk is:
- A. Risk that cannot be diversified away
 - B. Stock specific risk
 - C. Related to the financial health of the company
 - D. Determined by current tax law
6. Which of the following trades in the capital market?
- A. Shares of an IPO
 - B. Commercial paper
 - C. Negotiable CDs
 - D. Treasury bills
7. Generally, which of the following would not be found in the pool underlying an asset-backed security?
- A. Mortgage loans
 - B. Student loans
 - C. Auto loans
 - D. Credit card receivables
8. An investor in a 25% tax bracket is considering buying a 6% municipal bond. What would a corporate bond have to yield to be equivalent?
- A. 6%
 - B. 8%
 - C. 7.5%
 - D. 4%
9. Which of the following agencies issue debt that is backed by the U.S. government and pays interest and principal monthly?
- I. GNMA
 - II. FNMA
 - III. FLB
 - IV. FHLMC
- A. I, II, III, IV
 - B. I, II
 - C. II, IV
 - D. I only



10. The rate covenant applicable to an issue of municipal bonds would most likely be found in which of the following?
 - A. Legal opinion
 - B. Amortization schedule
 - C. Revenue bond indenture
 - D. Underwriting agreement

11. If U.S. Treasury bonds are paying interest on January 15 and July 15, how many days of accrued interest would be added to a trade which settled Thursday, March 11, in a non-leap year?
 - A. 53 days
 - B. 54 days
 - C. 55 days
 - D. 56 days

12. If an individual purchased \$100,000 5-year municipal bonds at a price of 105, and two years later the bonds are called at 103, which of the following would be the tax consequences?
 - A. 2 point capital loss
 - B. 3 point capital loss
 - C. No capital loss
 - D. Only the amortized loss

13. If your client would like to receive a dividend on a stock, he would need to own the stock by the:
 - A. Payable date
 - B. Declaration date
 - C. Ex-dividend date
 - D. Record date

14. In order to do a discounted cash flow calculation on a bond you would need all of the following except:
 - A. Principal amount
 - B. Coupon rate
 - C. Number of interest payments
 - D. Dividends paid



15. On the same day Woody buys 1 UPS Jan 200 put at 2 and sells 1 UPS Jan 210 put at 6 when the market price of UPS is \$207. Woody must deposit:
- A. \$200
 - B. \$400
 - C. \$600
 - D. \$1,000
16. Manuel buys 1 HPJ May 60 call at 4 and 1 HPJ May 60 put at 3 when the market price of HPJ is \$61. HPJ rises to \$67 and then he lets the put expire and closes out the call for its intrinsic value. Which of the following describes Manuel's closing position?
- A. \$700 loss
 - B. \$700 gain
 - C. Zero
 - D. \$600 gain
17. A customer purchases one XYZ May 50 put at 2.50 with the price of XYZ stock at 55. If the customer simultaneously exercises the long put and purchases 100 shares of the XYZ stock at 43.50, the resulting profit or loss would be:
- A. \$0 profit
 - B. \$400 profit
 - C. \$650 profit
 - D. \$400 loss
18. The primary purpose of partnership democracy is:
- A. Management by both general and limited partners
 - B. To safeguard the interests of limited partners
 - C. To provide for an equal sharing agreement between the general partner and the limited partners
 - D. To provide a written consent for the general partner to act outside of the agreement



19. Which of the following characteristics should an investor have if he is interested in direct participation programs?
- I. Substantial liquid assets
 - II. The ability to commit money for long periods of time
 - III. The ability to analyze the risks as well as the merits of the program
 - IV. A need for future passive income or losses
- A. I, III
 - B. I, II
 - C. I, III, IV
 - D. I, II, III, IV
20. A specified adult under FINRA Rule 2165 - Financial Exploitation of Specified Adults would include which of the following:
- I. A natural person age 65 or older
 - II. A natural person age 50 or older
 - III. A natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests
 - IV. A natural person age 70 or older
- A. I, II, III, IV
 - B. I, III
 - C. II, III
 - D. III, IV
21. FINRA Rule 2231 - Customer Account Statements, requires member firms to send an account statement to customers no less frequently than:
- A. Monthly
 - B. Quarterly
 - C. Semi-annually
 - D. Annually
22. Mid-West Brokerage received a TIF and took no exception. How many day(s) does the firm have to complete the transfer of the assets?
- A. One business day
 - B. Two business days
 - C. Three business days
 - D. Four business days



23. On the same day in her margin account, Lynsey purchased 100 shares of HD at \$300 and shorted 100 shares of MTN at \$280. Her margin account has a free credit balance of \$500. She is required to deposit how much?
- A. 0
 - B. \$1,000
 - C. \$500
 - D. \$2,000
24. The term open order under FINRA Rule 5330 - Adjustments to Open Orders includes which of the following:
- I. An order to buy
 - II. An open stop order to sell
 - III. Limit orders
 - IV. An open stop order to buy
- A. I, II, III, IV
 - B. III, IV
 - C. I, II, III
 - D. I, III
25. When a dispute occurs within the industry, how is it handled?
- A. Through the Code of Procedure
 - B. Through the National Adjudicatory Council
 - C. Through the Code of Arbitration
 - D. Through the Department of Enforcement



Series 7 Practice Questions Answers and Rationale

1. C SEC Rule 147 allows securities that are going to be sold in one state only (intrastate offering) to be exempt from federal registration. These securities must be registered in the state in which the offering is going to be taking place (registration by qualification). Under SEC Rule 147 100% of the purchasers must be residents of the state in which the securities are registered. During the first six months after issue, securities purchased under Rule 147 can only be sold to residents of that state. After six months, the security is freely saleable across state lines. 80% of the company's revenue must be produced in the state and 80% of the proceeds from the new issue must be used in the state.
2. C FINRA is concerned about the objectivity of research reports. Due to this concern, FINRA rules require that firms clearly explain their ratings systems. Firms may not tie an analyst's compensation to investment banking revenues. If the firm has received investment banking business from a company that is the subject of a research report during the previous 12 months, that fact must be disclosed. Additionally, if the firm expects or intends to solicit during the next three month investment banking business from the company that is the subject of a research report, that fact must be disclosed. The analyst must disclose in their research reports (and public appearances) whether they or any member of their household have a financial interest in the subject security and whether their employer firm owned 1% or more of any class of a subject company's equity securities at the close of the previous month.
3. A When assets are inherited they are inherited at their fair market value as of date of death (the same value that is used in the estate tax calculation). Jacquelyn inherited that house at \$500,000. She would owe tax on the \$10,000 gain she realized when she sold the house, at long-term capital gains rates. All inherited assets are taxed at long-term capital gains rates, regardless of their holding period.
4. D A member must test and verify supervisory policies and procedures, and document in written form, the following areas: safeguarding of customer funds and securities; maintaining books and records; supervision of supervisory personnel; transmittal of funds or securities from customers to third parties, from customer accounts to locations other than a customer's primary address, and between customers and registered representatives (including the hand delivery of checks); and changes in customer account information, including address and investment objective changes and validation of such changes.
5. A Systematic risk is risk that cannot be diversified away. It is the risk that changes in the overall economy will have a negative effect on individual securities. There are certain types of risks that are considered systematic, including market risk, interest rate risk, and inflationary risk. To diversify by asset class helps to reduce systematic risk.
6. A Commercial paper, negotiable CDs, and treasury bills are all short-term, very liquid investments that trade in the money market. Money market instruments mature in one year or less. The capital market is where shares of an IPO trade (as well as many other types of securities).



7. A In the pool underlying an asset-backed security are non-mortgage loans such as student loans, car loans, and credit card receivables. When home loans are in the underlying pool, the security created is called a mortgage-backed security (MBS).
8. B The taxable equivalent must be more than the municipal bond yield since the interest income is taxed at both the state and federal levels. To find the taxable equivalent yield you take the municipal bond yield of 6% and divide it by the complement of the tax bracket owed ($100\% - 25\%$ which is the tax bracket owed) = .75, this is the denominator of the fraction. The formula is 6% divided by $.75 = .08 = 8\%$. To double check, if the corporate bond earned 8% then that would be \$80 of interest income annually. 25% of the interest income would be owed in taxes, $\$80 * 25\% = \20 owed in taxes. This leaves the investor with \$60 after taxes which is equal to a municipal bond at a 6% yield.
9. D The only agency backed by the full faith and credit of the U.S. government is GNMA – Government National Mortgage Association. GNMA issues pass-through securities that pay interest and principal to the bondholder monthly.
10. C The rate covenant refers to the indenture of the revenue bond where the issuer agrees to charge sufficient rate of use fees to pay the bond interest and principal.
11. C Accrued interest is calculated from the morning of the last interest payment date up to, but not including, the settlement date. Remember that for government bonds actual days are used in the month rather than a 30-day month. Thus, calculating from the morning of January 15 through the end of the month we have 17 days including January 15 through January 31. February, since it is a non-leap year, runs from the 1st through the 28th for another 28 days. In March, the settlement was March 11, and remember it is calculated up to but not including that settlement date, so we must figure up through March 10 for a total of 55 days.
12. C Municipal bonds bought at a premium must be amortized. Thus, the premium of 5 divided by the 5 years to maturity multiplied by the two years that have elapsed equals 2. The basis is reduced by that amount to 103. Since the bonds are called at 103, there is no capital loss or gain.
13. D Those shareholders on record as of the record date will receive the dividend.
14. D In order to do a discounted cash flow calculation on a bond you would need to know the principal amount, coupon rate, the number of interest payments, and current market rates (the discount rate used in the equation).
15. C Woody has a put spread. It is a credit spread since the net of the premiums is +\$400, this is the most Woody can make. The best case scenario for Woody would be that the market price of UPS increases and both contracts expire out-of-the-money. However, if the market falls, the short put would be exercised first, requiring Woody to buy the stock at \$210. Should UPS continue to fall, Woody can sell those shares for \$200. The spread is \$10 (200 versus 210). Break-even is the higher strike minus the net of the premiums = $\$210$ minus $\$4 = \206 . The most he can lose is $\$6$ per share times 100 shares = \$600.



16. C Manuel established a long straddle, buying both a call and a put for an initial out-of-pocket position of -\$700. Intrinsic value on a call is the difference between the market price and the strike price, $\$67 - \$60 = \$7$. The put expired worthless and Manuel did a closing sale of the call at its intrinsic value of $\$7 \times 100 \text{ shares} = +700$. His net position is zero, he broke even.
17. B When the customer buys the put at 2.50, he has an outflow of \$250. When he buys the 100 shares of stock at 43.50, he has an outflow of \$4,350, for a total outflow of \$4,600. When he exercises the May 50 put, he has an income of \$5,000, leaving a \$400 profit.
18. B In a limited partnership, partnership democracy speaks of the limited partner's ability to vote and bring about certain changes in the partnership such as removing the general partner or buying and selling property which safeguards the interest of the limited partners.
19. D A direct participation program is ideal for an individual who needs passive income or losses in the future, who has substantial assets, and the ability to commit some of those assets for long periods of time. Any investor in any program should be able to analyze the risks and the merits of the program.
20. B A specified adult under FINRA Rule 2165 - Financial Exploitation of Specified Adults would include a natural person age 65 or older, and a natural person age 18 and older who the member reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests.
21. B FINRA Rule 2231 - Customer Account Statements, requires member firms to send an account statement to customers no less frequently than quarterly. This account statement must include a description of any securities positions, money balances, or account activity. The account statement must include a statement that advises the customer to report promptly any inaccuracy or discrepancy to his or her brokerage firm.
22. C Once the firm validated the TIF they have three business days to complete the transfer of the assets.
23. C In a margin account, the transactions are netted against each other daily to determine if there is an additional amount to be deposited. She purchased \$30,000 worth of HD and shorted \$28,000 worth of MTN, leaving her with a \$2,000 net purchase position. Regulation T for equities is 50%. $\$2,000 \times .50 = \$1,000$. She can use the \$500 free credit balance towards the purchase, ultimately she is required to deposit an additional \$500 to meet the margin requirement.
24. C The term open order under FINRA Rule 5330 - Adjustments to Open Orders includes an order to buy or an open stop order to sell, including but not limited to good 'til cancelled, limit or stop limit orders which remain in effect for a definite or indefinite period of time until executed, cancelled or expired. Open stop orders to buy, orders marked to do reduce or do not increase, and orders subject to reverse stock splits are not to be adjusted.
25. C When a dispute occurs in the industry, the Code of Arbitration is followed.