The Compensation Variance

Competitive compensation is essential to attracting and retaining high-caliber, single-family office executive directors. Establishing an effective framework and selecting the right compensation model can help facilitate successful negotiations.

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The opportunities created by a truly global economy have led to sustained growth in the number and wealth of self-made, “super rich” individuals. In addition, these visionaries, innovators and entrepreneurs are wealthier – both on average and in aggregate – than previous generations. Increasingly, these individuals are gravitating to the single-family office model, fueling the proliferation of these operations in the United States and abroad. The appeal of the single-family office is its ability to provide multigenerational financial and lifestyle support within a cohesive long-term plan. This requires a centralized management structure. At the core of efficient operations often sits the single-family office executive director.

Working with wealthy populations can be exhilarating and rewarding but can also be demanding. Most executive directors would agree that the role is seldom defined by the title. Some single-family offices are run like corporations, while others require a greater degree of personal commitment. From concierge health care to family security, single-family offices are being asked to provide an ever-expanding array of services and support. Because the goals and resources of every family are distinctive, each single-family office is unique as well.

Finding an executive director with the right blend of skills, experience and temperament to thrive in the role can be overwhelming by itself. With so much at stake, figuring out how to appropriately and fairly compensate this individual can seem nearly impossible. Meanwhile, demand for qualified candidates from new and existing single-family offices is increasing even as multifamily offices are drawing from the talent pool. Alternative investment firm interest in qualified candidates further complicates the competitive landscape.

For the past five years, we have chronicled the evolution of the single-family office space in a series of research reports highlighting emerging trends. Our latest effort examines what is often one of the most contentious aspects of maintaining a single-family office – executive director compensation.

As some wealthy families have learned, establishing a framework for transparent negotiations and selecting the right model can take the pain out of the process. This report also outlines a basic approach that has facilitated negotiations for a number of highly successful family office operations.

We hope that you will find this report engaging and informative. If you would like to discuss findings in greater detail, we encourage you to contact us directly.

Sincerely,
Richard J. Flynn

Principal and Head of the Family Office Group
Rothstein Kass

It is clear that competitive compensation is essential to attracting and retaining capable executive directors.

In negotiations, these candidates are seeking compensation for a range of specialized skills and experience that they bring to the position. Absolutely critical to their career development and in order to be provided with and capitalize on significant financial and professional opportunities, executive directors must meet the following three criteria:

- Criterion No. 1: Develop a Deep Understanding of the Needs and Wants of the Family.
- Criterion No. 2: Deliver Astounding Verifiable Results.
- Criterion No. 3: Communicate the Value Delivered to the Exceptionally Wealthy Family.

The proliferation of the model has supported widely varying definitions of what a single-family office operation encompasses. For the purposes of this report, we consider a single-family office to be an organizational structure that manages the financial and personal affairs of one wealthy family. Within this framework, single-family offices generally provide two principal categories of expertise —wealth management and support services (Graphic 1).

Note: To date, the actual number of single-family offices in operation is impossible to specifically quantify. Due to this sampling restriction, we make no claims as to the representativeness of this research sample to the single-family universe at large. We recommend you consider the research findings as suggestive and directional only.

Key Themes

- The proliferation of single-family offices and competition from other financial services firms are increasing demand for qualified executive directors.

- Because single-family offices vary greatly in their scope of operations and objectives, candidates represent a diverse range of professional experience.

- Variations between single-family office structures make comparative compensation analysis more challenging.

- Executive director compensation packages follow two basic approaches—participant and employee. In a participant model, executive directors receive "a piece of the action" as part of overall compensation, greatly enhancing earnings potential.

- Though each negotiation and the surrounding circumstances are unique, there is an established framework for successful negotiations.

"The relationship between the executive director and the single-family office client is often a complicated one. The level of trust that is required in an efficient family office can make the executive director seem nearly indispensable. At the same time, the executive director may develop a close bond or a sense of duty toward the family, making it more difficult to engage in conversations about compensation," said Rick Flynn, a principal and head of the Family Office Group at Rothstein Kass. "In reality, regular and disciplined review of the compensation structure is usually in the best interests of both parties. It offers needed transparency into the scope and cost of services being provided to arrive at a reasonable and sustainable package. The continuity that this allows can be invaluable to the wealthy family."

Graphic 1:
The Array of Family Office Services

Investment Management

Traditional asset management
- Asset allocation
- Manager selection
- In-house investments

Alternative investments
- Hedge funds
- Private equity

Administrative
Data aggregation
Bill paying
Tax preparation or coordination
Acting as the day-to-day CFO

Advanced Planning
Estate planning
Asset protection planning
Wealth enhancement strategies

Private Investment Banking
Buying and selling interests in businesses and other assets

Capital raising
- Sourcing bank loans
- Sourcing investors

Lifestyle
Family security
Concierge services
Medical concierge
Philanthropic advisory
Formal family education
Managing fine art/collectibles
Property management

Source: *The Family Office: Advising the Financial Elite* (2010)

"The investable assets of single-family offices continue to climb. More often than in previous generations, 'self-made' single-family office clients have derived a substantial portion of their wealth from both domestic and international business interests. These entrepreneurial individuals require consistent and reliable service that spans continents. In addition to the primary single-family office operation, many clients now also support outpost family offices. These essentially serve as extensions of the single-family office, delivered through a multifamily office model that allows the overseas provider to support several ultrawealthy clients by sharing resources," said Alan Kufeld, a principal in the Rothstein Kass Family Office Group.

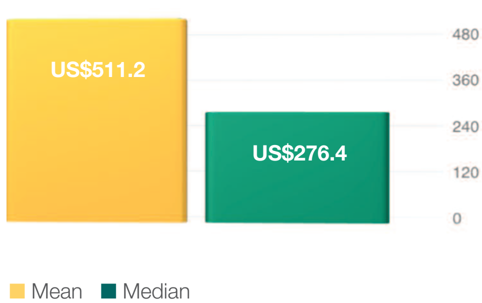
To gain insight into the current competitive environment, we surveyed the executive directors of 139 single-family offices in the first quarter of 2012. Among topics addressed was executive director compensation. Statistical analysis of participant responses is combined with a detailed overview of the criteria for success.

The mean investable assets of the single-family offices that participated in our survey were just over US$500 million (Exhibit 1). The median investable assets were about half as much. Slightly more than half of participating single-family offices were domiciled in the United States (Exhibit 2).

In 2011, based strictly on this sample of executive directors, the average total compensation for an executive director was around US$1.6 million (Exhibit 3). Meanwhile, the median total compensation was significantly less, about US$760,000. Clearly, a number of very high-earning executive directors are driving the mean compensation number.

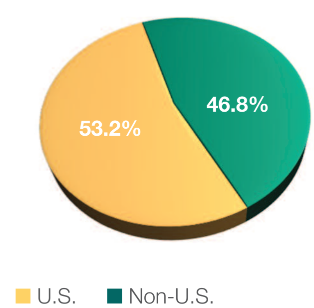
The figures in Exhibit 3 represent total incomes paid to executive directors in 2011 and could include previously deferred compensation. Because of the particular qualities and characteristics of the single-family offices we surveyed, we applied a segmentation model based on the two principal payout models employed by single-family offices (Exhibit 4). The "participant" model was used by approximately 40 percent of the single-family offices. This designation refers to situations where the executive director has "a piece of the action." This can encompass many different tactical approaches, from an overall carried interest to a percentage of selective investments. The majority of single-family offices utilize a more traditional employee model, often with incentives including discretionary bonuses.

Exhibit 1:
Investable Assets of Single-Family Offices 2011



N = 139 single-family offices

Exhibit 2:
Official Location of the Single-Family Office

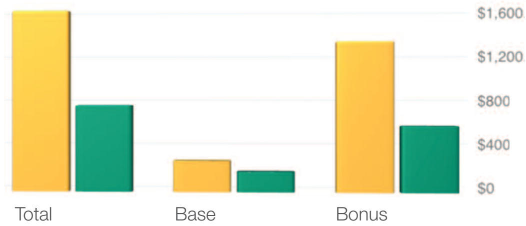


N = 139 single-family offices

Those executive directors working under the participant model averaged more than US$3 million (Exhibit 5). Their median compensation was slightly greater than US$1.4 million. Meanwhile, the mean compensation for executive directors working as employees was about US$472,000, with median compensation slightly greater than US$300,000.

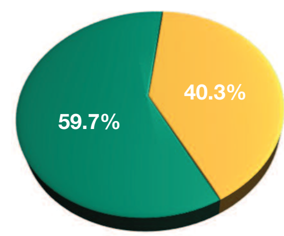
"Our statistical findings give credence to the widely shared belief that the executive director position is usually highly incentivized. Bonus compensation seems to be roughly four to five times larger than base compensation, findings that are consistent with our experiences," said Flynn. "Both parties to the negotiation usually agree philosophically that this is the most appropriate model. Wealthy families appreciate the alignment of interest that incentivized compensation can engender, while executive directors recognize the potential to maximize earnings."

Exhibit 3:
Total Compensation



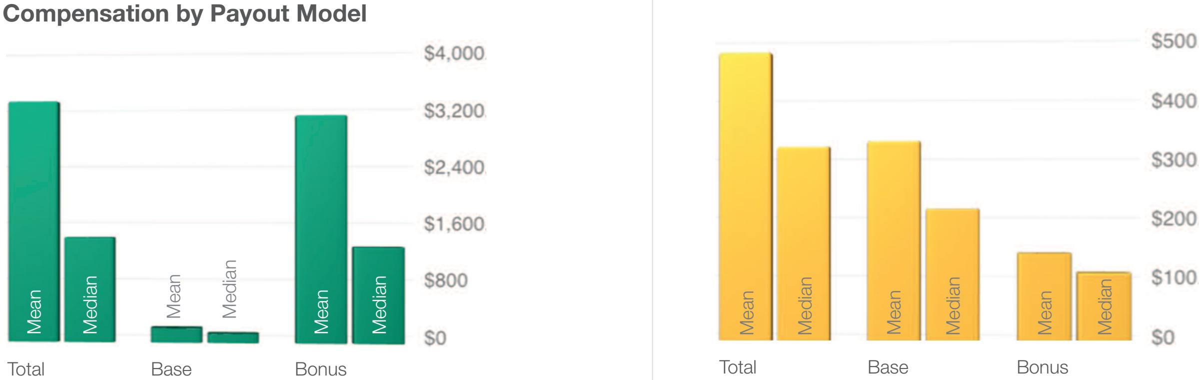
Executive Director | Median | *N = 139 single-family offices*

Exhibit 4:
Payout Models



Employee | Participant | *N = 139 single-family offices*

Exhibit 5:
Compensation by Payout Model



Executive Director | Participant

Executive Director | Employee

N = 139 single-family offices

Compensating the Executive Director

"Decades of success with an incentivized compensation model have given some single-family offices the confidence to employ a participant model for executive director compensation. This approach has gained the most traction among larger, well-established single-family offices. Placing a premium on continuity, these single-family offices offer executive directors a financial stake in the venture. Some executive directors have served several generations through the family office structure. Our research has consistently confirmed that, for executive directors, having in-depth knowledge of the long-term family needs, objectives and dynamics is vital to maintaining a cohesive and adaptable family strategy," said Flynn.

Efforts to develop an appropriate compensation package for an executive director are highly dependent on individual circumstances. What makes sense in one situation could be entirely unsuitable under other conditions. Tax regimes and regulatory environments can contribute to observed discrepancies. In the United States, for example, it is possible to incorporate defined benefit retirement plans into the executive director's compensation package, enabling significant tax deductions. Such retirement plans may not be available in other jurisdictions.

As the number of single-family offices continues to increase, new variations on the single-family office will continue to emerge. Fortunately, there is a series of steps that wealthy families can take as they initiate compensation negotiations that have the potential to greatly enhance the prospects for success. These measures are addressed in detail on the following page.

"The average base salary for an executive director in an employee-based compensation model actually slightly exceeds that of the participant model. However, bonus compensation can be more than 10 times larger. This likely reflects the level of experience, range of responsibilities and corresponding skill set that the position demands. From these findings it is understandable that the participant model is reserved for only the wealthiest of single-family offices. Many smaller operations simply do not have the resources to offer that level of compensation. For these family offices it is especially important to make negotiations an ongoing and continuous process. Adapting the package as the role evolves promotes long-term retention," said Flynn.

Steps to Compensating the Executive Director

Step 1:
Determining the Parameters

Negotiations should begin by establishing and clearly articulating the limitations that are acceptable to both parties. Parameters impacting bonus and performance incentives are among the most critical. Comparative compensation analysis, though imperfect in its application, has proven to be a viable starting point for productive discussions. Broadly speaking, the negotiations encompass three main areas:

- Base salary
- Bonus (direct and/or deferred)
- Benefits

Step 2:
Structuring the Compensation Package

Once general agreement on the parameters has been achieved, options for implementation are nearly infinite. By evaluating a selection of legal structures, techniques and products, the family office can conclude how best to combine the various compensation components.

Step 3:
Establishing a Contingency Plan

A critical but often overlooked aspect of the negotiation process is the development and implementation of a contingency plan. There are two basic components to the plan – transitional and financial. The first deals with a potential change of control at the single-family office and can include reassigning roles and preserving critical data. The extent of the operational issues is directly correlated to the roles and responsibilities of the executive director. When we address this matter, we regularly use an evaluative matrix and run scenario analyses to ensure a smooth transition. Financial considerations are more directly tied to the compensation package and address concerns ranging from deferred disbursement to the liquidation of mutual assets. Contingency plans are generally funded using some combination of available assets and life and/or disability coverage.

Step 4:
Refining the Compensation Package

Even the best compensation arrangement can quickly become dated. The family and the executive director should be prepared to refine the compensation arrangement at regular intervals. Whether the plan has become slanted in favor of one party to the detriment of the other, or the family agenda has changed, keeping the plan up to date is essential to the efficient functioning of the family office and ensuring continual alignment.

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 *The Family Office: Advising the Financial Elite.*

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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* and *The Family Office: Advising the Financial Elite.*

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Alan S. Kufeld is a principal in Rothstein Kass' Family Office Group. He specializes in income and estate tax planning, wealth management and preservation, and federal, state and local tax compliance for high-net-worth individuals. His clients include hedge fund managers, management companies and multi-generational families. Alan also advises entertainers as well as business owners and executives from a wide range of industries, including financial services, garment, professional services, entertainment and technology. He is a frequent speaker at high-net-worth industry events and has authored numerous articles for professional publications.

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Rothstein Kass is a premier professional services firm that has served privately held and publicly traded companies, as well as high-net-worth individuals and families, for more than 50 years. As trusted advisors to our clients, Rothstein Kass provides accounting, auditing and tax services, as well as a full array of integrated advisory services, to clients across industry spectrums and in all stages of organizational development.

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. The Family Office Group applies proven expertise with the utmost discretion and attention.

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

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