Forum

Private Wealth Management

Charitable Organizations
An In-Depth Discussion of
Investment and Governance Trends

ALSO IN THIS ISSUE

Defining the Multigenerational Family Mission

Why We Give – Strategic Philanthropy

Volume 8 / Issue I

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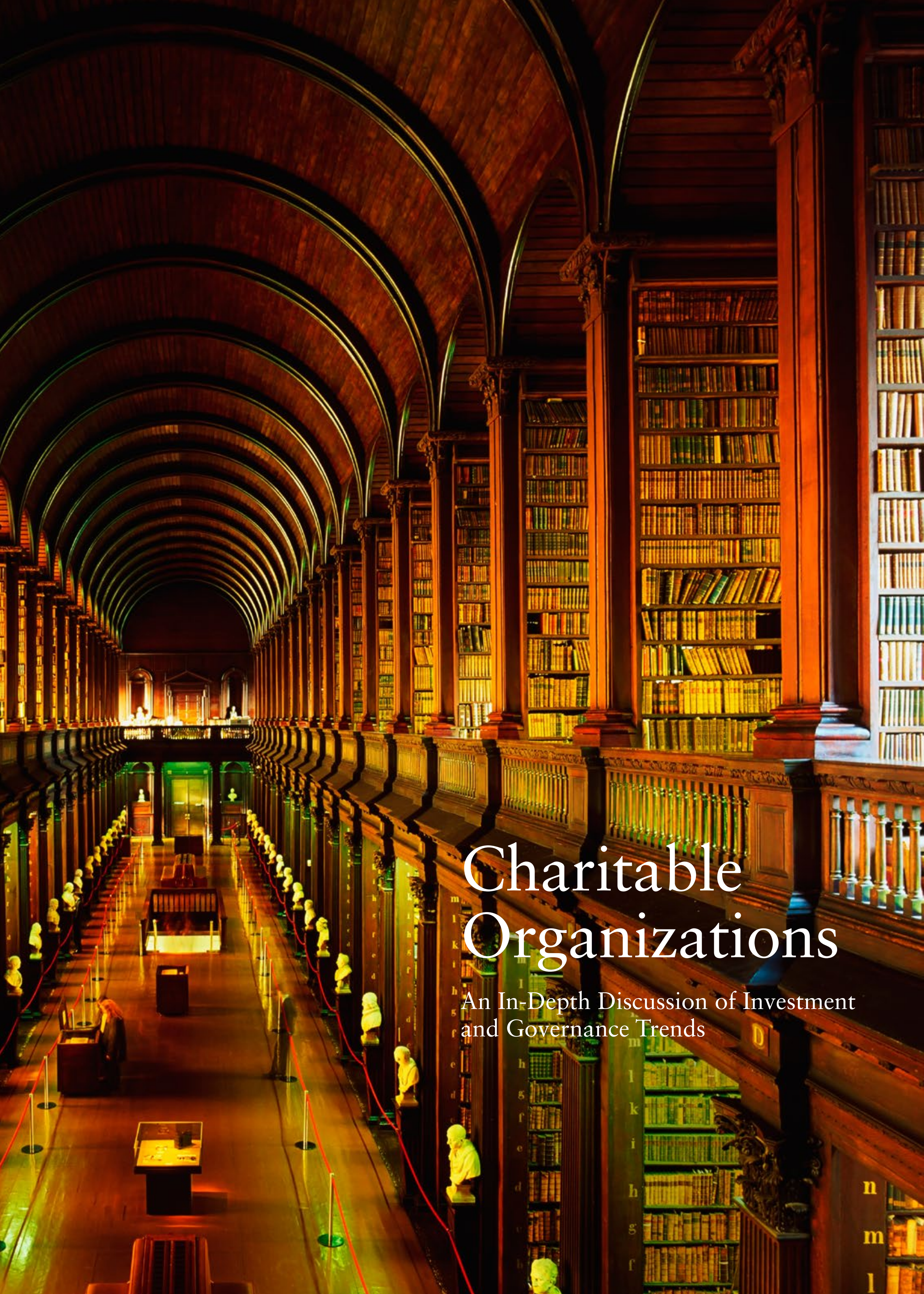

Charitable Organizations

An In-Depth Discussion of Investment and Governance Trends

JOHN MALLORY
Managing Director

John Mallory is head of the Investment Management Division's US West Region and region head for Private Wealth Management, based in Los Angeles. In addition to his regional responsibilities, he heads the Goldman Sachs Institutional Client Solutions business. Previously, John was the regional manager of the Florida region, including coverage of Latin America. His prior roles at the firm have included head of the Asset Management Services Group and chief operating officer of the Investment Management Services Group.

John joined Goldman Sachs in 1998 and was named managing director in 2000 and partner in 2012. Prior to joining the firm, John worked at Brown Brothers Harriman & Co., where he was head of the Hong Kong office. John is a director of the Los Angeles Philharmonic Association and serves on the Executive Committee and as chairman of the Finance and Investment Committee. John is also a trustee of the John Thomas Dye School, where he is a member of the Executive Committee and serves as chairman of both the Finance and Investment Committees. Previously, he served on the boards of the Goldman Sachs Trust Company, N.A., and the Goldman Sachs Trust Company of Delaware.

Charitable organizations are increasingly facing a challenging investment and governance climate regardless of their level of assets. The economy has hampered donations, volatility has made returns uncertain and demands on their resources have remained or even grown. To understand more about the investment and governance issues impacting charitable organizations, we spoke with John Mallory, Karey Dye and Chris Blume, senior members of the Goldman Sachs Institutional Client Solutions (ICS) business. ICS provides ongoing market insights and expertise along with client-specific solutions to small and midsize charitable organizations.

FORUM: Each of you speaks with numerous boards of directors and investment committees. What are some topical investment themes you are asked about?

JOHN: We are seeing more interest in passive investing, especially in the equity space. The trend is driven by increased awareness of passive investing due to the growing ETF markets and by the desire to lower fees. We think that there is merit to the inclusion of passive investments in a portfolio, but there are also some subtleties that need to be considered.

One of the investment decisions to be made is where to shift from active to passive management and where to remain active. For example, based upon historical return data, we noticed that active managers in less efficient sectors outperformed their benchmarks more often than active managers in more efficient sectors. Therefore, we have adopted an active/passive approach where we remain active in these less efficient sectors but adopt a passive stance in the more efficient sectors.

KAREY DYE
Managing Director

Karey Dye serves as a senior adviser to the Goldman Sachs Institutional Client Solutions business, providing holistic governance advice to complement our investment process. Karey also assists donors and their advisers in developing efficient charitable giving strategies, including the creation and administration of nonprofit family charitable vehicles such as private foundations, donor-advised funds and supporting organizations. Karey is the president of the Goldman Sachs Philanthropy Fund, a donor-advised fund that is a public charity established to encourage and promote philanthropy and charitable giving.

Karey joined Goldman Sachs in 2000, after practicing law at the firm of Vinson & Elkins L.L.P. While in private practice, Karey specialized in trusts and estates and tax-exempt organization matters. Her volunteer activities include serving on the planning committee for the University of Texas Nonprofits Institute, on the board of Episcopal High School, where she chairs the advancement committee, as president of the endowment board at St. Martin's Episcopal Church (previously serving as chair of the audit committee) and on the board of the Foundation for DePelchin Children's Center.

There are caveats to passive investing that an investor should be aware of. Some ETFs, especially in the high yield fixed income area, do not always track their respective benchmarks very well (often referred to as "tracking error"), and some are relatively expensive. An investor should consider both expenses and tracking error when considering passive investment vehicles.

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CHRIS: Another common concern across many boards and investment committees is the investment grade fixed income allocation of their investment portfolios. While high-quality investment grade bonds served charitable organizations well during the 2008 financial crisis, investors are now worried about their future returns. First, they recognize that in a low-yield environment, bonds will produce much less income than they historically have. Second, rising interest rates will likely produce price declines that will more than offset modest income, likely resulting in negative returns. We think this market view is reasonable. Our base case for investment grade bonds is modest negative returns over the next two years, as rates begin to normalize.

However, even modest fixed income returns can represent a significant headwind to a charitable organization that has ongoing spending requirements and wants to maintain its purchasing power in perpetuity. A challenge for organizations is how they would shift their portfolio's allocation if they were to reduce their fixed income exposure. A shift to cash does not solve the challenge, as cash is even more greatly impacted by the low-yield environment. A shift to equities might increase the portfolio's potential return, but equity returns could be subdued given current valuation levels. Such a change also requires a willingness to take on additional risk. A shift from fixed income into hedge funds is often considered, although an investor needs to be mindful of the increased illiquidity introduced by alternative investments.

While many boards and investment committees will examine these potential shifts, we find that most do not make material changes. They recognize that investment grade fixed income plays a unique role by dampening a portfolio's volatility, providing income and serving as a deflation hedge. During periods of severe economic shocks when the stock market tumbles, high-quality fixed income often appreciates as interest rates plunge. Many charitable organizations will allocate at least 15% of their portfolio to high-quality fixed income. This follows a common rule of thumb of having at least three years of spending set aside (3 years at a 5% spend rate). Such an allocation can help charitable organizations have "staying power" through a down market cycle.

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FORUM: In terms of asset allocation, what shifts have you seen in recent years away from the "endowment model"?

CHRIS: In the mid-2000s, we saw a lot of interest in the endowment model, an approach that allocates a significant amount of assets to illiquid investments such as private equity while decreasing the allocation to investment grade fixed income. The rationale for the endowment model is that illiquid assets can provide a source of excess returns and endowments can bear the associated illiquidity given their long-term investment horizons. Many smaller charitable organizations saw the great success that many of the largest universities had with the endowment

CHRIS BLUME
Managing Director

Chris Blume is the chief investment officer of the US Portfolio Management Team, which provides multi-asset class solutions and implementation for institutional investors, focusing on customized asset allocation, tactical implementation, risk management and portfolio construction. Prior to joining the Portfolio Management Team, Chris was a senior member of the Investment Strategy Group (ISG), where he was responsible for developing market and economic views and advising clients on both strategic and tactical asset allocations. During his time in the ISG role, Chris spent two years in Hong Kong to establish the group's presence in the region.

Chris spent the first 10 years of his career at Goldman Sachs as a fixed income portfolio manager in Goldman Sachs Asset Management, where he managed portfolios for central banks, pensions, insurance companies, foundations and accounts with specific asset/liability structuring needs. Chris joined Goldman Sachs in 1994 and was named a managing director in 2006.

model and wanted to emulate them. We discouraged these smaller charitable organizations from following the endowment model.

Since the financial crisis, we have seen that charitable organizations have become much more skeptical of the endowment model. They have witnessed the woes of large universities and their need to issue debt in late 2008. These charitable organizations have also heard less publicized stories about smaller institutions that could not access the debt markets as easily as their larger peers. This questioning of the endowment model has been healthy, as it has not resulted in the complete rejection of illiquid investments, but rather a more realistic view of their role in a portfolio.

FORUM: How should charitable organizations think about benchmarking?

CHRIS: Designating appropriate benchmarks and documenting them in the charitable organization's investment policy statement is an important best practice. At Goldman Sachs, we generally like to have two sets of benchmarks for each pool of assets.

One type of benchmark is a very high level benchmark that is easy to replicate and seeks to mirror the overall volatility of the strategic asset allocation. We call this type of benchmark a "reference portfolio" benchmark. An example of such a benchmark for a moderate-risk portfolio would be a simple blend of 50% equities and 50% investment grade bonds. This benchmark is helpful in tracking how a charitable organization's strategic asset allocation decisions are faring. The reference portfolio benchmark allows investors to gauge whether it was helpful to have diversified into additional asset classes over a particular period of time. For example, would an investor have been better off investing in international equities and high yield fixed income, or just purchasing two indexed funds that mirror the 50/50 reference portfolio blend?

As this reference portfolio benchmark is high-level, we also like to have a "strategic" benchmark that is more granular and mirrors the charitable organization's specific long-term strategic asset allocation. For example, if the strategic asset allocation has 4% in high yield corporate bonds and 2% in emerging market local debt, the strategic benchmark would have a 4% and 2% allocation to the respective fixed income indexes. This index is helpful as differences between the portfolio return and the strategic benchmark are largely driven by excess manager returns, tactical tilts (the temporary overweighting or underweighting of specific sub-asset classes or sectors) and rebalancing practices. A good performance attribution system can further parse how much excess performance is due to each of these factors and help boards and investment committees understand which specific decisions are working well and which are not.

Finally, clients are also interested in peer group benchmarking. Universities in particular are quite interested in how they rank relative to their peers, as tracked by the National Association of College and University Business Officers (NACUBO) survey. However, there are major caveats with benchmarking to these peer universes. First, does a specific entity want to mirror its peers? Perhaps the entity is quite a bit more conservative due to its unique circumstances relative to the peer universe. Does the entity want to become more aggressive just for the sake of being in line with its peers, even though this might not be the right portfolio strategy given their specific needs and risk tolerance? One does not want the tail to wag the dog! Second, some of these surveys are a bit opaque with regard to their methodologies.

Designating appropriate benchmarks and documenting them in the charitable organization's investment policy statement is an important best practice.

RESPONSIBLE AND SUSTAINABLE INVESTMENT FRAMEWORK

	SRI: SOCIALLY RESPONSIBLE INVESTING	ESG: ENVIRONMENTAL, SOCIAL AND GOVERNANCE	IMPACT: DOUBLE OR TRIPLE BOTTOM LINE INVESTING
MOTIVATION	■ Adhere to value system and/or social, political, or religious rationales, regardless of potential return concessions through potentially limited investment universe	■ Maximize risk-adjusted financial return through investment analysis and decision making that encompasses environmental, social and governance factors and an entity's impact on its stakeholders, the environment and society	■ Deploy capital to address social and/or environmental problems while achieving a financial return
IMPLEMENTATION EXAMPLES	■ Portfolio exclusion policy ■ Negative screens on publicly listed securities ■ Corporate engagement and shareholder action	■ Integrated analysis ■ Positive screens on public and private investments ■ Thematic investments (e.g., clean tech) ■ Corporate engagement and shareholder action	■ Private equity and debt financing ■ Social impact bonds ■ Social venture capital
OUTCOMES	■ Capital withheld from "bad" investments	■ Capital directed toward better ESG performers	■ Capital allocated to projects that result in demonstrable positive impacts that improve the lives of disadvantaged people and underserved communities

As a result, explaining return differences can be challenging. So while we feel that comparing oneself to one's peers is a useful exercise, we do believe that there are limitations as well.

FORUM: Another trend we increasingly hear about, especially with younger generations, is socially responsible investing ("SRI") or impact investing. What is your take on the applicability of these investments for charitable organizations?

CHRIS: This is a topic that we do encounter more frequently now. There is a generational shift happening, as the younger generation is generally much more interested in these investments than the older generation. When thinking about these investments, we will often highlight three major considerations.

The first consideration for a charitable organization is whether socially responsible investments make sense for their organization's goals and objectives. We think that the key determining factor is how such an investment would resonate with the stakeholders (this often simply means donors) of the organization. We see the introduction of socially responsible investments more often when the stakeholders are more like-minded about certain social issues. For example, if there is a private foundation set up by one family, they can decide their point of view and not worry about how others might perceive their decision. Another example is when an environmental organization embraces socially responsible investments with a focus on the environment, knowing that their donors will appreciate such a stance. This can also perhaps increase their fundraising.

So while we feel that comparing oneself to one's peers is a useful exercise, we do believe that there are limitations as well.

Second, there are a range of investments that might be considered socially responsible. The most basic type incorporates negative screens into a portfolio. For example, a hospital foundation may tell an investment manager that it does not wish to have any direct exposure to companies selling alcohol or tobacco products. Typically these negative screens just apply to direct holding and do not require a “look through” to the underlying holdings of mutual funds or ETFs. A second type of socially responsible investing applies positive screens to investments. In particular, Environmental, Social and Governance (ESG) investing seeks out companies that are outstanding with respect to ESG issues. Finally, there is impact investing, which is sometimes referred to as “double bottom line” or even “triple bottom line” investing. The double line refers to both making a financial return for the investor and driving demonstrable social and/or environmental impact. Investors can both make direct impact investments and, more commonly, invest through funds that likely have liquidity terms similar to private equity.

A primary consideration when determining whether socially responsible investments are appropriate for a charitable organization’s portfolio is how to weave them into a portfolio. We think that a first step for an investor ought to be determining the overall strategic asset allocation. The second step should involve thinking about how to implement the socially responsible investments. Essentially, determining the asset allocation is like building the house; the implementation is like furnishing it. Investors should continue to consider strategic asset allocation targets before moving into individual manager selection of socially responsible or impact investments. This approach can help ensure the alignment of the organization’s investment portfolio with its social and/or environmental objectives in a risk-managed way over time.

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FORUM: We see frequent headlines about fraud and lax vigilance of charitable funds. What are some important tools board members can use to protect both themselves and the investments of the charitable organizations they serve?

KAREY: We believe it's important for boards to operate in a professional manner and adhere to all legal requirements. This includes reviewing the charitable organization's annual financial audit by an independent firm and implementing a regular, professional review of all governing documents and policies. It's also important to have a conflicts of interest policy in place, which requires board members to disclose any activities or interests that could pose a conflict with the organization.

Board meetings should follow a formal process. Boards should use an agenda, keep minutes of all meetings and establish subcommittees for issues that require deeper analysis. The exact roles and responsibilities of the board members, investment committee, staff and investment adviser should be clearly defined. All parties involved should be held accountable for their actions.

Lastly, while oversight is important, board members should use their own business expertise to help their charitable organizations operate at a high level of professionalism.

FORUM: An investment policy statement (IPS) serves as an important tool for boards and investment committees in terms of risk management. Can you discuss some best practices you see charitable organizations adopting?

KAREY: A thoughtful IPS acts as a critical governance and investment tool for any charitable organization. It should provide a framework for making sound and deliberate decisions, ensure compliance with relevant laws and stipulate the exact roles and responsibilities of the various parties (i.e., the board, the investment committee, the staff and the investment adviser). The permanence of the IPS also safeguards institutional memory and continuity between successive boards.

The investment process articulated in the IPS should address the purpose of the assets, time horizon, spending needs and any potential constraints, such as illiquid holdings. The investment strategy and parameters of the IPS should balance the goals of the charitable organization with the risk required to obtain the required target returns. Boards and investment committees also need to receive relevant, actionable and timely advice to make decisions.

Boards and investment committees should have regular educational opportunities regarding the IPS to ensure they understand all of its components. As a helpful exercise, the board and investment committee should examine a negative situation with a comparable charitable organization to dissect what went wrong and review what policies and procedures are in place to prevent a similar situation from happening to their own organization.

The exact roles and responsibilities of the board members, investment committee, staff and investment adviser should be clearly defined.

It's also important to understand the historic context of the IPS. How has it evolved alongside the complexity of the marketplace? Keep in mind that no IPS is a substitute for great board and investment committee members. Candidates should have relevant professional backgrounds and demeanors, no personal agendas, a willingness to engage and learn from others, and sufficient time to dedicate to this crucial volunteer effort.

Remember that fundraising plays an important role in the organization and can be impacted by policies of the board and investment committee. Donors want to give to charitable organizations with strong policies, procedures and track records. Finally, a deep understanding of mission is crucial – a spending policy is not a purely mathematical exercise. Investing and spending must be mission-linked.

FORUM: Have you seen any changes to the roles and responsibilities of boards with respect to their investment advisers?

JOHN: There have been several perceptible shifts in approach among the boards and investment committees that we have visited with over the last five years. Without question, there is greater scrutiny being placed on investment advisers and more accountability demanded despite the general upward trajectory of markets over this time period. We attribute the shift to two developments. First, the volatility of the market moves during the financial crisis heightened board and investment committee members' awareness of their fiduciary responsibility and the vulnerability of their organization's finances. Second, the persistent low interest rate environment has increased the difficulty of achieving distribution rates through portfolio returns. This in turn has heightened the scrutiny of an investment adviser's ability to add value on a net of fee basis.

On the first point, the significant drawdowns in portfolio values during the 2008–09 time period were jarring for everyone. Certain charitable organizations, including some of the largest endowments, found themselves with less liquidity from their portfolios than they had anticipated. As a result, these organizations had to alter their allocations at exactly the wrong time and/or raise capital from alternative sources, oftentimes on unfavorable terms. Other organizations found the crisis to be a wake-up call regarding the downside risk associated with their portfolio in environments where correlations between asset classes converged.

For many small and midsize organizations, the most significant realization of those turbulent times was that they did not have the administrative heft in the form of permanent staff resources dedicated to investment oversight or a board that could dedicate enough time to oversight to allow them to be appropriately nimble and communicative when conditions warranted.

Many boards and investment committees have therefore authorized their investment advisers to take on greater responsibility for day-to-day discretionary oversight of the portfolio, including moving assets among different managers and rebalancing the portfolio on a more opportunistic basis. We believe that this trend, often referred to as an outsourced chief investment officer (OCIO) model, is appropriate for most small and midsize organizations. It allows both the board and staff to focus on more important issues impacting the organization, including defining the organization's appropriate risk appetite (which then impacts the IPS and strategic asset allocation), setting spending policy, monitoring secular shifts in the financial markets and their impact on the portfolio, and other key governance and risk management issues.

The other skill set that boards are increasingly requiring of their investment advisers is the ability to recommend and implement tactical investment ideas that can take advantage of relative valuation dislocations that sometimes occur on a temporary basis in financial markets. Again, the importance of taking advantage of these opportunities is heightened by the persistent low interest rate environment that has held back overall returns in balanced portfolios.

Many boards and investment committees have authorized their investment advisers to take on greater responsibility for day-to-day discretionary oversight of the portfolio.

Many investment committees view the successful tactical investing track records of their investment advisers as a way to lower the impact of fees on the overall portfolio. Of course, this only works if an investment adviser has a consistent track record of adding value through tactical asset allocation. We believe it is a mistake to ask investment advisers without direct investing experience (many have research but not investing skills) to try to generate tactical views and implementation strategies.

FORUM: What types of charitable organizations do you see choosing an OCIO most frequently?

JOHN: The OCIO model has gained popularity among endowments, public charities, pension plans and private foundations. The principles that make it attractive are relevant for all these types of charitable organizations. That said, OCIO tends to be more frequently adopted by small and midsize organizations that are often more resource-constrained. Last year's NACUBO survey revealed that institutions with less than $100 million in assets were using an OCIO over 50% of the time, while organizations with $100 million–$500 million in assets were choosing an OCIO 42% of the time, and only 21% of the time for organizations with $500 million to $1 billion in assets.

FORUM: What should those considering joining a charitable organization's board of directors know?

KAREY: It's important for prospective board members to be aware of the responsibilities associated with joining a board of directors since the board is accountable to all of the organization's stakeholders. Board members are assuming legal responsibilities so each person should understand any underlying laws that apply to the organization's operations and its investments and be sure that all important board policies are in place and current (including a conflicts of interest policy). In addition, each organization should have directors and officers liability insurance and have adequate internal controls in place to manage the various risks the organization is facing.

Before making any decision to join a board of directors, we recommend that our clients review background information about the organization, including the annual report, the most recent audited financial statement, and a long-range program and financial plan. It's also important to obtain a list of current board members with titles and affiliations, a description of board members' responsibilities, a board organization chart and a staff organization chart. Other considerations include reviewing the organization's newsletter, brochure and other publications, media about the organization and a biography of the chief executive.

Joining a board can be a tremendously rewarding and fulfilling experience when your abilities and interests fit well with the needs of the organization you are being asked to serve. To help ensure a positive experience, don't overlook the up-front due diligence.

JOHN: Imagine you are going to make a major financial gift to a charitable organization and how you might identify, evaluate and select an organization that can generate the most impact from your investment. Prior to making this kind of donation, most donors would perform a fair amount of due diligence on the organization and the proposed project. The approach you take to joining a board of directors should be even more rigorous. When you join a board, in addition to making financial contributions, you are assuming legal responsibilities for the organization and committing to make a significant donation of your time, talent and heart.

The principles that make OCIO attractive are relevant for all these types of charitable organizations.

Board service offers many benefits, including the opportunity to build your professional network, make personal connections with others who share your values and passions, learn about a new issue or constituency, and broaden your exposure to a new community. Certainly, you can benefit in these ways by simply volunteering with a charitable organization, but serving on a board of directors also allows you to watch over your financial investment in an organization in a deeper way and perhaps with greater impact.

When you join a board, in addition to making financial contributions, you are assuming legal responsibilities for the organization and committing to make a significant donation of your time, talent and heart.

Serving as a board member can also present a number of challenges and occasional disappointments. For example, an organization may not decide to go in the strategic direction an individual board member believes it should, or there can be professional disagreements and/or personality conflicts on the board or between the board and staff. And there are circumstances when board members may find themselves overseeing an organization in a crisis due to an unexpected leadership change or downturn in the economy.

Ideally, individuals join boards because they are passionate about the mission of the organization, and are committed to helping the organization reach that mission despite the sometimes significant bumps along the way.

Planning Matters:

Defining the Multigenerational Family Mission

Many affluent families desire to preserve their wealth for the continuing benefit of their descendants and philanthropic causes rather than having their estates simply divided and distributed among beneficiaries. Planning for this type of long-term "legacy" generally focuses on tax and legal estate planning techniques. While these techniques are important, they may not address fundamental concerns such as: How will our wealth affect our heirs' core values? Will our heirs be responsible stewards? Will they be able to work together to preserve our legacy for its intended purposes? Families can often find it difficult to initiate a basic dialogue with future heirs regarding family estate planning issues, let alone raise these types of concerns.

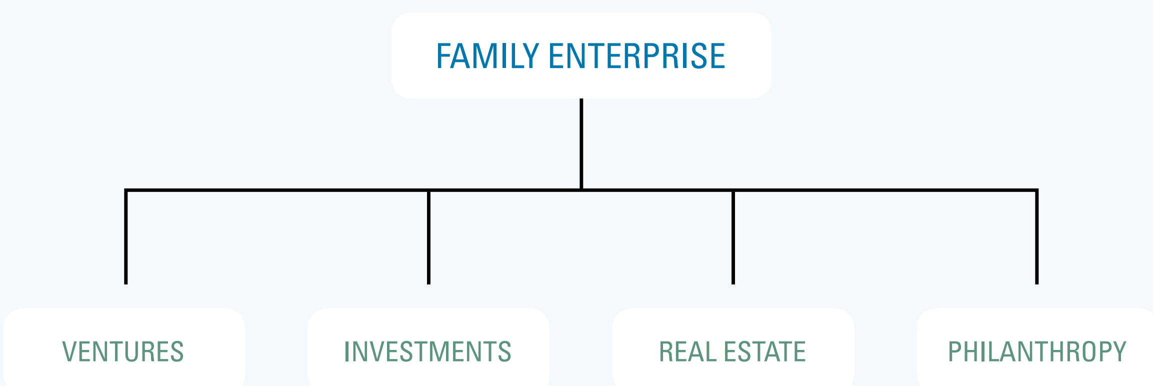
For heirs, the rewards of preserving a shared legacy can include greater investment opportunities, more control over business and entrepreneurial ventures, the ability to make a more significant philanthropic impact, and enhanced family continuity and sense of community. With responsible stewardship, each generation can pass the family legacy on to the next. But the diverse individual needs and interests of an evolving family can potentially lead to conflicts or mismanagement, or otherwise cause a legacy to be dissipated. The task for a family that wishes to successfully sustain a shared multigenerational legacy is to identify a unifying purpose and mission and develop leadership in each generation to steward the legacy according to this shared mission.

With responsible stewardship, each generation can pass the family legacy on to the next.

The Family Enterprise

Family legacies typically originate from a successful business or entrepreneurial venture, and evolve over time into a diversified collection of legal, financial and philanthropic interests with interrelated family stakeholders (e.g., family-owned businesses, pooled trust arrangements, family limited partnerships, and family charitable foundations and funds). Viewing this collective wealth as an affiliated "family enterprise" provides a framework for identifying an overarching purpose and mission for the family legacy.
The individual family members, along with their collective skills, knowledge and experiences, make up the human resources of this family enterprise, and its success and longevity will rely on their ongoing growth and development.[1]

FAMILY ENTERPRISE FRAMEWORK



Viewing a multigenerational family's collective wealth as an affiliated family enterprise provides a framework for families to develop an overarching mission and system of governance for their wealth.

Using this concept of the family enterprise, certain qualities and practices can be identified within families who have successfully sustained similar family enterprises over generations. Research has shown that there are seven key attributes common across families who have successfully transferred significant wealth over multiple generations:[2]

- Shared purpose and values that extend beyond family wealth
- A sense of community that is maintained across generations
- Professionally managed business and financial activities
- Continual adaptation and resiliency
- Free choice to remain united in their shared interest in the family enterprise
- Active development of family members' financial skills
- Commitment to give back to the community

The good news for families planning a legacy is that these qualities can be developed and reinforced through practices such as developing a family mission statement, holding regular family meetings, establishing a family constitution and family council, and educating and developing the successor generations. Engaging in these practices across generations can prepare younger generations to receive a legacy and allow senior generations to gain confidence that their legacy will be responsibly stewarded according to family purposes and values.

The Family Mission Statement

For a family enterprise, the mission statement is an expression of the family's values, purpose and goals. It is the reason family members choose to remain united in their effort to sustain the family legacy. Any family is naturally composed of diverse members with individual needs and desires, but at the core of each family is a kinship and affiliated identity based on a common belief system. These shared beliefs form the family's core values, a key trait of resilient families who approach change and adversity as a shared and manageable challenge.[3]

Identifying family values is a good starting point for developing a family mission statement. Recounting family history can often help identify core values, particularly those that reemerge during significant events or those the family calls upon during times of adversity or other challenges. When family members facing a difficult situation ask themselves what their parents or grandparents would do in such a case, they are often seeking to identify the core family values that their elders would have drawn upon.

Next, the family should find consensus around their goals and vision for the future. What types of investment, business and philanthropic activities should the family pursue? How should the enterprise support the needs and expectations of family members? How does the family want to be known in the community? What should the family enterprise look like in 20, 50 and 100 years?

Any family is naturally composed of diverse members with individual needs and desires, but at the core of each family is a kinship and affiliated identity based on a common belief system.

A well-crafted mission statement should incorporate the family's values into a description of how the family intends to accomplish its goals and make its vision a reality. An effective mission statement should be a clear, operational and lasting declaration of the family's purpose. It should serve as a touchstone for significant family decisions, and allow members of each generation to clearly understand what the family stands for, why its purpose is important and how they can contribute to achieving the family's goals and vision. Each generation should periodically revisit the mission statement to ensure that it continues to express the purpose and goals of the evolving family. The family dialogue and process of creating and reviewing a mission statement can be as meaningful as the end result.

Family Meetings

Sustaining a family enterprise across generations requires more focused and consistent communication than ordinary family discussions. While the idea of an organized family meeting may initially seem rather formal, such meetings can provide a good forum for parents who want to start a dialogue with children regarding family investments, philanthropy and estate planning. Regular family meetings are an opportunity for families with significant wealth to share information, make important decisions, develop the stewardship and financial skills of younger generations and discuss the family's common values and goals.

The family dialogue and process of creating and reviewing a mission statement can be as meaningful as the end result.

EXAMPLE FAMILY MISSION STATEMENT

We are a family committed to our members and descendants being responsible, well-educated citizens who practice the family work ethic and make constructive contributions in the local community and world at large. Each member is encouraged to develop and use self-supporting, marketable skills that contribute to the enhancement of his or her own self-esteem and independence.

We urge family members to adopt lifestyles that are healthy and personally satisfying at such a profile as to preserve the maximum level of family privacy given the public nature of our business.

We urge the continuation of the orientation of prudent, careful investing with a long-term view of outcomes so that all the descendants may enjoy the benefits of the foundation the family has built.

We believe clear, constructive communication is at the core of our long-term success as a family. We encourage all efforts to further harmony, develop humor and perspective on life, and balance long-term concerns while enjoying the present; and to enhance communicative, caring and amicable relationships among family members.[4]

As younger generations mature and families expand, these meetings facilitate an important channel of communication for maintaining continuity and community. Extended families with shared interests in a legacy are bound to have different perspectives and expectations that can easily lead to conflict in the absence of communication. Family meetings provide a format for constructively resolving differences and avoiding the conflicts that can potentially tear families apart.

Good preparation will ensure a productive and effective meeting. Planning a meeting should include identifying the purpose of the meeting, deciding who should attend, developing a specific and clear agenda, and adopting meeting rules of conduct. Larger families may choose to select a planning committee or professional facilitator to canvass family members for their concerns and goals in order to develop a meaningful agenda. A professional facilitator can also provide guidance during the meeting process, and help manage complex family discussions or dynamics. It may be appropriate to include outside professionals such as attorneys, accountants and financial advisers when agenda topics include family legal, tax or investment issues. A written meeting summary, including significant decisions, action items and follow-up responsibilities, should be circulated following the meeting. Agreeing to a set of ground rules for a family meeting can facilitate an environment of respectful and constructive communication in which all family members feel comfortable sharing their views. Some examples of common ground rules include:

- We will demonstrate respect by being on time and prepared, and avoiding other distractions during the meeting
- We will listen and allow others to speak until finished without interruption
- We will each speak for ourselves and not others
- We will ensure that everyone is heard and able to contribute their views on issues
- We will respect confidentiality and not disclose anything discussed without unanimous agreement

The location of a family meeting should be comfortable and free of distractions that can arise at a family home or office. Hotels and resorts have good accommodations for meetings while providing an environment to enjoy leisure and recreation activities together outside the meeting. A successful meeting should be a productive, positive and enjoyable family experience.

Family Constitution and Family Council

A family constitution expresses the mutual agreements and principles necessary for a diverse and growing family to sustain shared interests in their family enterprise. Unlike a mission statement, which affirms a family's purpose and goals, the family constitution defines the family's relational roles, rules and processes regarding the governance of the family enterprise. Examples of issues that may be addressed in the family constitution:[5]

Agreeing to a set of ground rules for a family meeting can facilitate an environment of respectful and constructive communication in which all family members feel comfortable sharing their views.

- Identification of roles and responsibilities for the governance of the family enterprise, and how family members should qualify and be selected for those roles
- Employment and compensation policies for family members employed in a family business, or managing family investments and assets
- The process for making family decisions, such as majority vote, unanimous agreement, or delegation to individuals or committees
- Policies regarding confidentiality of family information
- The process for family members to exit the family enterprise
- The process for amending the family constitution

A family constitution is not intended to be a substitute for documents such as trusts, partnership agreements, corporate bylaws and the like. However, it can influence and enhance the interaction of the parties to these entities (e.g., trustees, beneficiaries, shareholders, directors and partners) by guiding who should serve in certain roles, and how they should manage and administer those entities based on family constitution principles. A family constitution may also prescribe legal agreements for stakeholders in the family enterprise, such as prenuptial, noncompete or buy-sell agreements.

For a founding first generation, in which decisions are typically centralized, the idea of a family constitution may not seem relevant. But each successive generation will face their own unique challenges if they wish to maintain a shared interest in a family enterprise. Second-generation siblings must overcome rivalries and learn to work together. Third-generation branches of cousins and more extended families face increasingly diversified needs, interests and allegiances between family branches and the extended family. Establishing a family constitution early in the generational cycle allows successive generations to become familiar with its operating principles as they come of age and assume their roles in the family enterprise.

In addition, forming a representative family council can help a growing family maintain a unified voice as it expands into a confederation of family lines. The family council can regularly inform the extended family regarding the enterprise's affairs and welfare, and represent their interests regarding significant decisions. The family council can also administer the family constitution, and ensure that the family purpose and mission continue to guide the direction of the enterprise. Nevertheless, families should continue periodic gatherings of the entire family to maintain their sense of community and shared purpose.

Whether a family creates a family constitution or some other form of governance, clearly defining family rules, roles and processes will support the resiliency of the family enterprise by providing stability during adversity and change. A study of wealthy multigenerational families found that over 70% of the families in the study who have sustained a significant family enterprise over four or five generations have some form of family constitution and family council.[6]

Forming a representative family council can help a growing family maintain a unified voice as it expands into a confederation of family lines.

Developing the Next Generation

To sustain a multigenerational family legacy, each generation must subscribe to the family's shared purposes and mission and develop the competencies to steward the legacy according to that mission. Some heirs will grow into active roles in the family enterprise, such as trustees, directors and managers of family assets and entities, while others will continue in more limited roles such as beneficiaries, shareholders and limited partners. In any case, each heir must acquire the necessary skills and competencies to become an informed and responsible member of a family community holding a shared interest in a complex enterprise.

Heirs should be encouraged to accept challenges that test the limits of their abilities, and live with the consequences of their choices without being rescued by family resources.

Challenges for children of inherited wealth may include overcoming tendencies such as dependency and entitlement to become motivated and productive adults. Experts recommend engaging children early and often in dialogue regarding money issues. Practices such as chores and structured allowances can begin as early as ages three to six to help develop budgeting skills and encourage capacities for hard work, delayed gratification and sustained effort. These characteristics have been found to help overcome dependency and inspire lifelong productivity and well-being. Participating in volunteer activities can expand young children's world views and sense of compassion, which can help them overcome attitudes of entitlement and form positive notions of philanthropy.[7]

For teen and young adult heirs, the family community and enterprise can provide a framework for developing practical skills, responsibility and leadership. Young heirs may be employed in the family office or businesses, or given a role in overseeing a portion of the family investments or philanthropic activities. Family elders may serve as mentors or administer internships for younger heirs. Regular family meetings can provide a structured forum for educating the next generation regarding general financial and investment principles, or specific details regarding family businesses, investments, philanthropy and estate planning strategies. Involvement in civic and philanthropic activities outside the family enterprise is also important for developing responsible citizenship and leadership within the greater community.

Each heir's path of development will be a culmination of family efforts along with his or her own individual pursuits, education and life experiences. Heirs should be encouraged to accept challenges that test the limits of their abilities, and live with the consequences of their choices without being rescued by family resources. Family wealth can be a resource to support each heir's pursuit of his or her individual calling, and help heirs achieve their potential, but expectations regarding financial competencies and family values should be clearly defined and communicated for those participating in the privileges of the family legacy. These competencies and values may be demonstrated in the following ways:

- Having the ability to budget, track spending, save and live within one's means
- Having the ability to manage debt and credit, and maintain a favorable credit score
- Understanding basic investment principles such as asset allocation, asset classes and the relationship between risk and return

- Avoiding overindulgence and dependency on material things, alcohol or other substances
- Expressing compassion and not exhibiting excessive attitudes of entitlement
- Seeking challenges and demonstrating self-motivation and work ethic
- Having involvement in community and philanthropic activities

Conclusion

Sustaining a multigenerational family legacy is a notoriously difficult journey. Professional advice regarding management of investments and assets, estate planning and taxes is essential. The practices we have discussed can help ensure an enduring legacy by encouraging a family culture of stewardship, and creating opportunities for each generation to discover and renew the family values and purpose that inspired the legacy.

For teen and young adult heirs, the family community and enterprise can provide a framework for developing practical skills, responsibility and leadership.

In My View:

Why We Give – Strategic Philanthropy

We have all been solicited to give. We give to support a friend, to fund a cause we believe in and to broaden our exposure. For many of us, initial small gifts may expand into a commitment of our time, a major donation, a seat on a board of directors or a name as honoree on a program.

Sometimes, we find ourselves at a place in our lives where we can think strategically about our giving. We can start with a clean slate and ask ourselves important questions: What do I care about? How can I make an impact? How will I measure the results?

The inspiration that drives strategic philanthropy generally comes from a personal connection and a deep moral sense that an injustice or inequity needs to be righted: foundations are formed to research a cure to a disease that took the life of a loved one, food pantries are established to feed the homeless whom we pass by each day, and need-based scholarships are established at educational institutions that launched our careers and shaped who we are. No doubt your philanthropy was influenced by a personal experience and a feeling that something must be changed.

Finding Your Cause

In my case, I grew up near the chaparral of the Santa Monica Mountains in California and was introduced to the ecology movement in grade school. I had a youthful sense that we were wasting precious resources and not taking care of our planet properly. I was affected, and I developed a personal connection to something that I believed needed to be changed.

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ANDY KAISER
Managing Director

Andy Kaiser is global head of Private Banking and Wealth Advisory Services for Goldman Sachs Private Wealth Management. He is a member of the Management Committee for Goldman Sachs Bank USA and the firm's Community Investment Committee. Andy also serves on the boards of the Goldman Sachs Trust Company and the Goldman Sachs Philanthropy Fund. Andy has served in various roles in the Fixed Income Division, Investment Banking Division, Investment Management Division and Goldman Sachs Bank USA since he joined the firm in 1986. He was named managing director in 1997 and partner in 2006.

Andy is a member of the board of directors of NatureServe, which collects and tracks information on ecosystems, habitats, and at-risk plant and animal species in the Western Hemisphere. He is also on the advisory boards of the Stanford University Graduate School of Education and the Robert Day School of Economics and Finance at Claremont McKenna College.

Years passed and my work at Goldman Sachs began to bring me back to my interest in environmental issues. In the Risk Markets Group, we set up climate and natural catastrophe hedging transactions for corporate clients. We became convinced that there were capital markets solutions to social and environmental issues, a theme that was later drafted into the firm's first environmental policy.

While Goldman Sachs' ability to convene financial and human capital to solve problems was a far better platform than any work I could do as an individual, the time had come for me to use my education, experience and network to pursue issues of my choosing. I share my experience with the hope that it will provide some guidance and best practices for those interested in deepening their commitment to charitable organizations.

Due Diligence Is Key

The search process that led to my first significant commitment of time and resources to a charitable organization was very much like the due diligence process that companies undertake in evaluating a merger. As you start your own search process, we recommend that you interview a number of board members and executives with the following framework in mind:

1. **MISSION** – Does the organization's mission fit with my values, interests and goals?

2. **TEAM** – Is the executive staff passionate about what they are doing, committed to the mission, qualified and capable of achieving the mission?

3. **GOVERNANCE** – What are the standards and ethics of the organization? Is there a conflicts of interest policy? What is the composition of the board, and who is represented on the audit committee?

4. **FINANCIAL CONDITION** – What are the organization's sources of funding, and are they stable and diverse? Is there an endowment, and is it needed to fund operations? Does the organization have appropriate financial controls? Who is the auditor?

5. **YOUR ROLE** – Do I bring any value to the organization and its board? What role can I play to add value, and is that aligned with the expectations of the organization?

Since it is highly likely that your charitable support will be in demand from many deserving charitable organizations, you can also begin a process of elimination by identifying aspects that do not fit in with your personal beliefs. For example, if you feel charitable organizations should be apolitical, you may want to screen out any organizations that are heavily focused on political advocacy.

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I came to NatureServe after speaking to nearly a dozen different environmental organizations. NatureServe appealed to my belief that land and animal stewardship should be nonpartisan. Its scientists set quality standards for the environmental data collected and develop tools for using this information in land use decision making. Think of them as the "big data" provider that informs environmental decisions. Government agencies, corporations and conservationists use this information to make decisions regarding developing federally owned parks and military facilities, building private manufacturing plants, and acquiring or restoring land for conservation purposes. Ultimately, NatureServe promotes biodiversity, a key barometer of the health of our planet.

The passion and dedication of NatureServe's staff, and their commitment to their mission, was another big attraction of the organization. In some respects, the organization's underdog position also interested me. The data collected by NatureServe is not quite as emotionally appealing or as photogenic as images of endangered animals, which are used effectively to raise millions of dollars. I thought I could make a bigger impact with an organization the size of NatureServe.

Identifying Your Value to the Organization

When you join a board, the various ways you can contribute may not be obvious. My finance background seemed out of place in an organization run by scientists with a strong commitment to biodiversity. I wanted to get involved and help, but how? It was my ability to bring a different perspective that eventually proved most valuable.

My initial observation was that NatureServe had a very valuable asset: the data used in land development and conservation decisions involving billions of dollars. There was also a heavy concentration in funding from projects for the federal government, and the board and staff had little business experience. The impact I could make was to bring a business perspective to the organization's operating model and help create a more stable and diversified financial base to fund its mission-oriented strategy.

When you join a board, the various ways you can contribute may not be obvious.

A number of events occurred shortly after I joined the board, including the financial crisis, a government shutdown and the budget sequester, which drew more on my business experience managing through crises. Having witnessed the leadership of Goldman Sachs address new challenges during the financial crisis and having played a small role myself in the creation of the Goldman Sachs Bank, I was able to lend some perspective to the challenges charitable organizations were facing with depleted endowment valuations and a sudden decrease in donor sponsorship.

I encouraged the organization to keep its endowment fully invested in its longer-term asset allocation, helped set a course to generate funding from new sources, and mentored the CEO on setting strategy and getting buy-in from her staff. Gradually, the organization has emerged as a stronger entity, with more diversified funding from foundations and the corporate sector.

During board discussions, you may not always feel that you are contributing knowledge that helps the executive leadership or the staff do their jobs more effectively. They are experts at what they do, and you may feel like an outsider. You can add value, however, by simply asking questions, both with the genuine intent to learn more about what they do and also sometimes with the purpose of challenging the way things are done.

Board Diversity

I have been a proponent for more diversity on the board and believe our board is stronger today because of its diversity. We live in a diverse world, and all facets are impacted by how we decide to use our land and natural resources. When I joined the board eight years ago, I was the only member from the corporate sector among mostly scientists and conservationists. Having a more diverse board would be reflective of the biodiversity the organization aims to support.

The membership committee of the board began to target more candidates with corporate and government experience. In selecting potential board members, we look beyond experience and try to find the same passion for the organization's mission that is shared by the executive team. The board dynamic now benefits from the different perspectives of current and former government officials, corporate executives, conservationists and scientists.

In selecting potential board members, we look beyond experience and try to find the same passion for the organization's mission that is shared by the executive team.

Balancing Commitments

Every board member faces the challenge of balancing the time and financial commitment required from their philanthropy with other responsibilities. My own experience has proven that I always have more capacity when I am deeply committed and fit in well with the organization and its mission. This is the benefit of strategic philanthropic thinking. When you can step back and think strategically about finding the fit between what matters to you and how you can make an impact, your ability to find the balance and capacity to make an impact is greater.

The practical reality, however, is that you will find that the organization will demand more of your time and financial resources for every year of your involvement. We advise you to go back to thinking strategically about your commitment to this organization. Factor in the length of time you expect to be involved and assess whether you have the capacity to increase your involvement and funding over that period. Realize that you will be thought of as a major donor well beyond the expiration of any term limits on the board.

Be honest with yourself and try to reach an understanding with the organization about the level of your involvement. You are about to enter into a long-term relationship. As with any other relationship, each party's expectations should be well understood at the outset. With a strategic approach and clear understanding of your role, this philanthropic relationship can be among the most fulfilling relationships of your lifetime.

Endnotes

PLANNING MATTERS ARTICLE

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Additional contributor:

Timothy Brugh
Vice President

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