Changing of the Guard

Single-family offices are undergoing drastic remodeling to emerge in the image of the younger generations who now control them.

July 2009

Rothstein Kass

July 2009

Rothstein Kass

Throughout history, societies have exhibited a preoccupation with its wealthiest members. This is especially true of thriving capitalist cultures, where wealth creation becomes a competitive endeavor. In the United States, there exists a strong fascination with the ultra-wealthy, many of whom have attained near-celebrity status. Many Americans aspire to a lavish lifestyle and emulate the behaviors and habits of those that achieved these goals. However, the mistaken impression that money can cure all ills generates little understanding of the multitude of challenges that wealthy families encounter. Like most Americans, wealthy individuals are focused on family, health and career. The complexity of advanced planning requirements distinguishes the ultra-wealthy from other segments of the population and has made servicing this community an arduous – but profitable – undertaking.

Advisors to the ultra-wealthy have long recognized that there is a difference between a life of luxury and one of leisure. While the affluent are undeniably focused on enjoying the benefits of their wealth, exactly what this entails is highly subjective. For most, finding the right balance among wealth management, philanthropic, lifestyle and administrative initiatives can be a daunting task. Applying a cohesive approach to these functions has typically involved a level of oversight more commonly associated with mid-sized corporations. Because of the personalized attention, customized product offerings and overall quality of core asset allocation services, the single family office emerged as the preferred advisory services model. Concentrating on the lucrative asset allocation portion of the business, single family offices typically enjoyed positions as trusted advisors to the high-net-worth community.

More recently, as noted in an earlier Rothstein Kass research report (“The Multifamily Office Solution”), the desire to share resources after most families have seen a decline in assets has emphasized the need to reevaluate advanced planning tel strategies andd eifeageifilc”/cahdkk/RYee'T/RlSYee'T/RgShkheh/cahgdcf'T/lYdahhhhih'TRsS'T/RtS'T/c'T/ackdklcld'TRtS'T/c'TeakeYdd'T/RsSY'T/RlScee'T/Rg

Key Themes

- A new generation of leadership is initiating significant structural and philosophical changes to the single-family office model

- Most single-family offices are concentrating efforts and resources on the core investment functions

- Internal control of administrative, advanced planning and lifestyle services are viewed as ancillary to the new generation of leaders at single-family offices and these functions are increasingly outsourced to third-party specialists. The majority of internal personnel and vendor relationships are evaluated as part of the shifting goals and are generally replaced as part of the transition

- Very little loyalty is shown in assessing professional relationships with law firms and banks, that stand to lose business to competitors that are better aligned with the vision of the new generation of leadership

- Back-office service providers are the least likely to change when new generations assume responsibility for single-family offices

- Second generation family members report that generational transition will bring a new level of professionalism and efficiency to single-family office organizations that may have operated in a less formal fashion under previous generations

About the Research

The business of private wealth management is at a critical juncture in its evolution. Our earlier research, “The Multifamily Office Solution,” revealed that as the choices for family office-style services has proliferated, many families are choosing to join forces with another family or merge their operations into a multi-family office to pool resources and streamline costs. Commercial entities, such as brokerages, private banks and independent advisory firms, are also forming family office units to compete for the lucrative business of wealthy families by delivering a broad array of capabilities with personalized attention.

In contrast, the expense and oversight required to successfully maintain a single-family office have rendered it a structure that appeals only to the wealthiest and most dedicated of families. As the management and control of an office passes to a younger generation, it’s common for new leadership to reassess many of the organization’s strategic elements against a new measurement criteria, a necessary process that can lead to difficult and transformational decisions. For many, the single-family offices that remain will bear little resemblance—in focus or in personnel—to the operations that their parents established.

Exhibit 1: 94 SFOs surveyed after transition

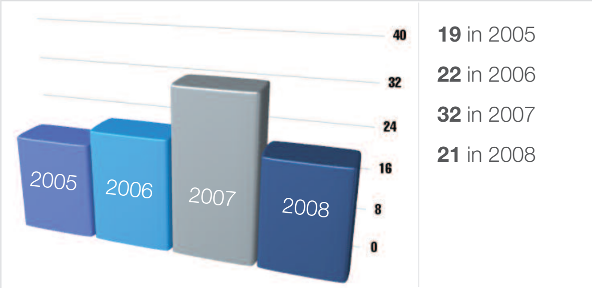


Exhibit 2: AUM at the time of transition

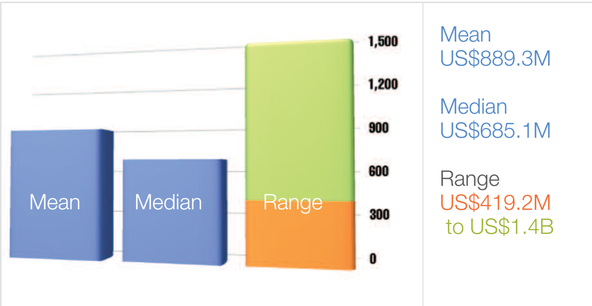
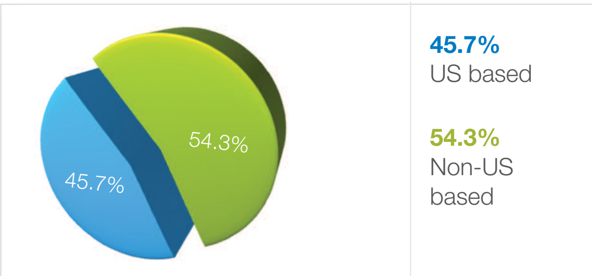


Exhibit 3: Geography



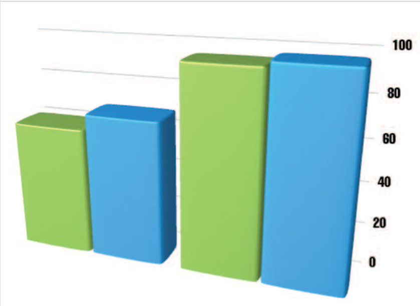
Over the course of four years, we spoke with single-family offices that had transitioned effective control from one generation to another, in an effort to understand the implications of a leadership change on these organizations. During that time we conducted in-depth interviews with nearly 100 global family offices that are now controlled by the second generation of wealth. The offices in our study had average total assets of nearly US$900 million and median assets of US$685 million.

Survey results showed that younger generations had plans to initiate pervasive changes in the office after their ownership transition was completed. These transformations generally transpired within six months from the advent of the new management.

Intensifying the Investment Focus

Investment management has long been the central focus of most family office structures, and new leadership has reinforced this by increasing the resources dedicated to managing the pooled family assets. Oversight of the investment process has become an even greater priority, as recent performance returns have disappointed, on both an absolute and relative basis, leading to a greater degree of skepticism toward the investment management process.

Exhibit 4: Providing Investment Services



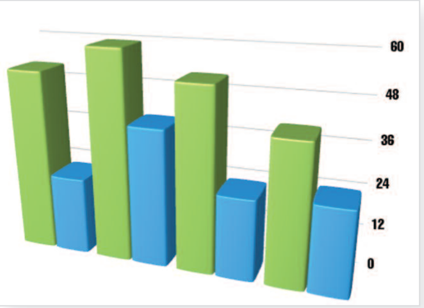
Before Transition	After Transition
Internal investment management	
60.6%	68.1%
Outsourced investment management	
94.7%	96.8%

"Wealthy families have always exhibited a strong interest in investment management aspects of the family office because they recognized that these activities provide the foundation to preserve the benefits of wealth, from lifestyle and recreational interests to charitable involvement. Careful planning can also allow for substantial generational transfer of wealth," said Rick Flynn, a principal in the Rothstein Kass Family Office Group. "The next generation is taking the reins at a time when confidence has been shaken by market volatility and scams targeting the ultra-wealthy. They are demanding a greater degree of transparency and control, looking beyond quarterly statements to understand how returns are derived. While this approach will serve the community well, investors should resist the temptation to chase short-term returns while marginalizing the expertise of the professionals that have been retained to pursue long-term investment objectives."

When push comes to shove, services that are perceived as secondary or tertiary to the primary goal of investment management are restricted. The principal in-house administrative and advanced planning services provided by single-family offices were slashed by the organizations in our survey as they coped with the sometimes divergent goals of managing expenses, meeting investment goals and aligning resources.

The statistical findings that follow reflect the percentage of respondents that indicate that they offer these services through internal capability. It's important to note that administrative services and advanced planning are still a critical part of an ultra-wealthy family's overall financial needs and specific services are often offered through third-party providers on an as-needed basis.

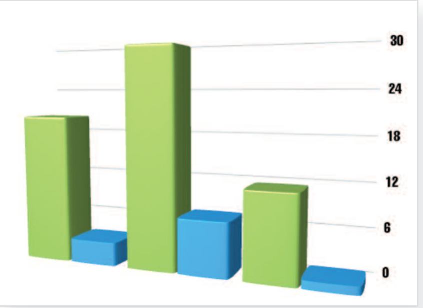
Exhibit 5: Providing Administrative Services



Before Transition	After Transition
Coordination or preparation of tax returns	
52.1%	22.3%
Data aggregation	
59.6%	39.4%
Personal bookkeeping	
52.1%	23.4%
Bill paying	
40.4%	24.5%

"Outsourcing non-critical administrative functions is a growing practice because if executed properly, this tactic benefits both high-net-worth families and the family offices that serve them. Single-family offices are able to offer a wider range of secondary options, while streamlining operations to concentrate on higher-margin investment management functions," said Mark Hutchison, a tax principal in Rothstein Kass' Beverly Hills office.

Exhibit 6: Providing Advanced Planning Services



Before Transition	After Transition
Wealth enhancement	
20.2%	3.2%
Wealth transfer	
29.8%	7.4%
Asset protection	
11.7%	1.1%

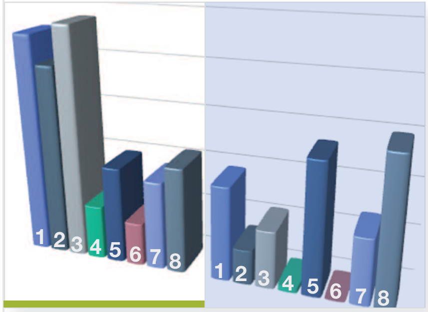
"Given the relative age and career stage of the new leadership generation at SFOs, we expected to see some decline in the scope of advanced planning services offered. The individuals that have assumed management control are typically much younger and tend to place more emphasis on wealth creation and lifestyle concerns. Many of these younger individuals also view estate planning as a difficult subject to broach and a task that can be deferred until later in life," said Alan Kufeld, a tax principal in the Rothstein Kass Family Office Group. "The use of outsourced providers can partially account for the steep after-transition decline. However, the numbers also indicate that these many individuals remain unaware of the tax advantages of long-term planning. Thorough and regular evaluation often provides immediate tax benefits, while asset protection plans help to guard against a wide range of threats to the estate."

Lifestyle needs, which tend to be more personal in nature, have also moved outside the centralized structure of the single-family office. This decision allows family members to pursue only those that are of interest to them at their own expense, further streamlining the operations and expenses of the advisory organization.

Two lifestyle services have, however, grown in relevance during the same time–security and healthcare. The interest in security is consistent with trends seen among other segments of the affluent population. Engaging a security consultant to help a family assess its risks, put crisis response plans in place, and design an overall security program is now in place in roughly half of single-family offices. This area also shows signs of continued expansion as wealthy individuals protect their family security as well as their financial assets.

Likewise, emergency healthcare is often coordinated as part of a broader security initiative and has grown commensurately. This is especially important among families with business interests and real estate in more than one country requiring family members to travel regularly and risk exposure to unexpected physical dangers in locations without immediate access to high quality medical care.

Exhibit 7:
Providing Lifestyle Services



Before Transition | After Transition

1. Philanthropic advisory
81.9% 35.1%

2. Formal family education
71.3% 12.8%

3. Concierge services
86.2% 21.3%

4. Assistance in growing and managing a collection
20.2% 2.1%

5. Family security
36.2% 48.9%

6. Luxury acquisition
16.0% 0.0%

7. Managing residences. Jets, helicopters and mega-yachts
33.0% 24.5%

8. Overseeing emergency and dramatic healthcare needs
39.4% 54.3%

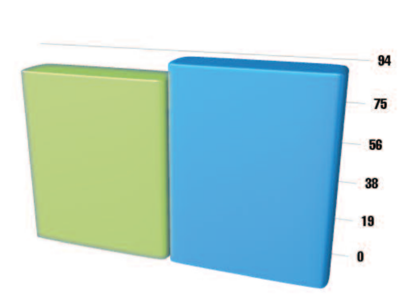
"Global economic uncertainty has increased the risk of international travel, increasing the demand for kidnap and ransom insurance as part of a comprehensive security services program. Placing responsibility for family security with a single family office shows the level of trust that these advisors have earned from their clients. The increasing demand for in-house security-related capabilities suggests a potential area for industry growth in the years ahead, but falls outside the industry's core asset management experience," said Mr. Flynn. "For a small group of firms structured as celebrity family offices, family security is frequently a central component to the relationship."

Out With the Old…

Streamlining the operational focus of a single-family office can rarely be achieved without making changes to the professionals, both internal and external, who oversee the related functions. As such, the younger generations who are now at the helms of their single-family offices are instituting personnel changes they believe will better reflect their priorities and enable them to reach their goals.

This shift in thinking is clearly exemplified in the recruitment of new senior managers to fill the crucial roles that ensure a family office's day-to-day activities match its long-term agenda. In 86 percent of cases the office's executive director was replaced shortly after a management transition, and 93 percent of single-family offices brought in a new investment professional to orchestrate all its interrelated financial activities.

Exhibit 8:
Changes in Key Personnel After Transition

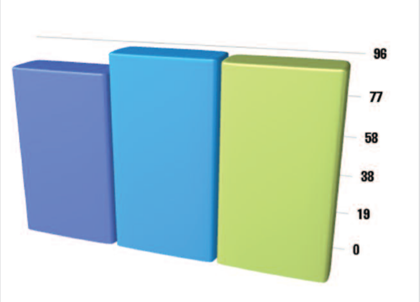


Executive Director	86.2%
Chief Investment Officer	93.6%

"When generational change has arrived at the single family office, it has typically been fast and far-reaching. Even long track records and proven returns have not shielded the vast majority of executive directors and CIO-level personnel against the forces of change. While this is creating opportunity for many dynamic firms to serve as trusted advisors to the next generation of wealth, the options for old-guard firms are less promising," said Mr. Flynn. "Some will continue to work with the parents or serve in a diminished advisory capacity."

Not surprisingly, the offices in our study had an equally high level of turnover among the array of vendors servicing their assets. Approximately nine in 10 offices released either the investment, accounting, legal and/or banking professionals of their parents and grandparents to seek new counterparts of their own choosing. The reasons behind this all-encompassing change include a desire to access state-of-the-art strategies and techniques and benefit from more aggressive and competitive pricing. Moreover, new leadership is seeking to avoid difficulties stemming from historical relationships and ideals, while cultivating loyalty with a new generation of providers.

Exhibit 9: Changes in Key Vendors After the Transition



Investment managers	86.2%
Accounting firms	95.7%
Consultants on the family dynamics and related issues	94.7%

N = 94 SFOs

"The high-rate of post-transition turnover among investment managers and accounting firms demonstrates that the new generation is acutely aware of the disparity in the scope and quality of services offered by competing firms. Recent market volatility will support the continuation of this trend as declining net worth and poor relative performance have compelled many families to reassess these relationships," said Mark Murphy, president and chief executive officer of Northeast Private Client Group. "Once a suitable provider has been selected, regular review is imperative, but continuity is the key. Constantly switching providers to chase the hot strategy can lead to a significant departure from stated objectives over time."

Exhibit 10: Changes in Attorneys Used After the Transition

Private client attorneys 89.5%

N = 51 SFOs

Business attorneys 96.9%

N = 62 SFOs

Exhibit 11: Changes in Banking Relationships After the Transition

Commercial bankers 86.2%

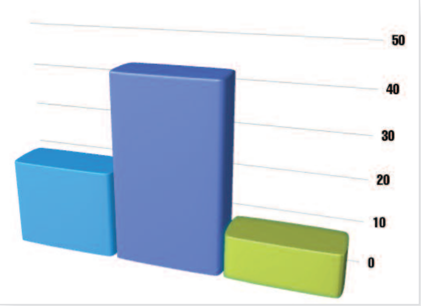
N = 94 SFOs

Private bankers 91.2%

N = 34 SFOs

"The emerging leaders of SFO structures are typically better educated and more focused on relationship building initiatives than their predecessors. Most have developed extensive networks of business contacts. Many of their peers represent the next wave of financial services industry visionaries, who will shape the future of capital markets. Second-generation single family offices are eager to access this expertise to stay abreast of innovation," said Mr. Hutchison.

Exhibit 12: Changes in Back-office Support After the Transition



Broker/dealers	20.4%
N = 58 SFOs	
Trust companies	43.4%
N = 53 SFOs	
Technology vendors	9.9%
N = 91 SFOs	

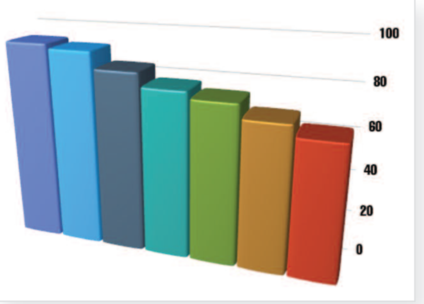
There were far fewer changes in back-office support among the family offices in our study due in part to the commodity-like nature of these services and the terms of existing contracts.

"Back office operations – particularly broker/dealers and technology vendors—are retained at a far greater rate than executive management or even professional services representatives. This is mainly because back-office support has been viewed as a commoditized function. Unless there was a problem, most high-net-worth individuals had little interest or understanding of these processes," said Mr. Flynn. "More recently, regulatory focus on counterparty risk management has elevated the importance of vendor management functions, requiring more diligent oversight by the SFO management."

… In With the New

The generation that established the 94 single-family offices in our survey was heavily influenced by the dynamics of World War II, global expansion and emigration. As a result, many of the offices were built around unique personal perspectives that remained unchanged for the duration of the patriarch's or matriarch's life. Younger generations have typically benefited from higher levels of education and financial success than their forbearers, and many of the changes discussed herein are an attempt to infuse that knowledge and experience into an operation that they believe will benefit from a more sophisticated approach.

Exhibit 13: Motivations for the Changes



Become more "business-oriented"	**93.6%**
Increase the professionalism of the family office	**91.5%**
Tap higher quality talent	**84.0%**
Reduce expenses	**77.7%**
Improve investment performance	**74.5%**
Improve the ability to mitigate taxes	**68.1%**
Improve operational efficiency	**62.8%**

"In an industry already known for its high standards of professionalism, it was surprising to learn that being more business-oriented rates as a more prevalent motivation for SFO transition than more tangible benefits such as reducing expenses and improving investment performance. This suggests that as the next generation looks to build its own legacy, they will do so with heightened emphasis on transparency and due diligence functions. Given the ambitious nature of this transition, missteps are inevitable. The advantages of a unified approach to wealth management and advanced planning justify these endeavors," said Mr. Flynn.

About the Authors

Russ Alan Prince is the world's leading authority on private wealth, the author of more than three dozen books on the topic, and a highly-sought counselor to families with significant global resources, and their advisors. He is co-author of *Inside the Family Office: Managing the Fortunes of the Exceptionally Wealthy.*

www.RussAlanPrince.com

Hannah Shaw Grove is a widely recognized author, columnist and speaker, and an expert on the mindset, behaviors, concerns, preferences and finances of high-net-worth individuals. She is co-author of *Inside the Family Office: Managing the Fortunes of the Exceptionally Wealthy.*

www.HSGrove.com

About the Contributors

Steven A. Kass is a Co-Managing Principal of Rothstein Kass as well as a member of the Firm's board of directors. Prior to his advancement to Co-Managing Principal, he provided accounting, audit, tax and consulting services to a diverse group of privately held and publicly traded businesses. Additionally, he was also extensively involved with advising clients within the Firm's Financial Services Group. A CPA, Mr. Kass is also the former chairman of AGN International Ltd., a worldwide association of separate and independent accounting and consulting firms in 80 countries.

Steven Kass can be contacted at:
917.438.3950 or skass@rkco.com

Richard J. Flynn is a Principal and the head of Rothstein Kass' Family Office Group. A lawyer and advanced planning specialist, he advises high-net-worth clients on wealth enhancement, wealth transfer and asset protection planning. His clients include hedge fund managers, business owners and other executives, professional athletes, and entertainers. He is co-author of *Fame & Fortune: Maximizing Celebrity Wealth*. He also contributed to the publication *Beyond Performance: How Hedge Funds Can Strengthen and Build Their Affluent Client Base.*

Rick Flynn can be contacted at:
917.438.3956 or rflynn@rkco.com

Mark Hutchison is a Tax Principal at Rothstein Kass. He specializes in entertainment industry taxation, real estate and personal financial planning for owners and executives of closely-held businesses. His experience covers a broad range of tax matters including federal taxation for service, production and distribution companies in the entertainment industry, mergers and acquisitions, multi-state income, public companies, income tax planning for pass-through entities and franchise tax matters. He also assists high-net-worth individuals with federal, state and local tax issues, as well as estate planning and representation before federal and state tax authorities.

Mark Hutchison can be contacted at:
310.887.5211 or mhutchison@rkco.com

Alan S. Kufeld, CPA, is a Tax Principal in the Family Office Group of Rothstein Kass. He specializes in providing income, trust, estate and gift tax planning, wealth preservation, and compliance for federal, state and local tax matters affecting high-net-worth individuals. His clients include hedge fund managers, multi-generational families and business owners.

Alan Kufeld can be contacted at:
917.438.3992 or akufeld@rkco.com

Mark B. Murphy is the President and Chief Executive Officer of Northeast Private Client Group, a national financial services and wealth management firm with advisory services offered through Park Avenue Securities. Mr. Murphy and his Northeast Private Client Group team provide strategic planning and financial services to closely held businesses, mid-size companies, celebrities, professional athletes, hedge fund managers and other high-net-worth individuals.

Mark Murphy can be contacted at:
mmurphy@northeastprivate.com
www.NortheastPrivate.com

Rothstein Kass Publications

Fame & Fortune: Maximizing Celebrity Wealth
By Russ Alan Prince, Hannah Shaw Grove and Richard J. Flynn

The first empirically valid analysis of celebrities available to the public, this primer will help high-profile individuals and their closest advisors understand how to protect, enhance and pass along their hard earned wealth.

Beyond Performance: How Hedge Funds Can Strengthen and Build Their Affluent Client Base
As competition in the hedge fund sector intensifies, it will be more important than ever for hedge fund professionals to zero in on the priorities and expectations of their client base. Authors Russ Alan Prince and Hannah Shaw Grove share the research they have conducted with wealthy individuals and families that invest regularly, and significantly, in hedge funds and funds-of-funds. Their findings will help hedge fund firms understand the most effective ways to reach, cultivate and retain high-net-worth investors.

Copies of publications are available upon request via www.rkco.com

About Rothstein Kass

Rothstein Kass is a premier Certified Public Accounting firm, recognized nationally as a top service provider to the alternative investment financial services industry. Rothstein Kass provides traditional audit and tax services, as well as strategic business counseling, family office, regulatory compliance and SEC advisory services, and insurance and risk management consulting.

The Rothstein Kass Family Office Group offers a wide range of financial, wealth planning and lifestyle management services to family offices and high-net-worth individuals, including family members, business owners and members of the financial services, entertainment and sports industries. Comprised of seasoned financial professionals and certified public accountants, the Family Office Group applies proven expertise with the utmost discretion and attention.

Rothstein Kass has offices in New York, New Jersey, California, Colorado, Texas and the Cayman Islands.

Rothstein Kass

1350 Avenue of the Americas
New York, NY 10019
212.997.0500
www.rkco.com

California • Colorado • New Jersey • New York • Texas • The Cayman Islands