

Investment Policy of the Caucasus Nature Fund

As Amended in May 2013
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 Nature Fund (CNF).

II PURPOSE OF THIS INVESTMENT POLICY STATEMENT

This statement of Investment Policy is adopted by CNF'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 CNF's assets.
3. Offer guidance and limitations to the Investment Consultant and Investment Manager(s) regarding the investment of CNF's assets.
4. Establish a basis for evaluating investment results.
5. Manage CNF's assets according to prudent standards.
6. Establish the relevant investment horizon for which CNF'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

CNF's Board is responsible for directing and monitoring the investment management of CNF assets.

Under CNF'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 composition of the Investment Committee will be as determined from time to time by the Board. The Treasurer and the Executive Director shall be members and the Chairman available to act as alternate in the event that one of those two is not available to take any required action. The Investment Committee is open to the participation of other Board Members. Decisions delegated to the Investment Committee may be taken by action of any two of the Executive Director, the Treasurer and the Chairman.

For as long as CNF does not have a professional internal staff dedicated to investment management, the Board plans to delegate certain responsibilities to professional experts in various fields. These include, but are not limited to:

1. An “Investment Consultant” with the duties described in IV(A) below.
2. One or more “Investment Manager(s)”, with the duties described in IV(B) below.
3. A “Custodian”, with the duties described in IV(C) below.
4. 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 CNF’s assets prudently.

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

Upon appointment of an Investment Manager for the specified assets or investment in a non-managed asset such as an ETF (Exchange Traded Fund), the Board will not reserve any control over investment decisions, but instead will monitor and oversee performance as described in this policy. 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

If an Investment Consultant is appointed by the Board, its role is that of advisor to the Board. Investment advice concerning the investment management of CNF 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. Assistance with the engagement of Investment Managers, including organizing the respective “pitching process”, and documenting decisions to engage Investment Managers. Setting annual risk tolerance limits for Investment Managers (see IX below).

4. Conducting investment manager reviews at least annually and new manager searches when requested by the Board; advising the Board on allocations to ETFs and other non-managed investments.
5. 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 CNF's assets.
6. Providing "Due Diligence", or research, on Investment Manager(s) including a peer manager review performed on an ongoing basis, no less than annually.
7. 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.
8. Monitoring and evaluating compliance by the Investment Manager(s) with the Investment Management Policy.
9. Communicating matters of policy, manager research, and manager performance to the Board.
10. Meet telephonically or in person at least quarterly with the Investment 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 CNF.

If the Investment Consultant is acting as an Investment Manager in respect of all or part of CNF 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 CNF. Unless otherwise specified in the investment guidelines for any particular manager, any change of more than 15% in the portion of a Manager's portfolio allocated to a particular 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. Voting at shareholders' meetings shall be as agreed in the relevant appointment letter/investment management agreement.
6. The currently effective investment guidelines for individual investment managers shall be annexed to this Investment Policy from time to time.

C. Responsibility of the Custodian

The custodian will physically (or through agreement with a sub-custodian) maintain possession of securities owned by CNF, 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 CNF accounts. The Investment Consultant or one of its affiliates may also act as Custodian.

V. LONG-TERM GOAL OF THE ENDOWMENT

CNF'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 CNF 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:

Increase in Purchasing Power = Total Return – 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, CNF intends to increase its endowment each year by at least that portion of its return on endowment investment equal to inflation.

CNF recognizes that in order for CNF to reach its ultimate grant spending goals (approximately Euro 1.75 million annually in 2008 Euros) it will have to increase its endowment through additional donations and 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 CNF'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 CNF'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 CNF'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 CNF 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 CNF is to emphasize Total Return.

The primary objectives in the investment management for CNF assets shall be:

To Balance the Desire for Long-Term Capital Growth (increase in Purchasing Power) with CNF's near-term spending needs.

CNF's spending and investment strategies over at least the years 2013-2020 will be marked significantly by the existence of its sinking funds:

- Approximately Euro 600,000 in GEF funds remain at the outset of 2013 which are to be spent on grants by 2016

- Approximately Euro 12 million of BMZ funds are on hand of which Euro 10 million are to be spent on grants by 2030 and Euro 2 million are to be spent on operating costs in the Caucasus by 2030.

Spending on grants will be prioritized from:

- annual donations and sinking fund usage and
- interest and dividends from CNF's investments that are in excess of amounts necessary to cover operating expenses and permit the maximum allocation to reserves.

CNF's investment earnings or management fees are expected to be more than sufficient in the coming years to cover European administrative expenses (and Caucasus administrative expenses not covered by the 2030 Sinking Fund). Investment of the endowment funds should take into account CNF's need to cover administrative costs from its endowment, and will therefore take into account the need for dividend and interest income.

Spending on Caucasus operating costs will be prioritized from the earmarked BMZ sinking funds.

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 CNF's assets is 10 years, with a long-term horizon of perpetuity.

Over the investment horizon, using a three-year rolling average, **it is CNF's goal to exceed a total nominal return of 5% p.a. net of investment expenses.**

The investment goal above is the objective of the aggregate CNF, 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.

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 CNF assets understands how it defines risk so that the assets are managed in a manner consistent with CNF's investment objectives and investment strategy.

The Board defines risk primarily as:

Not maintaining purchasing power of any given asset class over CNF'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 CNF assets during a one-year period. This will be defined separately for each Investment Manager or asset class. It is defined for CNF 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 Executive Director, based on the most recent budget approved by the Board and projections for future spending, will periodically review with the Investment Consultant its expenditure plans for the sinking funds and the needs required to be covered from investment income on a rolling two year basis. . The Executive Director 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 CNF 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 CNF 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 CNF's assets grow 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 Investment Committee for quarterly review and the Board for semi-annual review. The Investment Committee will report semi-annually to the Board on its actions and on the performance of the portfolio. The Board will receive an in person review of investment performance and recommendations with the investment advisor at least once per year.

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.