



**IDAHO**  
DEPARTMENT OF FINANCE

C.L. "BUTCH" OTTER  
Governor

GAVIN M. GEE  
Director

November 4, 2009

Re: ("the Firm")

Dear M

This is in response to your September 24, 2009 request for an interpretive opinion from this Department regarding the Firm's proposed fee structure for the Firm's vested employee stock option service ("VESOS"). It is our understanding that the Firm intends to offer its VESOS in compliance with the Securities and Exchange Commission Release No. 34-60127 ("SEC Release".)

**Fee Structure**

Based on the information submitted in your initial request as well as the supplemental information provided, it appears that the proposed fee structure would be considered a performance fee. Performance fees are only permitted if the Firm adheres to the provisions set forth in 17 CFR 275.205-3 under the '40 Act. As an alternative to the performance based fee, you may wish to research whether a tiered assets under management fee would be compatible with your proposed service.

Please be advised that this interpretive opinion is based solely on the information you provided and your representation of the facts, and any different facts or circumstances might require a differing conclusion. Moreover, this letter only expresses the Department's position on the enforcement action and does not purport to express any legal conclusion regarding the applicability of the statutory or regulatory provisions of the Idaho Uniform Securities Act.

If you have questions or comments regarding this matter, please contact the undersigned.

Sincerely,

Nancy C. Ax  
Securities Analyst

**SECURITIES BUREAU**

Bureau Chief - Marilyn T. Chastain  
800 Park Blvd, Suite 200, Boise, ID 83712  
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STATE OF IDAHO  
PT OF FINANCE

Idaho Department of Finance  
P.O. Box 83720  
Boise, ID 83720

To Whom It May Concern:

Please find the enclosed check written out to the Idaho Department of Finance. We are requesting an opinion in regards to our proposed compensation for services rendered to clients by our Investment Advisory service.

is a company currently in the process of registering as an investment advisory firm in the State of Idaho. The individuals at the firm acting as Investment Advisor Representatives for the company are and .

Our firm will be providing two types of services; the first is very straight forward, the second is more complicated. First, we will be managing client accounts, given discretionary authority, and deriving our fee based on a percentage of assets under management (probably 1.5%).

The second (and primary) service our firm will offer is working with employees who hold vested employee stock options. As the service can be moderately complicated, we thought it appropriate to include an explanation of how the process will work; the explanation is included as follows:

Recently, the SEC made a change to the rule dealing with margin requirements on short call option positions, the rule can be found in 12 CFR 220.12 (f)(1). This rule affects the tens of thousands of employees nationwide who work for publicly traded companies and are given stock options as part of an overall compensation package.

Commonly, these vested options are underwater and not worth anything to the employee, or help by the employee in anticipation of an increase in the company stock price. Our company will work with these employees to generate monthly income at no cost to the employee. Employees can make consistent, in many cases monthly, income without (in most cases) having to give up their vested options. Our firm can work with these employers and help them generate consistent income without the employees having to invest any money for management of our firm.

will help employees capture the time/extrinsic value of their vested options on the open options market. Clients using for this service will not invest any money with when using this service. The underlying assets are the vested stock options; will not be managing these clients' actual funds.

Short calls will be sold and managed according to clients stated objectives. However, at no time will short calls be sold at a price below the vested options the employee holds. For example, the employee holds vested employee stock options at \$10, will only sell short positions at a strike price of \$10 or higher. This will mitigate any risk of clients having to take a loss or being required to bring in funds to cover a loss.

Clients have the option of using to manage their assets, but such assets will be put in a completely separate account and fees will be taken based off a percentage of assets.

The fee structure is the issue for which we are asking an opinion. There is no known process similar to what we are proposing for which would can model our fees off of. A percentage of assets under management would not work because these clients would not be giving our firm any money whatsoever for us to begin trading. They would be giving us the right to use his/her vested options in order to generate income. The employee may never have to give up their options; in fact these vested options would continue to be held by the employer designated captive broker so that nothing would need to even change hands.

A percentage of assets under management would only work if we were to go out onto the open market, determine the total value of the options the employee has vested, and then asses a charge based on that amount. For instance, a employee "John Smith" has 10,000 vested options with an exercise price of \$8 that expire in four years. Mr. Smith decides to sign up with our firm and provides a statement showing exactly what options he has vested.

The issue we run into is that while employee options many times are vested with 5+ years to expiration, the open market sells options with 2 years maximum expiration. The prices assessed might be excessive, also it would be very difficult to collect from each client due to the fact that no money comes into the account outside of the premium we are able to generate selling near month call options.

Our proposal is for our firm to charge a percentage of the funds under management on a monthly basis to cover both our operating expenses and generate a profit.

For instance, Mr. Smith signs over authority for us to trade using his vested stock options. We are able to generate \$1000 in the first month. A check from the custodian would be mailed to Mr. Smith in the amount of \$667, while our firm would receive \$333. In effect, we would be taking 33% of assets under management on a monthly basis.

We understand that this could be interpreted as a performance fee. Performance fees are restricted in order to discourage investment advisors from taking large risk, not in the best interests of their client, in order to hit it big on a trade and make large profits while taking on excessive risk. With the process we are proposing this would not be possible.

The only way we expose clients to the possibility of risk is if we were to sell a call with a strike price below the exercise price of his/her vested options. For instance, if for Mr. Smith, who holds vested options at \$9.00, we were to sell \$8.00 calls in order to increase revenue there would be a significant risk. If the price of stock were to finish above \$8.00, the employee would be forced to buy MU stock at market value if it is between \$8-\$9 and then sell it at \$8. The maximum risk is \$1 per share, or \$10,000 if there were 100 contracts sold. In order to eliminate risk of a loss, we would only sell calls at a strike price at or above that of the vested options held by the employee. In Mr. Smith's case, if we were to sell the \$9 call and the price of the stock were to finish above \$9, the vested option can be exercised at \$9, and the stock can then be sold at that same price. The profit would be the amount of premium received in the sale of the current month call.

The agreement we are in the process of working out with a broker would not allow for us to ever sell strike prices below the vested price, and our own agreement with clients would be structured in order to spell out those same terms.

Clients would not be asked to pay our firm from any personal funds; fees would be collected directly from the client accounts and all funds in client accounts will be distributed at the end of every month by the custodian. Each client account would show a \$0 balance at the start of each period. No client funds will be managed; trades will be made using the vested employee stock options only.

We feel that this fee structure is the only way to fairly compensate both our firm as well as clients. We are able to be paid for the large amount of time and effort required to maximize the amount of income each client will receive and clients are able to generate income off what would otherwise be a non-performing asset.

Clients would be free to discontinue with our services at any time with 30 days notice. And could take back options should the price of the company stock increase significantly and the employee be inclined to sell off the options and no longer use them to generate income.

Please advise us on your opinion as to the appropriateness of such fees. We want to make sure we are able to serve clients in the best way possible while always staying in compliance with applicable regulation.

Feel free to contact me with any questions or if additional information is needed. We appreciate your time and hope to hear a response soon.

Sincerely,



**IDAHO**  
DEPARTMENT OF FINANCE

C.L. "BUTCH" OTTER  
Governor

GAVIN M. GEE  
Director

October 1, 2009

Re: ("the Firm")

Dear M

We are writing to request additional information in connection with your September 18, 2009 request for an opinion from this Department regarding a proposed fee structure for the Firm's vested employee stock option service. We are seeking additional information relating to the services the Firm intends to provide in connection with its proposed fee. We are also unsure how the Firm's proposed option call writing service will interact with the Securities and Exchange Commission's recent rule change detailed in Release 34-60127 ("SEC Release").

**Background**

Your letter indicates that the Firm intends to offer a service to employees of publicly traded companies that have been issued vested employee options. The Firm is developing this service in response to the SEC Release. In general, for purposes of margin rules, writing calls without the underlying collateral would be deemed "naked." "Naked" transactions required a deposit of cash margin. The SEC Release modifies margin requirements to allow account holders to use vested and currently exercisable vested employee options issued by publicly traded companies as collateral for writing call options that have the same underlying security as the vested employee options.

**Fee Structure**

According to your letter, the Firm will work with employees holding vested options to generate monthly income at no cost to the employee by writing call options that have the same underlying security as the employee's vested options. The employee will authorize the Firm to trade using his vested stock options. The vested options will be held by the employer's designated captive broker. The Firm wishes to charge a monthly fee of 33% on all premium income that is collected.

**SECURITIES BUREAU**

Bureau Chief - Marilyn T. Chastain  
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Mail To: P.O. Box 83720, Boise ID 83720-0031  
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Typically, investment advisor fees in excess of 3% are considered excessive and generally require additional disclosure relating to the services offered by the Firm in justification for such fees. Moreover, based on the information provided, it appears that the proposed fee structure would be considered a performance fee. Performance fees are only permitted if the Firm adheres to the provisions set forth in 17 CFR 275.205-3 under the '40 Act.

In order to complete our review, please provide our Department with a detailed explanation of the services to be provided by the Firm in connection with the Firm's proposed call writing service. Please indicate if the Firm's fee includes broker-dealer fees that will be charged in order to execute the proposed transactions. Please provide any proposed agreements the Firm has with the broker-dealer or the custodian.

### **SEC Release**

Based on the information set forth in your letter, the Department is uncertain how the Firm's proposed service will interact with the requirements set forth in the SEC Release. In order to avoid the typical margin requirements, the SEC Release sets forth several requirements. One of these requires the account holder to pledge the vested employee options to the broker-dealer and provide the broker-dealer with an irrevocable power-of-attorney authorizing the broker-dealer to exercise the vested employee options on the account holder's behalf if the listed call options are assigned or if the broker-dealer determines it is necessary. Given this requirement, it is not clear to us how the Firm's service that involves a client authorizing the Firm to trade the client's vested stock options will work within the parameters of the SEC Release.

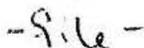
Moreover, it appears that the transactions governed by the SEC Release require an agreement between an account holder, the broker-dealer, and the Issuer that must be approved by the International Securities Exchange, LLC. I have enclosed a copy of the SEC Release to assist you in formulating your response.

Please provide additional information demonstrating how the Firm's proposed strategy will work in conjunction with the SEC Release. If the Firm has obtained a legal opinion relating to its proposed activities, please provide. Also, include any proposed agreements that have been approved by the International Securities Exchange, LLC and identify the broker-dealer that the Firm is working with in connection with its proposed activities.

### **Summary**

We request the above information no later than October 23, 2009. If you have questions or comments regarding this matter, please contact the undersigned.

Sincerely,



Nancy C. Ax  
Securities Analyst

enclosure