

Test Alert!
to Accompany the 4th Edition LEM

5/28/08

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 rationales.

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

Introduction

The information in this *TestAlert!* is designed to update Kaplan Financial's Series 7 License Exam Manual, 4th Edition, to match the upcoming 5th edition when it is published. 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.

Changes to the LEM

Page 20 Insert the following:

Round lots for over-the-counter equity securities

TAKE NOTE

For over-the-counter (OTC) equity securities that trade at or above \$175 per share, the unit of trade or round lot will be 1 share. For these securities, trades of less than 100 shares will no longer be considered odd-lot transactions and for last sale dissemination purposes will be treated as round lots.

QUICK QUIZ 1

- Forty shares of ABAB trade at \$208 per share in the OTC market. For reporting purposes which of the following will be considered to have traded?
 - 40 odd lots
 - 1 odd lot
 - 40 round lots
 - 1 round lot

Page 263 Insert the following:

Discretionary Accounts and Nonconventional Investments (NCIs)

Nonconventional Investments (NCIs) are alternative investments that do not fit a common category. Examples would include:

- **Hedge funds**—aggressively managed and unregulated portfolio of investments that uses advanced investment strategies.
- **Distressed debt**—debt instruments of companies that have declared bankruptcy or are considering declaring bankruptcy.
- **Equity-linked notes (ELNs)**—a debt instrument where the final payment at maturity is based on the return of a single stock, a basket of stocks or an equity index.

FINRA is concerned that retail investors do not fully understand the risks associated with these NCIs. Accordingly, FINRA requires members that sell these products to conduct the appropriate due diligence. Regarding discretionary accounts and these products, appropriate due diligence may require members to receive prior written consent before purchasing them.

**QUICK QUIZ 2**

2. A registered representative wishes to purchase shares of the Mega Risk hedge fund for one of his clients in their discretionary account. According to FINRA, due diligence should require
 - A. that this trade be disallowed by the firm's principal.
 - B. the customer's prior written consent to make the purchase.
 - C. written notice to FINRA that the trade has occurred.
 - D. no action other than to purchase the shares.

Page 266 Insert the following:

Fiduciary Responsibility and Trading Authority

A custodian cannot delegate away fiduciary responsibility but can grant trading authority and investment decisions to a qualified third party.

Page 282 Insert the following:

Margin Extensions and Introducing Broker/Dealers

If payment is late, the broker/dealer may apply to its designated examining authority (DEA) for an extension, as it may do on behalf of cash account customers. For introducing broker/dealers, BDs who do not clear their own trades, the extension request is made by the clearing firm.

**QUICK QUIZ 3**

3. For nonclearing broker/dealers, requests for extensions of credit for their customers would be made by
 - A. the broker/dealer.
 - B. their designated examining authority (DEA).
 - C. the self-regulatory organization (SRO) the firm reports to.
 - D. the broker/dealer's clearing agent.

Page 299 Insert the following:

Portfolio Margining

Portfolio Margining is a different way to calculate margin requirements for an account based on the net risk of an entire portfolio of securities rather than a standardized percentage applied to each individual position. Margin requirements calculated this way are generally lower than those calculated conventionally. Certain rules must be met in order to offer portfolio margining to customers.



QUICK QUIZ 4

4. When calculating margin requirements using the "portfolio margining" method, which of the following is TRUE?
 - A. Margin requirements are based on the net risk of the entire portfolio.
 - B. Margin requirements are based on each individual position and its weighted representation in the portfolio.
 - C. This method of calculating margin is available to any customer who requests it and no additional criteria need be met.
 - D. This method of calculating margin must always be applied in any account having more than 10 positions.

Page 331 Insert the following:

Restricted Securities and Rule 144

Restricted securities are those acquired through some means other than a registered public offering. A security purchased via a private placement under Regulation D is a restricted security. Restricted securities may not be sold until they have been held fully paid for six months. According to Rule 144, after holding restricted stock fully paid for six months, an affiliate may begin selling shares but is subject to the volume restriction rules as enumerated below. In any 90-day period, an investor may sell the greater of:

- 1% of the total outstanding shares of the same class at the time of sale; or
- the average weekly trading volume in the stock over the past four weeks on all exchanges or as reported through Nasdaq.

After the six-month holding period, affiliated persons are subject to the volume restrictions for as long as they are affiliates. For unaffiliated investors the stock may be sold completely unrestricted after the six-month holding period has been satisfied.

Selling shares under Rule 144 effectively registers the shares. In other words, buyers of stock being sold subject to Rule 144 are not subject to any restrictions if they choose to resell.



QUICK QUIZ 5

5. Which of the following is subject to the holding period provisions of Rule 144?
 - A. A corporate insider who has held restricted stock for two years
 - B. A nonaffiliate who has held registered stock for three years
 - C. A nonaffiliate who has held control stock for six months
 - D. A nonaffiliate who has held restricted stock for three months

Page 332 Insert the following:

The De Minimus Filing Threshold for Affiliates and Insiders

When required, Form 144 must be filed no later than concurrently with the sale of the stock and the filing is good for 90 days.

If the intended sale during any 90 day period for an affiliate is small, the filing requirement is waived. This is known as the de minimis filing threshold for affiliates. Sales in amounts not exceeding 5,000 shares or \$50,000 in sale proceeds are permitted without filing Form 144.

QUICK QUIZ 6

6. For an affiliate selling restricted shares, filing Form 144 would be waived for sales meeting which of the following criteria?
 - I. The sale does not exceed 50,000 shares.
 - II. The sale does not exceed 5,000 shares.
 - III. The sale does not exceed \$50,000 in sales proceeds.
 - IV. The sale does not exceed \$100,000 in sales proceeds.
- A. I and III
- B. I and IV
- C. II and III
- D. II and IV

Page 350 Insert the following:

NYSE Rules 80A (rescinded) and 80B

NYSE Rule 80A has been rescinded. NYSE Rule 80B, still in affect, is intended to protect against rapid, uncontrolled drops in the market. Known as the **circuit breaker** rule, it deals solely with declines in the Dow Jones Industrial Average (DJIA). If there is a market decline of 10%, a one-hour halt is imposed. A market decline of 20% results in a two-hour halt, and a 30% decline results in a halt for the remainder of the day. The specific percentage or point change in the DJIA required to initiate market restrictions is subject to change over time.

Page 362 Insert the following:

Good Till Cancelled (GTC) orders

GTC orders are valid until executed or cancelled. However all GTC orders are automatically cancelled if unexecuted on the last business day of April and the last business day of October. If the customer wishes to have the order remain working beyond those specific days, the customer must reentered the order.



QUICK QUIZ 7

7. If a GTC order is unexecuted it will be automatically cancelled on
- A. the last day of the month.
 - B. the last business day of April and October.
 - C. June 30 and December 31.
 - D. the one-year anniversary date of when the order was entered.

Page 365 Insert the following:

NYSE Euronext Acquisition of the American Stock Exchange

NYSE Euronext entered an agreement in January 2008 to acquire the American Stock Exchange (AMEX). The combined business will enhance the NYSE's presence in options, exchange traded funds (ETFs), closed-end funds, and other products listed on the AMEX.

Page 524 Insert the following:

Counter Cyclical Investments

While some investments like stocks tend to move with the economic cycles, there are investments such as precious metals like gold that historically have been counter cyclical.



QUICK QUIZ 8

8. The S&P 500 index and housing starts have been falling. Which of the following is likely to be rising?
- A. Gold futures
 - B. Sales of industrial goods
 - C. Employment figures
 - D. Sales of consumer goods

Page 527 Insert the following:

Leading, Lagging, and Coincident Indicators

Be able to differentiate between leading, lagging, and coincident indicators. Also recognize that an indicator is not affected by whether there was an increase or decrease in a specific type of economic activity. For instance, an increase in inventories is a leading indicator that signifies a weakening economy. A decrease in inventories is still a leading indicator, but it signifies a strengthening economy.

Page 617 Insert the following:

Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 (SOX) was enacted in response to a number of major corporate and accounting scandals. This legislation established enhanced standards for all US public company boards, management, and public accounting firms. For instance, Sarbanes-Oxley created the Public Company Accounting Oversight Board (PCAOB) to oversee, regulate, inspect, and discipline accounting firms in their roles as auditors of public companies. In addition, the act requires self regulatory organizations (SROs) in the securities industry to establish research analyst conflict of interest rules for its members.

QUICK QUIZ 9



9. Enhanced standards for boards of directors of publicly traded companies and the accounting firms they hire are addressed in the
 - A. 1940 Investment Advisors Act.
 - B. Sarbanes-Oxley Act of 2002.
 - C. 1988 Insider Trading and Securities Fraud Enforcement Act.
 - D. Securities Investor Protection Act of 1970.

Answers to Quick Quizzes

1. **C.** For OTC equity securities trading at or above \$175 per share, each share represents one round lot. Because ABAB is trading at \$208 per share, 40 round lots have traded.
2. **B.** When purchasing nonconventional investments (NCIs) in discretionary accounts, due diligence according to FINRA should require that the customer give prior written consent to do the trade. NCIs would include hedge funds, equity linked notes, and distressed or low grade debt instruments.
3. **D.** For introducing broker/dealers; those that do not clear their own trades, requests for extensions of credit for both cash and margin accounts are made by the broker/dealers clearing agent to their designated examining authority (DEA).
4. **A.** Portfolio margining is a method of calculating margin requirements based on the net risk of the entire portfolio. This method of calculating margin is only available to accounts that meet certain requirements but having a minimum number of positions is not one of those criteria.
5. **D.** Only restricted stock is subject to the six-month holding period for both affiliates and nonaffiliates, registered shares are not and control stock is not. The nonaffiliate in Choice D who has only held the shares for three months will still be subject to the holding period until the six-month requirement is met.
6. **C.** For affiliates selling restricted shares, the filing requirement for form 144 is waived for sales of 5000 shares or less or for sales where the proceeds are not more than \$50,000. This is known as the de minimis filing threshold for Rule 144 sales.
7. **B.** If left unexecuted all GTC orders are cancelled on the last business days of April and October. If a customer wishes to have the order remain working beyond those dates the order must be reentered.
8. **A.** Of the choices given only an investment that is counter cyclical such as precious metals would be rising. The remaining choices are all cyclical; moving with the economic cycles. If leading indicators such as the S&P 500 (stock market) and housing starts were falling, it is not likely that the purchase of consumer goods and industrial goods or employment figures would be rising.
9. **B.** The Sarbanes-Oxley Act of 2002 set forth enhanced standards for boards of directors, management, and public accounting firms for all US public companies. It also requires that research analyst conflict of interest rules be established and enforced by all industry Self Regulatory Organizations (SROs).

Errata

There are no errata reported at this time.

To submit comments or suggestions, please send an email to errata@kaplan.com.



www.kaplanfinancial.com

1905 Palace Street, La Crosse, WI 54603

800-824-8742