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Last month Net Worth Strategies launched the first issue of *The Planner*, a free, bimonthly newsletter of financial planning articles, tips and insights from Net Worth Strategies and contributors who are leaders within the industry. We received a lot of positive feedback from readers like you about the first issue and believe you'll continue to find this newsletter beneficial.

This issue features results of our June survey. Many of you responded to our survey about how you price employee stock option planning services. Industry expert Dave Drucker has used the survey results, along with interviews with some of you, to write our feature article about pricing this service.

Second, many financial advisors wonder how to help clients protect the value of their options

against market downswings.

There are always diversification strategies to help balance employee stock option positions that are often heavily concentrated. However, in conjunction with diversification, you can also help protect a client's employee stock option worth using protective option strategies. Dr. Donald Moine, a well-known speaker and consultant to the financial planning industry, addresses this issue in a two-part series.

Next issue: *The Planner* will take an inside look at how financial advisors need to provide retirement distribution planning to clients today to avert potentially wealth draining consequences for the family after the client's death. Many financial pros think there is no need for convincing clients of this service since the arrival of the new proposed IRS regulations

for minimum required distributions. However, *The Planner* exposes the opportunity for retirement distribution planning created by these regulations and how to tap into it.

If you enjoy *The Planner's* content, please pass it on. New subscribers can get their own complimentary subscription by signing up at: NetWorthStrategies.com

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Planning Article of the Month:

How Do StockOpter Users Charge for Employee Stock Option Planning?

by David Drucker

The typical financial advisor who helps his or her clients develop plans for exercising employee stock options charges nothing for the service. Or at least this is the conclusion that might be drawn from the results of Net Worth Strategies' June 2001 survey of its StockOpter users...but it would be incorrect.

At first glance, the survey suggests that 28% of all respondents charge nothing to do options planning, 27% charge hourly fees, 13% charge a fee per engagement, and 16% charge for planning as a part of annual retainers or percentage-of-asset under management fees. However, the vast majority of those respondents who said they don't charge for option planning are really folding those charges into a percent-of-asset management fee structure. Modifying the survey results for this fact, it's now clear that about 39% of the respondents charge asset management fees and do option planning as part of that service, while only about 6% say they either don't know what to charge, or provide the planning as a free service accompanying the sale of insurance or investment products.

We asked Christopher D'Orsi, half of the Prudential team of Lerner and D'Orsi in East Brunswick, NJ why he responded that he charges nothing for options planning.

"Because," says D'Orsi, "we offer this advice as part of our fee-based asset management platform." D'Orsi and his partner, Neil Lerner, manage about \$145 million in assets of clients for whom they do comprehensive financial planning. Among those clients are a fair number holding stock options worth between \$600K to \$1 million before taxes. As to what he charges, D'Orsi says "Prudential has different wrap platforms, all having a different range of fees....our fees may range anywhere from .50% to 3% depending on the type of wrap account, asset class mix and account size.

One of the advisors who responded to the survey by saying his firm includes options planning as part of their total package of services -- and attendant fee structure -- is Roger Shake, CFP of the Legacy Consulting Group in Plano, Texas. Shake explains "Legacy is a wealth management firm doing fee-based, comprehensive, multi-generation financial and life planning for 47 families." His firm charges a flat fee of anywhere from \$4,000 on up for a client's initial financial plan, and ongoing fees that are a combination of percentage-of-assets for portfolio management and quarterly retainer fees for financial planning.

Depending upon when the client's options enter the picture, the planning for those options will be charged under one or another of these established fee structures. For example, if the

client has options the first time he or she walks in the door, then planning for those options will influence the flat fee Legacy quotes the client for his initial planning. However, if the client is beyond initial planning, is receiving ongoing service from Legacy, and is suddenly awarded options by his employer, then the option planning will be covered by his quarterly retainer fee, which could range anywhere from \$500 to \$7,000.

A similar system is used by Leisa Brown Aiken, CFP, CPA, an employee of Kabarec Financial Advisors, Ltd. in Palatine, IL. Kabarec, a fee-only advisory firm, quotes a flat fee for a client's initial planning and then switches to an asset management fee as the client continues to receive services from the firm.

"We'll do a separate fee initially for financial planning and then offset part of the planning fee against the percent-of-assets fee charged later in the year if they become an ongoing client," says Aiken. The existence of stock options in the client's financial makeup is one of many possible factors that determine the planning fee Kabarec quotes to its clients. But typically, says Aiken, "a more complex options analysis that we would use StockOp-ter for might run six hours at about \$200 an hour." In other words, the financial planning fee Aiken would quote a new client with options would include this \$1,200 element.

However, Aiken says "we wouldn't do just a stock option planning exercise," a sentiment that Shake agrees with. And that's what it may seem is happening with the 40% of the survey's respondents who say they charge either hourly or per-engagement fees for this type of planning. These fee structures suggest that the planning is being done in a vacuum, but that's not always the case, according to Chris Berg, CPA with Top Murphy & Company LLP in Portland, OR. Berg charges clients with stock options fees of approximately \$115 to \$165 per hour, saying the total engagement usually costs the client near the higher end of a \$2,500 to \$5,000 range.

Berg considers the client's complete financial picture, in spite of his tendency to charge hourly fees for a specific stock option planning engagement, by bringing in an independent (usually fee-only) financial planner as part of the team. "Typically what happens is I'll use StockOp-ter and do some projections

which the financial planner will use as input [to his planning efforts]," he says. So, between Berg's service and that of the financial planner, the client gets comprehensive advice. This works as well as it does because Berg poses no threat to the planner since he's not an asset manager and, he says, "many planners in our area don't want to get into the complexity of options planning, so they'll rely on the work we do...it's a team effort."

Among advisors who charge hourly fees, or base their engagement fee on an hourly rate, Aiken and Berg are in the majority as to the actual rate used. Nearly half of all advisors relying on an hourly fee charge between \$150 and \$200 an hour. Of the remainder, approximately half charge less and half charge more, ranging from somewhere under \$150 to as much as \$300 per hour or more. Berg's fees are a blend of the rates applicable to the different personnel within his CPA firm that actually do the stock option analysis so, for less complicated cases, his average hourly fee might slip below the \$150-\$200 range since less-costly employees can be used to a greater degree than their more expensive counterparts. Berg's total engagement fee (time multiplied by hours) is also in the majority of those who charge flat fees per planning engagement, as nearly three-quarters of all respondents of this type say they charge \$1,500 and up.

Net Worth also asked its users about the average value of their clients' stock options. Surprisingly, even with the market correction that has taken place over the last 15 months, values were sometimes considerably above the highest level postulated in the survey, i.e., \$1.25 million. Twenty-nine percent of respondents reported the average worth of their clients' options to be more than this amount. Another 24% said clients' options ranged in value from \$750,000 to \$1.25 million. And the other half of the respondents fell more or less evenly in the \$500,000-to-\$750,000, \$250,000-to-\$500,000 and below \$250,000 groups.

This is reflected in the experience of those advisors we spoke with as well. Shake said the average pre-tax value of his clients' option holdings range from as little as \$500,000 to his highest of \$9.5 million. D'Orsi cited a range for his clients of \$600,000 to \$1 million. Aiken didn't offer specific values, but noted that there is a wide disparity in the experiences of their option-holding clients. In their area, they encounter clients with options in companies

like Walgreen, which have lost some value, Motorola, which has lost tremendous value and, on the other hand, healthcare or pharmaceutical companies, whose stock values may have done quite well over the last year.

The percentage of an advisor's clients holding options is also interesting to note. While not a question on the Net Worth survey, it is obviously a reflection of the overall makeup of an advisor's client base. For example, Aiken, who says 37% of Kabarec's clients are retired folks, estimates 15% of the overall client base is holding options. Shake reports that among their 47 family clients, about 30% hold options.

Also not questioned by the survey is the likelihood that stock option planning will lead to other work, thereby increasing the overall fee to the advisor. This perhaps most commonly applies to practitioners charging on an hourly basis since they start out with the most limited scope of engagement, and therefore have more potential to expand the scope. Berg reports that, as part of the options planning process, he requests prior-year tax returns from his clients to be able to observe the effect of past option exercises on their taxes. In doing so, he says "something's often wrong, to their benefit or not."

Berg finds he can extend his services in three different ways. First, clients are simply disorganized for tax purposes, and he can help them get their records in order. But perhaps more important, the opportunity to review prior year returns allows him to find mistakes requiring return amendments which can not only increase Berg's fee, but often put money back in the client's pocket. Last, he finds that clients who have already exercised options don't know the correct tax basis for each group they've exercised (probably due to that state of disorganization mentioned earlier), so Berg helps them straighten it all out.

It seems clear that there are as many different ways to charge for stock option planning as there are ways to charge for financial planning, in general, since one is usually a subset of the other. While the Net Worth survey doesn't necessarily point out advantages to one fee structure over another, it should be very helpful to StockOp-ter users in knowing *what* to

charge for this valuable service in the context of whatever fee structure they're already using.

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Building Your Practice through Employee Stock Option Planning: Protecting Your Client's Net Worth From a Stock Options Meltdown – Part 1 of 2

by Dr. Donald Moine

During the year 2000, holders of employee stock options (ESOs) and company stock lost an estimated \$1 trillion as their stock options and equity holdings rapidly declined in value. Such bellwether stocks as AT&T, Cisco, JDS Uniphase, Lucent, Micron, Nortel, Texas Instruments, Worldcom and hundreds of other stocks lost 50% or more of their value. Prominent Internet stocks such as CMGI, Amazon, Priceline, Yahoo and many others lost from 80% to over 95% of their value.

How Protective Option Strategies Work

Looking at an actual example of how to use protective option strategies illustrates the power and flexibility of this financial tool. XYZ Tech (XYZT) is a broadly diversified technology company and was one of the most admired corporations in America. Its market capitalization was well over \$100 billion and over one thousand of its employees had stock options. The name of the company is being changed here to protect confidentiality.

The stock of XYZ Tech had an established trading range of \$50 to \$70 during the previous year. For the sake of this example, assume your client, an employee of XYZT, had fully vested options, which allowed him to purchase 100,000 shares of XYZT at \$50 a share.

During the year 2000, XYZT began to decline in value. Negative articles on the company and its prospects were published in the *Wall Street Journal* and many other publications. Analysts downgraded the stock. In addition, the entire stock market

began to decline. Hundreds of employees of XYZT wondered what they could do to preserve the value of the stock options they had worked so many years to earn. Your client came to you seeking help.

For several dollars per share, you were able to buy protective puts on your client's stock options. With the stock at \$60 per share, you and your client decided to buy \$50 puts going out for nine months. The puts gave your client the right to sell his stock at any time during those nine months at a guaranteed price of \$50 per share—even if the stock price crashed. Using another example, if you had purchased nine month protective puts on Priceline.com with a strike price of \$90 a share, you (or your client) would be guaranteed to receive \$90 a share for Priceline stock even though the stock fell to less than \$3 a share during that time period! If your client had 10,000 shares of stock, these protective puts could have saved him or her approximately \$870,000. That is \$870,000 that you would now have as assets under management. If your client wants longer term protection, a number of publicly traded companies now offer LEAP put options going out up to 30 months.

Returning to our example, as the price of XYZT declined, the stock options owned by employees rapidly lost value. However, your client's protective puts soared in value. Your client was able to completely maintain his net worth, minus the cost of the options. The stock of XYZT quickly dropped to below \$50 a share, making the options of many employees worthless. Your client was one of only a handful of executives who had utilized POS and who were relatively unharmed by this decline in the stock's price. In addition, you showed one of your other clients how to purchase \$70 put options and his net worth actually increased throughout the entire year even as the stock fell in value. This is because he was guaranteed the right to sell all of his stock at \$70 per share.

You also showed your clients how to sell calls on their stock and their vested options. A call option gives someone else the right to buy the stock from you for a certain period of time at a given stock price. For example, you showed one of your clients how to sell nine month \$75 call options on XYZT stock (or vested options) to collect \$5 per share. You did this for 10,000 shares of his stock, helping your client collect \$50,000 (minus commissions). You then used this money to buy

the above referenced protective puts at \$50 per share. You were thus able to use the premiums collected from the sale of these call options to finance the cost of the protective put options, a strategy known as a cashless collar. To your clients, it seemed like magic. Your clients were able to protect and preserve \$600,000 of their personal net worth at almost no cost. You created clients for life.

Best Case and Worst Case Scenarios

Let's examine best-case and worst-case scenarios using cashless collars with XYZT stock starting out at \$60 a share. You sell \$75 nine-month call options for \$5 a share and use the proceeds to buy \$50 nine month put options at the same price. In the worst case scenario, XYZT falls to \$20 a share. Instead of losing 2/3 of the value of his stock or options (which hundreds of other XYZT employees did), your client was able to sell his stock at \$50 per share because you had the foresight to buy the protective puts. If your client's options had vested at \$30 per share, he was able to lock in a guaranteed profit of \$20 per share thanks to your expertise. Hundreds of other employees of XYZT saw their hard earned stock options become worthless.

In a best-case scenario, the stock could have gone up to \$75 or more. In this case, your client would have gotten called out at that price and would have locked in a guaranteed 150% profit from the \$30 a share vesting price. This is also a 25% profit from the \$60 price of the stock at the time you put on the collar. Twenty-five percent additional profit is a very respectable return for a nine month holding period. Of course, you can make the holding period longer or shorter, depending on your client's needs and wishes. This additional return is all due to your expertise.

To summarize, by using this cashless collar, you helped your client either lock in a substantial gain or you helped him limit losses. If the stock stays flat or trades between \$50 and \$75 a share, your client was able to protect his or her net worth at almost no cost. In the world of investments and compensation, it doesn't get much better than that. If more financial planners and stockbrokers had known how to use collars, hundreds of billions of dollars of net worth could have been preserved this past year.

Educating Your Clients About Collars

Quite frankly, once the benefits of cashless collars are explained to clients, you don't have to do much persuading.

The biggest problem I have seen with financial planners and brokers is that they sometimes overcomplicate collars and in doing so, scare their clients. Remember that millions of average Americans go to financial planners for tasks as simple as picking mutual funds. They are easily overwhelmed by more sophisticated financial concepts. Don't lose business by rapidly overwhelming your clients with too many details about cashless collars. Share details at the appropriate time. Be respectful of your clients' level of expertise and use terms they can understand and feel comfortable with, as I illustrate below.

Ask your client how much his or her home is worth. Write that number down. Ask how much all the cars they own are worth. Write that down. Now, ask how much their stock options and company stock are worth. Write that number down. In many cases you will find that the stock options and company stock are worth more than the home and the cars put together.

Now, ask your client if he or she would like to get free homeowner's insurance. They will invariably say, "Yes." Then ask if he or she would like free automobile insurance. Again, you will hear an enthusiastic "Yes." Then ask if they would like free insurance to protect the value of their stock options and company stock. You may get a quizzical look. Your client might say, "I did not know you could insure the value of company stock or stock options." Now, tell your client, "I can't help you get free insurance on your \$300,000 home or on your \$50,000 worth of automobiles, but I can help you get nearly free insurance to protect the value of your \$1 million in stock options and company stock." With this introduction, I guarantee you that you will have a rapt audience.

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Part two of this article will appear in the next edition of *The Planner*.

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StockOpter tip of the month: Using StockOpter to Market Employee Stock Option Planning Services

Q: How can I use StockOpter to market my services to clients with employee stock options?

A: Using StockOpter as a marketing tool to attract new client prospects requires a minimum time investment from both the prospect and the financial advisor. The objective of the advisor is to develop a couple of

projections, not to do a full plan.

If you can obtain some basic option data, you can sit down with a prospect and illustrate the benefits of diversification and how to create an optimized strategy in a couple of minutes. By showing the prospect his or her total portfolio values using diversification and price sensitivity analysis, there is a high probability they will be convinced of their need for your services. Consider the following steps, but remember that you are not doing a full plan for the prospect:

1. Gather from the prospect enough info to roughly complete the Assumptions worksheet and input these into StockOpter. Use a client-specified growth rate for the underlying stock, but try to manage expectations to a reasonable return.

2. Obtain a copy of the client's current grant summary report and enter all or most of them into the Base Case worksheet.

3. Using the Strategies wizard, choose the "Exercise as late as possible (ALAP) then hold forever" strategy for the Base Case.

4. Create a second case sheet using the same strategy, but change the stock price to flat growth. (Use the initial stock price in all 15 years.)

5. From the Base Case, create a third case sheet with blank values and exercise and sell at least 20% of the available options each year without letting any expire. (You may want to optimize this diversified strategy for taxes.)

6. Create a fourth and final case sheet using the same diversification strategy and change the stock price to flat growth.

With steps 1 to 6 completed, you can now simply use StockOpter's Total Portfolio Value chart to illustrate the convincing evidence. Prospects will be able to see firsthand how diversification can help minimize the risk of a concentrated stock position. They can also better understand the importance of goal setting and how developing a strategy today maximizes their probability of meeting those goals in the future. In the end, you will establish yourself as an expert on employee stock options and can obtain a new client without having to develop a full plan.

What's New at Net Worth Strategies, Inc.

The past two months have seen several changes at Net Worth Strategies, Inc. which we believe will interest you.

New services: Net Worth Strategies kicked off a new financial advisory service called the **Net Worth Resource Center**, an employee stock option consultation

service designed to augment the planning skills of StockOpter users. The Resource Center is designed to provide support for complex employee stock option planning situations where users need some expert support to serve clients more quickly and effectively. In addition, the Resource Center can help review casework and make suggestions for improvement, or by developing alternative strategies to meet specific client objectives. For more information about our stock option consultation services, please review a detailed description on our web site at: www.StockOpter.com/StockOpter/docs/consulting.asp

New products: Soon to be introduced, **StockOpter 2.5**, is the new version of our employee stock option planning software. It will give financial advisors the ability to plot historical stock and index performance and apply the data to client situations. StockOpter 2.5 will also provide advisors with a diversification illustration and strategy tool and the ability to model multiple exercises within the same year. For more information about StockOpter 2.5, visit: www.StockOpter.com

MRD-Determinator 2.0 is available now and enables financial advisors to develop tax-efficient strategies for the inter-generational transfer of retirement assets under the new proposed IRS regulations for minimum required distributions (MRDs). For more information about MRD-Determinator 2.0, please visit: www.MRD-Determinator.com

New prices: Net Worth Strategies will increase prices on its products and training upon the release of StockOpter 2.5 in the next several weeks. Although prices are going up, you can still purchase StockOpter, StockOpter Training, and MRD-Determinator NOW and save. Register for stock option planning classes at the current low price and attend any of the currently scheduled sessions. For the current class schedule and prices visit: www.StockOpter.com/StockOpter/seminars.asp



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