

# *Test Alert!*

to Accompany the 3rd Edition LEM

5/29/08

series **26**

The information included in this release, in addition to your other Kaplan Financial Education 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 rationales.

Be sure to visit Kaplan Financial Education's Website at [www.kaplanfinancial.com](http://www.kaplanfinancial.com) for the latest updates to this *Test Alert!*

## Introduction

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This *TestAlert!* comprises information regarding changes in rules and regulations, and their coverage, that have taken place since the Series 26, 3<sup>rd</sup> Edition, was published. These changes have been incorporated into the 4<sup>th</sup> edition of the Series 26 License Exam Manual.

## General notes

- **FINRA** The text itself as well as the Glossary, Index, and HotSheets have been revised and augmented to reflect the merger of NASD and NYSE Regulation, Inc. to form the Financial Industry Regulatory Authority (FINRA). Where appropriate, references to FINRA replace references to NASD; however, the names of certain rules, NASD Rule 2790 and the like, have been left as is, as these will not change until conversion of the NASD Manual into the FINRA Manual has been completed.
- **Test Taking Tips** Additional examples have been added to the introductory material to augment the tips and warnings designed to help with test preparation.
- **Definitions** A number of definitions have been updated or clarified in the Glossary, and more have been added.
- **Questions** The question bank has been completely revised and updated to keep our test materials as reflective as possible of the Series 26 Exam.

## Specific topics

1. **Contractual Plans** The material dealing with contractual plans has been shortened and the salient facts summarized in a more comprehensive table, to reflect the fact that contractual plans are no longer sold. The material itself remains the subject of questions, since there are many plans still in effect, but the subject itself is receiving de-emphasis.
2. **Internal Revenue Code, Section 72(t)** Under Section 72(t) of the Internal Revenue Code, an IRA holder under the age of 59½ may avoid the 10% penalty for early withdrawal from his IRA. To qualify, he must receive the withdrawal as part of a series of substantially equal periodic payments made for the life (or life expectancy) of the individual, or the joint life expectancy of the individual and spouse. The payments may be computed according to one of three methods:
  - the minimum distribution method;
  - the amortization method; or
  - the annuitization method.

There is a further requirement that the method not be altered for five years from the date of the first payment, or age 59½, whichever comes later. A recent ruling allows a change to be made from the amortization or annuitization method to the minimum distribution method without triggering the 10% penalty, but the minimum distribution method must then continue to be used for all subsequent years.

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**QUICK QUIZ 1**

1. To avoid the 10% early-withdrawal penalty, regular, lifetime withdrawals from an IRA under Section 72(t) of the Internal Revenue Code may be computed as to amount by any of the following methods EXCEPT the
  - A. cash-flow method
  - B. annuitization method
  - C. amortization method
  - D. minimum distribution method

3. **Annual Compliance Meeting Venue** The compliance meeting which FINRA member firms must hold each year for their associated persons must have an interactive venue. For some firms, however, the requirement for actual in-person interaction is impractical or unrealistic. In these cases, the compliance meeting may take the form of an on-demand Webcast, provided participants have a means to address individual questions to the providers and receive answers to them in a timely fashion. The questions and answers must also be recorded and made available to other participants.

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**QUICK QUIZ 2**

2. KPL Securities, a broker/dealer firm, is planning its annual compliance meeting. Since it is impractical for the firm to bring the participants to a central location for a directly interactive venue, management has decided to provide it in the form of an on-demand Webcast. Which of the following requirements must be met?
  - A. Participants must pass a written exam on the material, which must be administered within 10 days of participation.
  - B. Participants must be able to ask individual questions and get them answered in a timely fashion.
  - C. The Webcast material must be approved by FINRA at least 10 days before first use.
  - D. The Webcast may only be viewed on computers with software that permits attendance to be monitored.
4. **Profile Plus** Building on the profile prospectus is a strongly recommended point-of-sale device called Profile Plus, designed specifically for presentation on the Internet. It would be provided by the broker/dealer and would consist of two summary pages:

- Page One would give the fund's title and objectives, a summary of its investment strategy, a graphical summary and average of the fund's 1-, 5-, and 10-year (or life-of-the-fund) performance, and a summary of risks to the investor.
- Page Two would summarize the expenses of investing in the fund, with both one-time and ongoing fees; describe portfolio turnover; and discuss potential conflicts of interest, such as control relationships or incentives offered to salespersons. Though the device is meant for online presentation, an investor should be able to request and receive a paper copy. A special strength of Profile Plus is that it would offer hyperlinks to the mutual fund prospectus and other documents to which the investor could click through for further details.

### QUICK QUIZ 3

3. Which of the following sales disclosure documents is specifically designed for presentation on the Internet?
  - A. Omitting prospectus
  - B. Statement of Additional Information (SAI)
  - C. Profile
  - D. Profile Plus

**5. Sales Disclosure Summary** The number of documents used in the presentation and sale of mutual funds has increased. The following table has been added to the License Exam Manual text to summarize the various disclosure instruments used in the marketing of mutual funds:

<b>Document</b>	<b>Purpose</b>	<b>Contains</b>	<b>Presented</b>
<b>Omitting Prospectus</b>	Rule 482 Tombstone ad	Some performance data and disclaimers	To announce a fund
<b>Preliminary Prospectus</b>	Red herring	No final price	Only to introduce a fund
<b>Prospectus</b>	Sale document	Full and fair disclosure of all material facts for investment decision	Prior to sale Prior to or with sales presentation
<b>Statement of Additional Information</b>	SAI More data for the investor	Additional details about the fund not necessary for the prospectus	Within 3 days of customer request
<b>Profile</b>	Rule 498	Summary of information in the prospectus	With confirmation, if used for sale
<b>Profile Plus</b>	Sale document	Electronic form of profile with dynamic links to other documents	On the Internet (hard copy on request)

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**QUICK QUIZ 4**

4. Which of the following may be used as an actual sale document for a mutual fund?
- I. The Statement of Additional Information
  - II. The prospectus
  - III. A fund profile.
  - IV. An omitting prospectus
- A. I and III
  - B. I and IV
  - C. II and III
  - D. II and IV

- 6. Broker/Dealer Financial Reporting** The material on the various financial and operational reports for which broker/dealers are responsible has been reorganized and updated. The following table has been added to the text to summarize the material:

**Broker/Dealer Regular Financial Reports Summary**

Carrying Firms	Fully Disclosed Firms
<b>FOCUS II</b> —due within 17 days of month's end and of quarter's end, or within 2 business days of termination of membership	<b>FOCUS IIA</b> —due within 17 days of quarter's end, or within 2 business days of termination of membership
<b>Audited FOCUS II</b> —due within 60 days of year's end	<b>Audited FOCUS IIA</b> —due within 60 days of year's end
<b>Balance Sheet and Statement of Net Capital</b> —unaudited semiannual report and audited annual report sent to customers	

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**QUICK QUIZ 5**

5. The FOCUS II report must be submitted
- I. by carrying firms only
  - II. by both carrying firms and fully disclosed firms
  - III. both monthly and quarterly
  - IV. quarterly only
- A. I and II
  - B. I and III
  - C. II and IV
  - D. III and IV

## Answers to Quick Quizzes

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1. **A** There is no cash-flow method for computing withdrawal amounts under Regulation 72(t) of the Internal Revenue Code.
2. **B** If the annual compliance meeting is in the form of an on-demand Webcast, participants must be able to ask individual questions and get them answered in a timely fashion. The questions and answers must also be recorded, and the recordings made available to other participants.
3. **D** Profile Plus is a two-page online document designed specifically for presentation on the Internet. An important feature of Profile Plus is the ability not only to peruse material directly, but also to click through to other disclosure documents offered by the mutual fund or sponsor.
4. **C** The prospectus, of course, may always be used in effecting sales of mutual funds. The profile may also be used for an actual sale, but if it is, the investor must receive a full prospectus with the confirmation of his order.
5. **B** Carrying firms must submit monthly and quarterly FOCUS II reports within 17 days of the end of the month or quarter. They must also submit an annual audited FOCUS II within 60 days of the end of their fiscal year.

There are no errata reported at this time.

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



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