

Test Alert!

to Accompany the 1st Edition, Revised
LEM

11/01/08

series **51**

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.

As always, we strive to provide you with the most current test preparation information. Be sure to visit Kaplan Financial Education's Website at www.kaplanfinancial.com for the latest updates.

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Introduction

The information found on this TestAlert! supplements the Kaplan Financial Series 51 License Exam Manual, 1st Edition Revised.

The Municipal Securities Rulemaking Board (MSRB) released a revised Municipal Fund Securities Limited Principal Qualification Examination (Series 51) study outline that will become effective November 1, 2008.

There are 60 multiple-choice questions assigned to the seven areas of the examination, as follows:

- Regulatory Structure—5%
- Product Knowledge—27% (was 20%)
- General Supervision—17% (was 20%)
- Fair Practice and Conflicts of Interest—17% (was 15%)
- Sales Supervision—18% (was 20%)
- Underwriting and Disclosure Obligations—6% (was 10%)
- Operations—10%

The MSRB rules require a dealer to supervise municipal securities activities of its associated persons and the conduct of its business. The Board has urged FINRA to look at a broker/dealer's supervisory personnel to ensure that compliance procedures are established and enforced by qualified people. The Board is of the view that violations of Board rules, particularly those that indicate a lack of effective supervisory controls, constitute a failure to supervise on the part of the designated principals and the firm.

With this in mind, a committee of industry professionals and the MSRB staff continually review the role of a municipal securities principal and the Series 51 exam. They concluded that a minor update of the content of the exam outline was needed.

After we completed a careful review of the newest study outline, the principal change is in the weighting of the exam. In addition, a few recordkeeping deletions and additions were made appertaining specifically to municipal fund securities. In addition to correcting some errors in the previous outline, we found the following minor changes:

- Part One—Regulatory Structure remains the same in number but a new section has been added dealing with antifraud provisions of the 1934 Act and rules as it applies to municipal broker dealers.
- Part Two—Product Knowledge was increased by 7%, and the Board added an entirely new section to the outline called “New Products Governed by the MSRB Rules.” However there are no items attached to the heading. They did, however, stress that the candidate must be able to demonstrate knowledge and appropriate uses of alternative higher education savings products which codifies what we've known for some time, that the Board is using more “real life” scenarios to test a candidate.
- Part Seven—Operations added to the outline “Customer Account Transfers” referencing G-26. The current 1st edition of the Kaplan Financial Series 51 study program includes coverage of this topic.

The outline removed reference to “Records of agency transactions; Non-clearing broker-dealers; Introducing broker-dealers,” and added “Transactions in municipal fund securities books and records maintained by transfer agents G-8(g).”

Breaking the Buck

Although mentioned in Unit 1 of the Licensing Exam Manual, the phrase “break the buck” has come to be widely used in financial periodicals in coverage of the financial crisis of the last half of 2008. To supplement your understanding of the phrase, please review the following.

Money market funds, just like other mutual funds, are required to calculate net asset value (NAV) at least daily, typically after markets close. A fund’s NAV price per share reflects the total value of the fund’s investments. Money market funds invest with the goal of maintaining a stable NAV of \$1.00 per share. Investors, therefore, can expect to get back one dollar for every dollar they invest in the fund in addition to interest or dividends the fund earns. Money market funds are said to break the buck when NAV falls below \$1.00 per share.

There is an expectation that when a money market fund is in jeopardy of breaking the buck, the investment management firm will take action to infuse the fund with cash in order to maintain a stable \$1.00 NAV per share.

Updates Made to the 1st Edition LEM

- Information regarding imposed taxes on withdrawals from 529 college savings plans for “nonqualified” uses was added.
- The description on deductibility of contributions to 529 college savings plans was expanded.
- A reference to the federal sunset provisions for 529 college savings plans was removed.
- A reference to any recently enacted MSRB interpretations was added to the section on recently enacted rules governing general supervision.
- References to old Rule G-38, on consultants, were removed.
- New Rule G-38, on solicitation of municipal securities business, was added.
- A technical change was made to revise the title of Rule G-20.
- A rule citation was revised to Rule G-21(f).
- Rule G-21(e) regarding advertisements for municipal fund securities was added.
- A reference to any recently enacted MSRB interpretations was added to the section on recently enacted rules governing fair practice and conflicts of interest.
- A reference to any recently enacted MSRB interpretations was added to the section on recently enacted rules governing sales supervision.
- A reference to any recently enacted MSRB interpretations was added to the section on recently enacted rules governing underwriting and disclosure obligations.
- A reference to any recently enacted MSRB interpretations was added to the section on recently enacted rules governing operations.
- Additional tax issues and updates.
- The Pension Protection Act of 2006 makes permanent the federal tax exemption on Section 529 tuition plans. The so-called sunset provision is gone.
- Withdrawals for college tuition and expenses are reduced by tax-free scholarships, fellowships, and certain other financial assistance. If the remaining expenses are less than the qualified distributions, part of the earnings will be taxable. You cannot assume that a withdrawal for qualified expenses is tax free.
- References to recently enacted MSRB interpretations were added to the LEM. These points are fortified with additional questions added to the question bank. For example, on page 60 of the LEM is a chart of supervisory responsibilities delineating specific situations and who exactly has the supervisory responsibility.
- Requirements regarding retaking qualification examinations and waiving qualification requirements.
- SEC requirements regarding lost and stolen securities.

1. Qualification and Numerical Requirements for Municipal Fund Securities Limited Principals

Numerical requirements for broker/dealers effecting municipal securities transactions are generally required to have at least two municipal securities principals (Series 53). Broker/dealers whose municipal securities activities are limited exclusively to municipal fund securities may count any municipal fund securities limited principal (Series 51) toward this numerical requirement.

As a practical matter, principals are required to enforce the supervisory procedures of the firm. For example, a sales representative (Series 52 or Series 7, or Series 6 for those firms limited strictly to municipal fund securities) who makes a recommendation to a customer must “have reasonable grounds . . . for believing that the recommendation is suitable.” FINRA understands that, under the MSRB’s interpretation of G-19, a sale of an out-of-state plan can be suitable.

For example, the underlying investment companies offered by the in-state plan could provide inferior management or a limited selection of investment choices. The fees associated with the in-state plan could also be higher than those associated with another plan out of state. Some states do not even provide a state tax deduction or any other benefits for their own citizens. A registered representative must consider all these factors and more before making the recommendation. Principals should be mindful that if a firm sold the bulk of the dollar value of 529 plan investments to nonresidents of the state that sponsored the plan, such sales would need careful attention and likely would draw the attention of regulators.

2. Rule G-40: Electronic Mail Contacts

Municipal securities broker/dealers must maintain an email account to permit communication with the MSRB and appoint a Primary Electronic Mail Contact (PEMC) to serve as the official contact between the member firm and the Board. The PEMC must be a registered municipal securities principal (Series 53 or Series 51). A Series 10 municipal securities sales supervising principal may NOT function in the PEMC role; however, an Optional Electronic Mail Contact may be appointed from among any of the associated persons.

Upon assignment of an MSRB registration number, each broker/dealer must electronically submit to the MSRB a completed Form G-40 setting forth, in the prescribed format, the following information:

- The name of the broker, dealer, or municipal securities dealer
- The date
- The MSRB registration number of the broker/dealer or municipal securities dealer
- The name of the PEMC and his email address and telephone number
- The name of the Optional Electronic Mail Contact, if any, and his email address and telephone number
- The name, title, and telephone number of the person who prepared the form. A broker/dealer may change the name of its Electronic Mail Contacts or other information previously provided by electronically submitting an amended Form G-40 to the MSRB.

Each member must review and, if necessary, update information on its PEMC and submit the information electronically to the MSRB within 17 business days after the end of each calendar quarter.

Any broker/dealer that, during the 17-business-day update period, submits its initial Form G-40 or modifies or affirms information relating to its PEMC is in compliance with the quarterly update requirement applicable to the quarter immediately preceding the 17-business-day update period.

3. Political Contributions

Form G-37x

Firms that are only engaged in the retail distribution of 529 plans would likely qualify to opt out of the reporting requirements of Rule G-37 on political contributions and resulting recordkeeping and supervisory

procedures requirements. MSRB Form G-37x is designed for firms that are not engaged in municipal securities business, as defined in Rule G-37.

New Rule G-38 pertains to the solicitations of municipal securities business by consultants. The MSRB has been concerned that increases in levels of compensation paid to consultants for successfully obtaining municipal securities business may be motivating consultants, who are not subject to the basic standards of fair practice embodied in MSRB rules, to use more aggressive or questionable tactics in their contacts with issuers.

New Rule G-38 prohibits broker/dealers from paying persons who are not affiliated with the dealers for soliciting municipal securities business on their behalf. With the exceptions provided for in the transition period mentioned below, no broker/dealer may pay a person who is not affiliated with it for obtaining or retaining municipal securities business. An affiliated person is anyone who is:

- a partner, director, officer, or employee of the broker/dealer (or bank); or
- an affiliated company of the broker/dealer.

An affiliated company of the broker/dealer means any entity directly or indirectly controlled by or controlling the broker/dealer.

The Board also defines a contribution as any gift, loan, advance, or anything of value made:

- for the purpose of influencing any election for federal, state, or local office;
- for payment of debt incurred in connection with the election; or
- for transition or inaugural expenses of the successful candidate for state or local office.

Transitional Payments

A broker/dealer may make payments to a person other than an affiliated person if solicitation activities were undertaken on or before the effective date of this rule, but only if:

- the broker/dealer was selected by the issuer on or before the effective date of this rule to engage in such municipal securities business;
- such person has not solicited municipal securities business from any issuer on behalf of the broker/dealer at any time after the effective date of this rule; and
- the broker/dealer sends to the MSRB two copies of Form G-38t to the Board by certified or registered mail by the last day of the month following the end of each calendar quarter during which payments to such person are made or remain pending. The form will be made available for public review.

4. Rule G-21(e) Regarding Advertisements for Municipal Fund Securities

The information below covers some additional points of advertisement rules pertaining to municipal funds securities.

In addition to the requirements that no broker/dealer publish any advertisement concerning municipal securities that it has reason to know is materially false or misleading, all advertisements for municipal fund securities are subject to the following requirements.

Each advertisement for municipal fund securities must include a statement that:

- advises an investor to consider the investment objectives, risks, charges, and expenses associated with municipal fund securities before investing;
- explains that more information about municipal fund securities is available in the issuer's official statement;

- if the advertisement identifies a source from which an investor may obtain an official statement and the broker/dealer that publishes the advertisement is the underwriter for one or more of the issues of municipal fund securities for which any such official statement may be supplied, the broker/dealer is the underwriter for one or more issues (as appropriate) of such municipal fund securities; and
- the official statement should be read carefully before investing.

Any advertisement that refers by name to a municipal fund security or its issuer must include the following disclosures where applicable:

- Unless the offer of a municipal fund security is exempt from SEC Rule 15c2-12 and the issuer has not produced an official statement (OS), a source from which an investor may obtain an official statement
- If the advertisement relates to municipal fund securities issued by a qualified tuition program (e.g., a Section 529 plan), a statement that advises an investor to consider, before investing, whether the investor's or designated beneficiary's home state offers any state tax or other benefits that are available for investments only in that state's qualified tuition program
- If the advertisement is for a municipal fund security that the issuer holds out as having the characteristics of a money market fund, statements to the effect that an investment in the security is not insured or guaranteed by the FDIC and, if the security is held out as maintaining a stable net asset value, that although the issuer seeks to preserve the value of the investment at \$1 per share or any other applicable fixed share price, it is possible to lose money by investing in the security

If performance data are included in an advertisement, it must provide a legend disclosing that the data represent past performance and that past performance does not guarantee future results. Unless the advertisement includes total return quotations current to the most recent month ended seven business days before the date of any use of the advertisement, the legend must also identify either a toll-free (or collect) telephone number or a Website where an investor may obtain total return quotations current to the most recent month's end.

In addition, if a sales load or any other nonrecurring fee is charged, the maximum amount of the load or fee must be included and, if the sales load or fee is not reflected in the performance data included in the advertisement, a statement must be included indicating that the performance data do not reflect the deduction of the sales load or fee and that the performance data would be lower if a load or fee were included.

If the information above is in a print advertisement, it must be in a type size at least as large as and of a style different from, but at least as prominent as, that used in the major portion of the advertisement.

Each advertisement must be approved in writing by a municipal securities principal or general securities principal before first use. Each broker/dealer must make and keep current, in a separate file, records of all this type of advertisement.

Any discussion of tax implications or other benefits of municipal fund securities included in an advertisement must not be misleading. In the case of an advertisement that includes statements regarding tax or other benefits offered with municipal fund securities, the advertisement also must state that the availability of tax or other benefits may be conditioned on meeting certain requirements.

To illustrate this point, only in 25 states and the District of Columbia do investors receive a tax deduction or tax credit if they reside in the state sponsoring the 529 plan. Deductions also vary from state to state. For example, Colorado permits residents to deduct the entire amount of their contribution to their in-state plan for each beneficiary, up to the maximum contribution limit.

On the other hand, Rhode Island allows only a \$1,000 deduction in total for joint filers and \$500 for single filers.

A print advertisement that includes the headline, “Pay for college TAX FREE!” is misleading. The headline implies that college costs could be covered and that there would be no tax implication throughout the investment process—even if the plan were offered to an out-of-state resident.

If the advertisement describes the nature of specific benefits, the advertisement must also briefly name the factors that may materially limit the availability of any benefits (e.g., residency, purpose of distributions, or timing of distributions). Statements of conditions or limitations must be presented in close proximity to, and in a manner no less prominent than, the description of any benefits. An advertisement that describes services provided with respect to municipal fund securities must clearly indicate the entity providing those services. If any person or entity other than the broker/dealer is named in the advertisement, the advertisement must reflect any relationship between the broker/dealer and the other party.

5. Enhanced Time-of-Trade Disclosure Requirements with Respect to the Marketing of Out-of-State 529 College Savings Plans

Dealers selling out-of-state 529 college savings plan interests are required to disclose to the customer, at or before the time of trade, and in a manner that is reasonably likely to be noted by an investor that:

- depending on the laws of the home state of the customer or designated beneficiary, favorable state tax treatment or other benefits offered by the home state may be available only if the customer invests in the home state’s 529 college savings plan;
- state-based benefits should be one of many appropriately weighted factors to be considered in making an investment decision; and
- the customer should consult with a financial, tax, or other adviser about how the state-based benefits would apply to his specific circumstances and may wish to contact his home state or any other 529 college savings plan to learn more about their features (the out-of-state disclosure obligation).

6. Exemption from New Issue Price/Yield Requirement

Rule G-21 now specifically exempts municipal fund security advertisements from each of these requirements.

- An underwriting syndicate that publishes an advertisement for an offering of a new issue of municipal bonds may show the initial reoffering prices or yields for the securities, even if the price or yield for a maturity has changed, provided the advertisement contains the date that the syndicate bought the securities from the issuer.
- In the event that prices or yields shown in a new-issue advertisement differ from the initial reoffering prices or yields, the advertisement must show the prices or yields of the securities at the time the advertisement is submitted for publication.
- In addition, the securities shown as being available from the syndicate may no longer be available from the syndicate at the time of publication or may be available from the syndicate at a price or yield different from that shown in the advertisement.
- A reference to any recently enacted MSRB interpretations was added to the reference to any recently enacted rules governing fair practice and conflicts of interest.

7. Forwarding Official Communications

There is sparse information about the forwarding of official communications in the current edition of the LEM. The following information, however, is subject to questioning on the new exam.

Official communication means any document or collection of documents pertaining to a specific issue of municipal securities that:

- is addressed to beneficial owners and was prepared or authorized by:
 - an issuer of municipal securities,
 - a trustee for an issue of municipal securities in its capacity as trustee,
 - a state or federal tax authority, or
 - a custody agent for a stripped coupon municipal securities program in its capacity as custody agent; and
- contains official information about the issue or issues, including but not limited to, notices concerning monetary or technical defaults, financial reports, material event notices, information statements, or status or review of status as to taxability.

If a broker/dealer receives an official communication to beneficial owners applicable to an issue of municipal securities that the broker/dealer has in safekeeping along with a request to forward the official communication to the applicable beneficial owners, the broker/dealer may use reasonable efforts to promptly retransmit the official communication to the parties for whom it is safekeeping the issue.

In determining what a reasonable effort is, if CUSIP numbers are included with the official communication to beneficial owners, the broker/dealer may use the CUSIP numbers in determining the issue(s) to which the official communication applies. If CUSIP numbers are not included, the broker/dealer may use reasonable efforts to determine the issue(s) to which the official communication applies. The broker/dealer is not in violation of any rule if it has done all it reasonably can to forward the communication.

A broker/dealer does not have to retransmit official communications without an offer of adequate compensation. If compensation is offered with the official communication, the broker/dealer may affect the retransmission and seek compensation concurrently. However, if the total compensation would be more than \$500, the broker/dealer may promptly contact the party offering compensation, inform it of the amount of compensation required, obtain specific agreement on the amount of compensation, and wait for receipt of the compensation before proceeding with the retransmission.

In determining whether compensation is adequate, the broker/dealer may make reference to the suggested rates for similar document transmission services found in “Suggested Rates of Reimbursement” for expenses incurred in forwarding proxy material, annual reports, information statements, and other material referenced in FINRA Rules.

Sufficient copies of official communications

A broker/dealer is not required to provide duplication services for official communications. If sufficient copies of official communications are not received and the broker/dealer elects not to offer duplication services, the broker/dealer may promptly request, from the party requesting the forwarding of the official communication, the correct number of copies of the official communication.

Nonobjecting beneficial owners

In lieu of retransmitting official communications to beneficial owners who have indicated in writing that they do not object to the disclosure of their names and security positions, a broker/dealer may instead promptly provide a list of nonobjecting beneficial owners and their addresses.

Beneficial owners residing outside of the United States

A broker/dealer may not be required to send official communications to persons outside of the United States, although broker/dealers may voluntarily do so.

Investment advisors

A broker/dealer may send official communications to the investment advisor for a beneficial owner, rather than to the beneficial owner, when the broker/dealer has on file a written authorization for such documents to be sent to the investment advisor in lieu of the beneficial owner.

8. Remarketing Activities Under Rule G-23 on Activities of Financial Advisors

A remarketing agent is broker-dealer responsible for reselling to new investors securities (such as variable rate demand obligations) that have been tendered for purchase by their owner. The remarketing agent also typically is responsible for resetting the interest rate for a variable rate issue and also may act as tender agent.

A broker/dealer that has a financial advisory relationship with an issuer with respect to a new issue of municipal securities may NOT act as an agent for the issuer in remarketing the issue unless the broker/dealer has expressly disclosed in writing to the issuer:

- that there may be a conflict of interest in acting as both financial advisor and remarketing agent for the securities with respect to which the financial advisory relationship exists; and
- the source and basis of the remuneration the broker/dealer could earn as remarketing agent on such issue.

This written disclosure to the issuer may be included either in a separate writing provided to the issuer prior to the execution of the remarketing agreement or in the remarketing agreement. The issuer must expressly acknowledge in writing to the broker/dealer receipt of such disclosure and consent to the financial advisor acting in both capacities and to the source and basis of the remuneration.

Disclosure to issuer of corporate affiliation

If the financial advisor for the issue is not a broker/dealer and the broker/dealer that acquires the issue or arranges for an acquisition has a control relationship with the financial advisor, the broker/dealer must disclose this affiliation in writing to the issuer prior to the acquisition and the issuer must expressly acknowledge in writing to the broker/dealer a receipt of disclosure. Each member firm must maintain a copy of these written disclosures, acknowledgments, and consents in a separate file for three years.

Disclosure to customers

If a broker/dealer acquires new issue municipal securities or participates in a syndicate that acquires new issue municipal, the member firm must disclose the existence of the financial advisory relationship in writing to each customer who purchases the securities from the firm at or before the completion of the transaction.

9. Rule G-32: Disclosures in Connection with New Issues

This rule has been updated to reflect our electronic world. In addition to the many other requirements found under Rule G-32, the managing underwriter must now provide promptly to all broker/dealers that purchase the new issue municipal securities a printable electronic version of the official statement in final form, but only if a printable electronic version has been prepared and the issuer does not object to distribution of such electronic version and the broker/dealer requests an electronic version and provides the managing underwriter or sole underwriter with an email address or other instructions acceptable to the managing underwriter or sole underwriter for electronic delivery of this version.

With the consent of the purchasing broker/dealer, sending a printable electronic version of the official statement in final form to the purchasing broker/dealer fully satisfies the requirements of the rule with respect to the official statement in final form.

Financial advisors

A broker/dealer acting as a financial advisor prepares an official statement in final form on behalf of an issuer and must make the official statement in final form available to the managing underwriter promptly after the issuer approves its distribution. If a printable electronic version of the official statement in final form has been prepared and the issuer does not object to its distribution, the printable electronic version must also be made

available to the managing underwriter or sole underwriter promptly upon request and delivery to the financial advisor of an email address or other instructions acceptable to the financial advisor for electronic delivery of this version. With the consent of the managing underwriter or sole underwriter, the printable electronic version fully satisfies the requirements of the rule with respect to the official statement in final form to be made available by the financial advisor.

Definitions

For purposes of this rule, the following terms have the following meanings. New issue municipal securities are municipal securities that are sold by a broker/dealer during the issue's new issue disclosure period but do not include commercial paper. New issue disclosure period is the period commencing with the first submission to an underwriter of an order for the purchase of new issue municipal securities or the purchase of such securities from the issuer, whichever occurs first, and ending 25 days after the final delivery by the issuer of the securities of the issue to or through the underwriting syndicate or sole underwriter.

Quick Quiz

1. Persons not affiliated with a broker/dealer who solicit municipal securities business for the broker/dealer may be paid for their services
 - A. if the firm files the Form G-37x within 30 days of payment
 - B. if the firm files the Form G-38t by the last day of the month following the end of the calendar quarter
 - C. if the firm has in place a Consultant Agreement approved by the MSRB
 - D. under no condition (nonaffiliated persons may not solicit business on behalf of the member firm)
2. The MSRB defines a contribution as any gift, loan, advance, or anything of value made for
 - A. the purpose of influencing any election for federal, state, or local office
 - B. payment of debt incurred in connection with the election
 - C. transition or inaugural expenses of the successful candidate for state or local office
 - D. all of the above
3. A broker/dealer whose activities are limited to the sale of municipal fund securities and variable annuities may in part qualify its newly registered representatives to perform both of these functions by fulfilling which of the following requirements?
 - A. Pass a Series 6 examination
 - B. Pass a Series 52 examination
 - C. Pass a Series 52 examination with a 90-day apprenticeship
 - D. Pass a Series 6 or 7 examination with a 90-day apprenticeship
4. Which of the following would be the least tax-favorable event in a 529 college savings plan at the state level?
 - A. Living in Utah and investing in the Utah 529 Plan
 - B. Buying books
 - C. Paying for room and board
 - D. Rolling over funds from one state's 529 plan to another
5. Trade reporting requirements for clearing purposes are determined by
 - A. the NSCC
 - B. the MSRB
 - C. SIPC
 - D. SEC
6. Which of the following statements is true?
 - A. A blind advertisement is permissible and not subject to MSRB advertising rules if the logo of the municipal fund security appears with no reference to the broker/dealer.
 - B. Generic advertisements are not permissible.
 - C. The term "form letter" means any written letter or electronic mail message distributed to 50 or more persons within any period of 90 consecutive days.
 - D. Only a municipal securities principal may approve advertisements.

Quick Quiz Answers

1. **D.** New Rule G-38 prohibits broker/dealers from paying persons who are not affiliated with the dealers for soliciting municipal securities business on their behalf.
2. **D.** A contribution made under Rule G-37 includes each of the above.
3. **D.** Either the Series 6 or Series 7 license qualifies an individual whose sales activities are strictly limited to municipal fund securities and variable annuities. MSRB Rule G-3 requires a 90-day apprenticeship period for newly hired people. Series 52 by itself does not qualify the holder to sell variable annuities.
4. **D.** There may be a tax benefit available within one state that may not be available in another.
5. **A.** Clearing requirements are set by the NSCC, and these requirements are the basis for a dealer's MSRB trade reports. The MSRB additional requirements include identity of dealers, their Executing Broker Symbols (EBSs), time (and date) of trade, and agency or principal capacity.
6. **A.** Blind ads are acceptable, and they fall outside MSRB G-21 if a logo identifying the municipal fund security appears with no reference to a broker/dealer being made. General securities principals and municipal fund securities principals (within the scope of their authority) may also approve advertising.



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