Investment Policy of the Caucasus Protected Areas Fund

Adopted January 14, 2009
Subject to Change by Action of the Board

I SCOPE OF THIS INVESTMENT POLICY

This statement of Investment Policy sets forth the policy, objectives, and restrictions that apply to investment of the assets of the Caucasus Protected Areas Fund (CPAF).

II PURPOSE OF THIS INVESTMENT POLICY STATEMENT

This statement of Investment Policy is adopted by the CPAF’s Board of Directors (“the Board”) in order to:

1. Define and assign the responsibilities of all involved parties.

2. Establish a clear understanding for all involved parties of the goals and objectives of investing the CPAF’s assets.

3. Offer guidance and limitations to the Investment Consultant and Investment Manager(s) regarding the investment of the CPAF’s assets.

4. Establish a basis for evaluating investment results.

5. Manage the CPAF’s assets according to prudent standards.

6. Establish the relevant investment horizon for which the CPAF’s assets will be managed.

This Investment Policy is intended to be specific enough to be meaningful, yet flexible enough to be practical.

III DELEGATION OF AUTHORITY

The CPAF’s Board is responsible for directing and monitoring the investment management of CPAF assets.

Under the CPAF’s articles by-laws, the Board is responsible for the overall investment of the foundations assets, but may delegate certain of its responsibilities to committees, its executive director, and professional service providers and other support. The adoption of or revision to this investment policy and the hiring or firing of an investment consultant and investment managers are non-delegable decisions of the Board subject to a qualified majority vote, subject to any exceptions therein set forth in the by-laws. The Treasurer is responsible for reporting to the Board about the management of the foundation’s endowment, and will do so with the assistance of the Executive Director and the Investment Consultant.
The Treasurer and the Executive Director shall constitute the Finance Committee hereunder, with the Chairman available to act as alternate in the event that one of those two is not available to take any required action. Decisions delegated to the Finance Committee may be taken by action of any two of those three individuals.

Under its Articles and by-laws, the Board is required to appoint an “Investment Consultant” with the duties described in IV(A) below. In addition it may delegate certain responsibilities to professional experts in various fields. These include, but are not limited to:

1. One or more “Investment Manager(s)”, with the duties described in IV(B) below.
2. A “Custodian”, with the duties described in IV(C) below.
3. Additional specialists such as tax attorneys, auditors, actuaries, and others may be employed by the Board to assist in meeting its responsibilities and obligations to administer the CPAF’s assets prudently.

All expenses for such experts must be customary and reasonable, and will be borne by the CPAF as deemed appropriate and necessary.

Upon appointment of an Investment Manager for the specified assets, the Board will not reserve any control over investment decisions, but instead, with the advice and assistance of the Investment Consultant, will monitor and oversee performance as described in this policy.

Direct investments (including in ETFs) may be made by the CPAF in accordance with the Investment Guidelines set forth in Annex 1 in consultation with the Investment Consultant. For direct investments, the Investment Consultant will regularly monitor and report to the Finance Committee and the Board on performance and continued suitability.

The Investment Consultant and Investment Manager(s) will be held responsible and accountable to make every effort to achieve the objectives herein stated. While it is not believed that the limitations will hamper investment managers, each manager should request modifications that they deem appropriate.

**IV ASSIGNMENT OF RESPONSIBILITY**

**A. Responsibility of the Investment Consultant**

The Investment Consultant’s role is that of advisor to the Board. Investment advice concerning the investment management of CPAF assets will be offered by the Investment Consultant, and will be consistent with the investment objectives, policies, guidelines and constraints as established in this statement. Specific responsibilities of the Investment Consultant include:
1. Assisting in the development and periodic review of the investment policy.

2. Assisting with the efficient structuring of custodial and reporting arrangements.

3. Advice and assistance with direct investments by the CPAF, including without limitation ETFs, deposits with banks and direct investments in bonds permitted hereunder.

4. Assistance with the engagement of Investment Managers, including organizing competitive tenders where appropriate (which shall always be the case where the Investment Consultant proposes to act as Investment Manager), and documenting decisions to engage Investment Managers. Setting annual risk tolerance limits for Investment Managers (see IX below).

5. Conducting investment manager reviews at least annually and new manager searches when requested by the Board; advising the Board on allocations to Exchange Traded Funds (ETFs) and other non-managed investments.

6. Instructing the Custodian to make investments and dis-investments in accordance with the Board’s asset allocation and investment manager decisions, and implementing (through instructions to the custodian, Managers or otherwise) any regular re-balancing of the CPAF’s assets.

7. Providing "Due Diligence", or research, on Investment Manager(s) including a peer manager review performed on an ongoing basis, no less than annually.

8. Monitoring the performance of the Investment Manager(s) and any unmanaged investments to provide the Board with the ability to determine the progress toward the investment objectives, and recommending changes in allocations to Investment Managers or in direct investments as are desirable or appropriate.

9. Monitoring and evaluating compliance by the Investment Manager(s) with the Investment Management Policy.

10. Communicating matters of policy, manager research, and manager performance to the Board.

11. Meet telephonically or in person at least quarterly with the Finance Committee to discuss investment performance, re-balancings to be effected and any proposed changes to allocation targets (see Annex 1). Attend (in person) a meeting of the Board at least once per year to review past year progress and discuss issues relevant to the investments of the CPAF.

If the Investment Consultant or one of its affiliates is acting as an Investment Manager in respect of all or part of the CPAF assets, it will review (and perform peer review of) its own performance with the aim of providing an objective assessment.

**B. Responsibility of the Investment Manager(s)**
Each Investment Manager will have full discretion to make all investment decisions for the assets placed under its direct management, while observing and operating within all policies, guidelines, constraints, and philosophies as outlined in this statement and in any appointment letter specifying permissible categories of investments. Specific responsibilities of the Investment Manager(s) include:

1. Discretionary investment management including decisions to buy, sell, or hold individual securities, and to alter asset allocation within the guidelines established in this statement or any appointment letter specifying permissible categories of investments.

2. Reporting, on a timely basis, quarterly investment performance results.

3. Communicating to the Board through the Executive Director and any Investment Consultant any major changes to economic outlook, investment strategy, or any other factors that affect achievement of such Manager’s investment objectives for the CPAF. Any change of more than 15% in the portion of a Manager’s portfolio allocated to a particular more in asset class (i.e., for an equity focused Manager, a shift from 80% to more than 95% equity) will be considered a change in investment strategy.

4. Informing the Board through the Executive Director and any Investment Consultant of any significant qualitative changes to the investment management organization: Examples include changes in portfolio management personnel, ownership structure, or investment philosophy.

5. Instruction on voting of stock proxies, as indicated by the Board, through the Investment Consultant to communicate with the individual asset managers, on behalf of the CPAF. Also, communicating such voting records to the Board on a timely basis.

C. Responsibility of the Custodian

The custodian will physically (or through agreement with a sub-custodian) maintain possession of securities owned by the CPAF, collect dividend and interest payments, redeem maturing securities, and effect receipt and delivery following purchases and sales. The custodian may also perform regular accounting of all assets owned, purchased, or sold, as well as movement of assets into and out of the CPAF accounts. The Investment Consultant or one of its affiliates may also act as Custodian.

V. LONG-TERM GOAL OF THE ENDOWMENT

The CPAF’s Endowment is intended to exist in perpetuity, and therefore, should provide for a substantial, stable flow of resources to carry out its grant-making spending in perpetuity. To attain this goal, the long-term financial planning of the CPAF will seek to maintain and if possible increase purchasing power by growing the endowment in excess of inflation plus spending. Therefore, the financial goal may be expressed by the following equation:

\[ \text{Increase in Purchasing Power} = \text{Total Return} - \text{Total Withdrawals}, \]

Where:
Total Return is the aggregate return from capital appreciation and dividend and interest income, and
Total Withdrawals = Grant Spending + Expenses + Inflation

New gifts in any given year will not be calculated in measuring performance.

Subject to investment returns and budget requirements, the CPAF intends to increase its endowment each year by at least that portion of its return on endowment investment equal to inflation.

The CPAF recognizes that in order for the CPAF to reach its ultimate grant spending goals (approximately Euro 1.75 million annually in 2009 Euros) it will have to increase its endowment through additional donations or keep grant-making and administrative expenditures initially below amounts targeted in the future so that the endowment can grow.

VI. INVESTMENT MANAGEMENT POLICY

1. Preservation of Purchasing Power - The Board may employ one or more investment managers of varying styles and philosophies to attain the CPAF's objectives. Consistent with their respective investment styles and philosophies, investment managers should make reasonable efforts to preserve capital, understanding that losses may occur in individual securities and that accounts in more volatile asset classes will fluctuate in value. Preservation of capital for this purpose means preserving principal plus achieving growth in excess of the rates of inflation in each of the currencies in which the CPAF’s assets are invested.

2. Risk Aversion - Understanding that risk is present in all types of securities and investment styles, the Board recognizes that some risk is necessary to produce long-term investment results that are sufficient to meet the CPAF's objectives. However, the investment managers are to make reasonable efforts to control risk, and will be report regularly (not less than semi-annually) to the Board (through the Investment Consultant or the Executive Director) to ensure that the risk assumed is commensurate with the given investment style and objectives. Investment of the CPAF shall be so diversified as to reduce the risk of large losses to a level deemed acceptable by the Board, unless under the circumstances it is clearly prudent not to diversify.

3. Adherence to Investment Discipline - Investment managers are expected to adhere to the investment management styles for which they were hired. Managers will also report regularly (not less than semi-annually) to the Board (through any Investment Consultant and the Executive Director) as to adherence to investment discipline.

4. Productive Employment of Cash - Cash is to be employed productively at all times, by investment in short-term cash equivalents to provide safety, liquidity, and return.

VII. INVESTMENT OBJECTIVES

In order to meet its needs, the investment strategy of the CPAF is to emphasize Total Return.

The primary objectives in the investment management for CPAF assets shall be:
To Balance the Desire for Long-Term Capital Growth (increase in Purchasing Power) with the CPAF’s near-term spending needs.

Given that administrative expenses in 2008 and 2009 are expected to be covered from other sources and the grant spending needs in 2008 are expected to be zero and low in 2009, the Board may, for example, instruct any Investment Consultant and Investment Managers to take the modest cash needs into account in constructing the portfolio. Beginning in 2010, it is expected that a quarterly draw will be made to meet the regular grant spending needs and administrative expenses of the CPAF.

VIII. SPECIFIC INVESTMENT GOALS

For the purposes of this statement, "investment horizon" shall be the time period over which the investment objectives, as set forth in this statement, are expected to be met. The immediate investment horizon for the CPAF’s assets is 10 years, with a long-term horizon of perpetuity.

Over the investment horizon, using a three-year rolling average, it is the CPAF’s goal to exceed a total nominal return of 6.5% p.a. net of investment expenses.

The investment goal above is the objective of the aggregate CPAF, and is not meant to be imposed on each asset class. The goal of each investment manager, over the investment horizon, shall be to:

1. Meet or exceed the market index or blended market index agreed upon by the Board that most closely corresponds to the style of investment management.

2. Display an overall level of risk in the portfolio that is consistent with the risk associated with the benchmark specified above. Risk will be measured by the standard deviation of quarterly returns.

The CPAF recognizes that in its start up phase when it seeks to make grants on the basis of an endowment capital that is significantly less than its target, it will be investing primarily in asset classes with a lower risk and a lower return. The total nominal return goal set forth above should be understood as the goal when the CPAF has total assets that allow it more flexibility to achieve its goals.

IX. DEFINITION OF RISK

The Board realizes that there are many ways to define risk. It believes that any person or organization involved in the process of managing the CPAF assets understands how it defines risk so that the assets are managed in a manner consistent with the CPAF's investment objectives and investment strategy.

The Board defines risk primarily as:

Not maintaining purchasing power of any given asset class over the CPAF’s 10-year investment time horizon. Purchasing power is defined as value of principal adjusted for the rate of Euro-denominated or dollar denominated inflation, as specified for each Investment Manager.
The Board defines risk secondarily as:

Excessive fluctuation in the value of CPAF assets during a one-year period. This will be defined separately for each Investment Manager or asset class. It is defined for the CPAF assets overall as a 5% down or 20% up change in value over a one-year time horizon. Either limit, if exceeded, will indicate that the portfolio may be subject to excessive volatility risk. When the measure is triggered it will require at a minimum a review of investment strategy with the Investment Consultant, if any, or the relevant Investment Managers or both.

X. LIQUIDITY

To minimize the possibility of a loss occasioned by the sale of a security forced by the need to meet a required payment, the Board will periodically provide the Investment Consultant with its two year rolling budget of expenditures required to be covered from the endowment. The Board will notify the investment consultant of changes to such budget in a timely manner, to allow sufficient time to build up necessary liquid reserves.

To maintain the ability to deal with unplanned cash requirements that might arise, the Board requires that a minimum of ½ of 1% of CPAF assets shall be maintained in cash or cash equivalents, including money market funds or short-term U.S., U.K., German or Swiss Government Treasury Bills or bonds.

XI. INVESTMENT GUIDELINES

Investment management of the assets of the CPAF shall be in accordance with the asset allocation guidelines set forth in Annex 1. It is intended that Annex 1 be revised periodically (at least once and perhaps twice a year) as the CPAF’s assets grow over its start-up phase to contemplate a more diverse set of assets.

XII. INVESTMENT MANAGER PERFORMANCE REVIEW AND EVALUATION

Performance reports generated by the Investment Managers and the Investment Consultant shall be compiled quarterly and communicated to the Board for review. The investment performance of total portfolios, as well as asset class components, will be measured against commonly accepted performance benchmarks.

Consideration shall be given to the extent to which the investment results are consistent with the investment objectives, goals, and guidelines as set forth in this statement. The Board intends to evaluate the portfolio(s) over at least a three-year period, but reserves the right to terminate any investment consultant or manager for any reason including the following:

1. Investment performance that is significantly less than anticipated given the discipline employed and the risk parameters established, or unacceptable justification of poor results.

2. Failure to adhere to any aspect of this statement of investment policy, including communication and reporting requirements.
3. Significant qualitative changes to the investment management organization.

Investment managers shall be reviewed regularly regarding performance, personnel, strategy, research capabilities, organizational and business matters, and other qualitative factors that may impact their ability to achieve the desired investment results.

XII. INVESTMENT POLICY REVIEW

To assure continued relevance of the guidelines, objectives, financial status and capital markets expectations as established in this framework statement of investment policy, the Board plans to review investment policy at least bi-annually and as the need maybe.
Asset Allocation Guidelines

This initial strategic asset allocation (target date, June 20, 2009) is proposed in light of the current assets of the CPAF and its proposed initial spending commitments and expected administrative expenses. In December 2008, the CPAF received an additional endowment donation of $500,000 from CI representing the Gregory Alexander contribution. Given the CPAF’s spending needs and investment income modeled in Attachment A, it is considered prudent to invest primarily in fixed income assets that will guarantee the required initial cash flow. If for example, the CPAF adopted a 50/50 equity/fixed-income allocation today, its ability to meet its spending plans would be put at risk. A sustained drop in the equity markets of say 5% in 2009 would already have that effect. As the CPAF gains more flexibility with additional donations, the weightings to asset classes other than fixed income is expected to grow significantly.

The allocation also reflects the availability to the CPAF of the Acacia Investment opportunity presented at previous board meetings. The Board approved an initial investment by the CPAF of $1,500,000 in Acacia as follows. $500,000 in the October opening which has been invested; $500,000 in the February opening; and $500,000 in the June opening. Up to an additional $1,000,000 could be invested after that depending on circumstances at the time. The Acacia investment will be reflected in the allocation as 100% equity. The Investment Consultant considers this allocation realistic.

The Investment Consultant will present a model of what a fully funded (Euro 50 million endowment) CPAF asset allocation might look like at the 2009 annual board meeting.

Of its overall portfolio, at least 90% of the CPAF’s assets must be invested in liquid securities, defined as securities that can be sold quickly and efficiently for the CPAF, with minimal impact on market price. Securities with defined exits windows occurring at least twice a year will count as liquid securities as long as not more than 20% of the CPAF’s assets are invested in such securities.

The maximum and minimum percentages below set forth permissible ranges within which the CPAF Board or its representatives may from time set the CPAF current or “target” allocations for asset classes.
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<thead>
<tr>
<th></th>
<th>Maximum</th>
<th>Minimum</th>
<th>Current Target</th>
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<tbody>
<tr>
<td>Cash(2)</td>
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<td></td>
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<tr>
<td>Fixed Income(2)</td>
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<td>60%</td>
<td>87%</td>
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<tr>
<td>Equities</td>
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<td>5%</td>
<td>13%</td>
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<tr>
<td>Real Assets (4)</td>
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<td>0%</td>
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<tr>
<td>Alternative Investments (5)</td>
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(1) At June 30, 2009 following staggered investment in Acacia
(2) For these purposes, cash includes bank deposits and other short-term investments with a maturity of two months or less, and fixed income includes bank deposits and other short-term investments with a maturity of more than two months.
(3) 100% of anticipated Acacia Investment in the amount of USD 1,500,000 at June 30 2009 allocated to equity
(4) Includes e.g., real estate, energy, timber, minerals, agriculture
(5) Includes e.g., absolute return strategies, low volatility hedge funds

Subject to the issuance of contrary instructions by the Board at any time, the Finance Committee, with the advice of the Investment Consultant, will have the following powers and responsibilities:

- It will implement the fixed income portion of the strategic asset allocation’s current target either through continued investments in bank deposits or government or corporate bonds approved that are allowable investment types under these guidelines, or through one or more debt asset manager appointed by the Board.
- Upon approval of any Investment Manager by the Board, it will effect allocations to such Manager consistent with Board’s instructions and the strategic asset allocation target.
- It may re-allocate funds among investment managers previously approved by the board in the same general risk category, provided that the overall target of the strategic asset allocation is respected.
- It may shift the exposure of the CPAF from that contemplated by the target allocation by up to 5 percentage points from higher categories of risk to lower categories of risk, provided that the asset allocation remains within the specified ranges established above.
- Re-allocate funds among asset classes and approved investment managers to achieve re-balancing of CPAF investments to target allocations for asset classes when allocations have been affected by changes in the value of investments (re-balancing)
The Finance Committee will report on its activities to the Board at each board meeting, which may vary these instructions. The Finance Committee will report any change in these instructions to the Investment Consultant.

Given the long-term investment orientation of the CPAF, the CPAF’s bias will be toward maintaining its target allocation rather than making frequent tactical adjustments. That said, target allocations may be adjusted in periods of extraordinary market turmoil or otherwise as decided by the Board. In addition, because individual managers will be adjusting their portfolios within their specific asset class mandates from time to time as they see fit, even if the overall allocation remains fairly constant due to re-balancing there will be tactical shifts from time to time in the individual portfolios.

The CPAF’s policy will be to re-balance semi-annually to its overall target allocation (absent circumstances which lead it to change its target allocation), if the weighting of any specific asset class (except Cash) exceeds the target allocation by more than 5%-points.

**Diversification of and by Investment Managers**

In order to achieve a prudent level of portfolio diversification, investments in equity securities with any one manager or class of investment (e.g., ETF) shall initially not exceed 20% of the total assets of the CPAF. The goal is to achieve optimal diversification and that this target should ultimately be reduced to below 10% as the CPAF’s total assets grow. Given the initial size of its endowment, however, it is believed that it will be important to place enough funds with certain managers so that the investment is meaningful.

The equity securities of any one company should not exceed 3.5% of the total assets of the CPAF, and no more than 15% of the total assets of the CPAF should be invested in any one industry. Individual government-issued securities may represent 5% of the total assets of the CPAF, while the total allocation to treasury bonds and notes of any single country’s issue may represent up to 40% of the CPAF’s aggregate bond position.

**Guidelines for Fixed Income Investments and Cash Equivalents**

1. CPAF assets may be invested only in investment grade bonds rated BBB (or equivalent) or better. High-Yield Bond and Convertible Bond Investments are specifically exempt from this requirement but must be managed by a well-established firm with a high degree of capability in credit analysis and invested in a portfolio with a record of competent credit management.

2. Fixed income maturity restrictions are as follows:
   - Maximum maturity for any single security is 15 years.
   - Weighted average portfolio maturity may not exceed 7 years.

3. Money Market Funds selected shall contain securities whose credit rating at the absolute minimum would be rated investment grade by Standard and Poors, and/or Moody's.

**Allowable Investment Types**
1. Cash Equivalents allowed include the following:
   - German, U.S., U.K., or Swiss Government Treasury Bills or bonds
   - Money Market funds in Euro, US dollars, or British pounds
   - Commercial Paper
   - Banker's Acceptances
   - Repurchase Agreements
   - Certificates of Deposit

2. Fixed Income Securities allowed include the following:
   - Fixed Income Securities of Governments and Corporations
   - Pre-2004 EU member state and U.S. Corporate Notes and Bonds
   - Pre-2004 EU member state and US Government and Agency Securities
   - Preferred Stock

3. Equity Securities allowed include the following:
   - Ordinary Shares of German and non-German Companies (common stock)
   - American Depository Receipts (ADRs) of Non-U.S. Companies
   - Convertible Notes and Bonds
   - Convertible Preferred Stocks

4. Mutual Funds allowed include the following:
   - Open-end Mutual Funds that invest in securities as allowed in this investment
     policy statement.
   - Closed-end Mutual Funds which invest in securities as allowed in this
     investment policy statement.

5. Alternative Investments allowed include the following:
   - Guaranteed Investment Contracts (GIC’s)
   - Low-Volatility Hedge Funds
   - Real Estate Investment Trusts
   - Private Equity

**Derivative Investments**

Derivative securities are defined as synthetic securities whose price and cash flow characteristics are based on the cash flows and price movements of other underlying securities. Most derivative securities are derived from equity or fixed income securities and are packaged in the form of options, futures, CMOs (PAC bonds, IOs, POs, residual bonds, etc.), and interest rate swaps, among others. The Board observes that many derivative securities are relatively new and therefore have not been observed over multiple economic cycles. Due to this uncertainty, the Board will take a conservative posture on derivative securities in order to maintain its risk adverse nature.

**Prohibited Investment Types**

Prohibited investments include, but are not limited to the following:

1. Individual (non-managed) Commodities and Futures Contracts
2. Private Placements (except indirectly to the extent forming part of an alternative Investment Manager’s portfolio or an insignificant part of the portfolio of an Investment Manager’s managing traditional investments).

3. Derivatives which increase portfolio risk above the level that could be achieved in the portfolio using only traditional investment securities, or derivatives used to acquire exposure to changes in the value of assets or indices that by themselves would not be purchased for the portfolio.

4. Private, Non-registered Limited Partnerships (other than hedge funds or other vehicles that invest primarily in assets or indices that by themselves could be purchased for the portfolio)

5. Venture-Capital Investments

Social and Environmental Screening

Companies and industry categories may be excluded from investment due to social or environmental screening preferences.

The CPAF’s current policy in this regard is that direct investments by the CPAF in securities of companies which have their main business focus on the following industries are prohibited: nuclear energy, defence industry, tobacco, genetic engineering and pornography. Excluded from this restriction are investments in investment funds and similar pooled investments.

The Board may consider imposing on Investment Managers screening on the management of assets including the exclusion of investment due to social and environmental preferences in the future.