

## **PURPOSE**

The purpose of this Investment Policy Statement (IPS) is to assist the Board of Trustees (the “Board”) of the American Association of Petroleum Geologists Foundation (“the Foundation”) in effectively supervising, monitoring and evaluating the performance of the Foundation’s investment assets.

The Investment Policy Statement serves the following objectives:

- Incorporating in a written document the principles, expectations, objectives and guidelines for the management and oversight of the Foundation’s investment assets.
- Setting forth an investment structure for managing the Foundation’s assets. This structure includes various asset classes, investment management styles, asset allocation and acceptable allocation ranges that, in total, are expected to produce a desirable level of overall diversification and total investment return over the long-term (greater than five years).
- Providing an effective framework for communications among the Board members, custodian bank(s), money managers, the Foundation’s investment consultant and other service providers.
- Establishing criteria to monitor, evaluate and compare the performance results achieved by money managers on a regular basis.
- Complying with all applicable trust, fiduciary, prudence and due diligence requirements that experienced investment professionals would utilize, and with all applicable laws, rules and regulations.

## **STATEMENT OF OBJECTIVES**

The objectives of the Foundation’s investment program are:

1. **To maintain the level of programs and services supported by the Foundation on an ongoing basis taking into consideration normal cost increases due to inflation.** The Foundation must achieve an investment return that is equal to or greater than foundation spending, associated expenses, and inflation.
2. **To maintain a predictable level of spending.** To achieve this objective, the Foundation has adopted a spending policy which allows for the spending of income (dividends, interest, rents, etc.) as well as capital value change (realized and unrealized). The spending policy is called Total Return and is defined on page 4.
3. **To control the costs of administering and managing the Foundation’s investment assets.** During the first half of each calendar year, the Board will evaluate the fee structures of the Foundation’s custodian(s), money managers, brokers, investment consultant and other service providers.

## **MANAGEMENT AND RESPONSIBILITIES**

### Board of Trustees

With respect to investment management issues, the Board of Trustees is responsible for:

- developing investment policies, including specific investment objectives and portfolio management and supervisory guidelines;
- developing Investment Manager Guidelines and Policies;
- implementation of investment and manager policies;
- employing and monitoring investment managers, investment consultants, custodian banks, brokerage firms and other financial service providers;
- allocating investment assets to investment managers;
- monitoring the Foundation's actual versus target asset allocation and rebalancing the portfolio when appropriate; and
- monitoring and controlling expenses associated with the management of the portfolio. (expenses include but are not limited to: consultant's fees, custodian fees, audit fees, legal fees, mutual fund fees, investment manager's fees, etc)

### AAPG Foundation Staff

With respect to investment management issues, the Foundation administration staff shall be responsible for the day-to-day tasks associated with the management and oversight of the Foundation's investment funds. Duties include working with the Investment Consultant in reviewing portfolio and manager performance, analyzing out-of-balance conditions with respect to stated asset allocation guidelines, monitoring cash flow projections to identify the need for fund withdrawals, and making recommendations to the Board accordingly.

The Foundation administration staff will also monitor the performance of the Investment Consultant and report promptly to the Board any material shortcomings or deviations which could materially affect the investment management process. Additionally, the staff will collect and report data-at least every 12 months- which will allow the Board to monitor and control all expenses associated with management of the portfolio.

### Investment Consultant

The Investment Consultant will be a registered investment advisor and be selected by and serve at the pleasure of the Board. It is the Consultant's duty to work with the appropriate Foundation staff and the Board to help serve the investment management process. This will include regular meetings with the Staff and the Board to provide an independent perspective on the issues facing overall management and oversight of the

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Foundation's investment funds. Specifically, the Consultant will analyze and make recommendations regarding investment policies, asset allocation issues, and performance measurement and evaluation. The Consultant will also play an active role in investment manager and other service provider search and selection, provide ongoing performance of Mutual Fund Managers and Investment Managers (including advising on any changes in key managers), and will promptly advise the Board when corrective action is required.

#### Investment Managers

***See Note 1 below.***

Investment Managers will be selected by and serve at the pleasure of the Board. Typically, the Board will rely upon the advice of the Investment Consultant when selecting and dismissing investment managers.

The duties and responsibilities of each money manager retained by the Foundation will include the following:

- Managing the Foundation's assets on a fully discretionary basis in accordance with this Investment Policy Statement and any other policies or directives that might be in force.
- Promptly informing the Board And its designee regarding all significant matters and changes affecting the investment of the Foundation assets, including, but not limited to:
  - Ownership of the firm
  - Organizational structure
  - Professional staff
  - Investment strategy
  - Portfolio structure
  - All material legal, SEC and other regulatory agency proceedings affecting the firm
- Complying with all applicable laws, rules and regulations from local, state, federal, and international political entities as it pertains to the management and oversight of the Foundation's investment assets.

The Board, with input from the Foundation's Investment Consultant, will establish specific guidelines for each money manager that is retained. These guidelines will outline the money manager's responsibilities, any investment constraints not outlined in the Foundation's Investment Policy Statement, as well as the performance measurement criteria that will be used when evaluating the manager on an ongoing basis.

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Managers will be given explicit written directions detailing their particular assignments, and will construct and manage investment portfolios that are consistent with the investment philosophy and disciplines for which they were retained. A sample of these guidelines is contained in the Appendix section, “Investment Manager Policies and Guidelines”.

#### Custodian

The Custodian(s) holds directly, through its agents, its sub-custodians, or designated clearing systems, assets as designated by the Board or its designee. The Custodian is accountable for registration of those designated assets in good delivery form, collection of income generated by those assets, and any corporate action notification. The Custodian is responsible for delivery and receipt of securities and cash when notified by the Board or its designee, and tracking and reporting of the aforementioned transactions. The Board may opt to designate other duties to the Custodian(s).

## **SPENDING POLICY**

The Board of Trustees has adopted the following “total return” Spending Policy.

#### Definition

The concept of “total return” refers to the combination of (1) income as defined by interest, dividends, rental income, and other similar income, and (2) capital value change (realized and unrealized). Distributions governed by this spending policy from the Foundation’s investment portfolio rely on this total return concept and therefore may be the result of income and/or capital appreciation. However, it is further recognized that the Board may from time-to-time see the need to preserve assets and establish spending limits.

#### Scope

This Spending Policy applies to all the Foundation investment funds except for the following.

- Any portion of gift instrument funds which represent closely-held securities, real estate, minerals or other income generating investments which cannot be pooled will rely on the actual income generated for spending.
- Gift instruments of non-income-generating assets (life insurance policies, etc.) will continue to hold those assets intact. These assets will not generate a spending amount until they mature or are converted into marketable securities.
- Gift instruments specifically established to provide for distributions of principal will continue to spend these amounts in accordance with the gift directives or the precedent set by the practice of the fund.

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#### Implementation Issues

Investment return in excess of distributable amounts will remain in the Foundation's investment portfolio(s).

All calculations are made once per year. Consequently, new funds will not receive allocations until the following year. Likewise, additions to existing funds will not result in an allocation adjustment until the following year. Although funds will be pooled for management purposes, investment return will be allocated to each fund based on the specific fund's market value at the beginning of each year.

#### Continued Viability

The Board understands the long-term nature of the Foundation's spending policies, but will review these policies at least annually- in the first half of each calendar year -to assess their continued feasibility. Particular attention will be paid to whether the Foundation's investment portfolio achieved positive real growth after expenses and distributions and before additional contributions.

## **ASSET ALLOCATION**

The time horizon for the Foundation's investment assets is long term. In theory, these funds are perpetual. The Board believes that the Foundation's risk exposure, return potential and liquidity posture are in large part a function of asset class mix and has identified the following asset classes for placement of the Foundation investment assets:

- Large-cap domestic equities
- Small and Mid-cap domestic equities
- International equities
- Domestic Fixed-income
- Equity Real Estate Investment Trusts (REITs)
- Cash and Cash Equivalents

#### Alternative Asset Classes and Investment Strategies

Alternative Asset Classes and Investment Strategies, such as oil & gas, timber, gold, cattle, etc. are approved asset classes. However, investments in these classes must be reviewed in detail by the Board, with input from the Foundation's Investment Consultant. Investment in any alternative asset class must be approved by a simple majority vote of the Board members.

The Board may choose to employ various "sub-asset classes" and investment management styles within each of the broad asset classes described above.

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Inputs to the asset allocation process include expectations for return, risk (as measured by an asset class's historical distribution of returns), and correlation (how two asset classes are expected to respond with respect to each other in a given market environment). Also, critical to the asset allocation process is a rate-of-return target, commonly referred to as a portfolio's "required rate-of-return" or "liability target".

The Foundation's asset allocation structure, rate-of-return target and other relevant information are described more completely in the Appendix: "Portfolio Description Foundation Assets".

## **ASSET CLASS GUIDELINES**

The Board realizes that the desired rate-of-return and the risk associated with the pursuit of these returns should be considered primarily at the total portfolio level. ALTHOUGH money managers and investment strategies may be evaluated in isolation, it is their contribution to the overall portfolio that is critical to the achievement of the Foundation's investment objectives. With this in mind, the following guidelines apply at the portfolio level unless otherwise stated.

These guidelines are not meant to be overly restrictive. Rather, these guidelines are meant to highlight specific areas that warrant ongoing monitoring and evaluation. More specific asset class guidelines may be included in the Appendix: "Portfolio Description Foundation Assets".

### **Domestic Equities**

The total allocation to domestic equities should be diversified with respect to economic sectors, industry groups and market capitalization. Specific attention should be given to each of these factors where there is substantial deviation from the weightings of a broad-based equity benchmark. In addition, security concentrations will be monitored to ensure that company-specific risk is monitored and reviewed. The Board recognizes that company specific risk can, at times, be an issue. The Board will monitor such circumstances on a case-by case basis. Permissible investments include:

- U.S. Common Stocks and Preferred Stocks
- American Depository Receipts (ADRs)
- Real Estate Investment Trusts (REITs)
- Mutual and Commingled Funds containing the above securities

The Board recognizes the use of stock warrants and stock index futures by mutual funds, especially index funds. The Board does not condone the use of these investments for speculative purposes. However, within the context of mutual funds, these are permissible investments.

### Domestic Fixed-Income

The total allocation to domestic fixed-income securities should have a weighted average Standard & Poors credit rating of A or better. In addition, the portfolio should be diversified across sectors (U.S. Government, corporate, mortgage-backed) and issuers, with special attention given to the weightings of corporate issuers to minimize company-specific risk. Particular attention should be given to these factors when there is a substantial deviation from the weightings and/or characteristics of a common fixed-income benchmark. Consideration should also be given to the overall duration of the portfolio with respect to that of the index to ensure no *unintended* bias is evident at the portfolio level. Permissible investments include:

- Securities of the U.S. Government, its Agencies and Instrumentalities
- Corporate Bonds and Notes
- Asset-Backed Securities
- Mortgage-Backed Securities
- Convertible Bonds
- Yankee Bonds (issued in US, denominated in US \$, issued by foreign corporations)
- Mutual and Commingled Funds containing the above securities

### International Equities

The total allocation to international equity securities should be broadly diversified among regions, countries, sectors, currencies and securities. The total allocation to emerging markets should be less than 20% of the international allocation. Specific attention should be given with respect to each of these factors in the case where there is substantial deviation from the weightings of a broad-based international equity benchmark. In these instances, the issue will be brought to the Board's attention as soon as it is identified. In addition, security concentrations will be monitored, and reviewed on a case-by-case basis. Permissible investments include:

- Non-U.S. Common Stocks and Preferred Stocks
- American Depositary Receipts (ADRs)
- Mutual and Commingled Funds containing the above securities

As with domestic equities, the Board acknowledges and approves the use of stock warrants and stock index futures within the context of mutual funds. The Board does not condone the use of the stock warrants and stock index futures for speculative purposes.

### Equity Real Estate Investment Trusts

Any allocation made to equity real estate investment trusts (REITs) should be broadly diversified among property type and geographic area.

### Alternative Asset Strategies

Typically, “traditional” securities will make up the major portion of the Foundation’s investment portfolio. However, the Board recognizes that “alternative” asset classes and investment strategies can be useful in an effort to enhance the long-term total return of the Foundation’s portfolio. Likewise, these investments and investment strategies can exhibit low relative correlations to the public markets and therefore may have a risk mitigating effect on the Foundation’s portfolio when used in conjunction with traditional asset classes.

The nature of some alternative asset classes and investment strategies makes it difficult to achieve exact targets. First, many alternative investments are structured under a “fund of funds” arrangement. These vehicles (usually partnerships) typically invest in a number of different investment strategies and asset classes. While fund-of-funds facilitate diversification, the Board recognizes that it does not control the underlying investments and strategies.

Second, the mechanism for investing in many alternative asset classes involves making a commitment to an investment of a specific dollar amount. However, the “committed capital” may actually be invested over a number of years.

In light of these realities, the Board recognizes that reaching the Foundation’s target allocation to alternatives may be a multi-year endeavor.

Since alternative investment strategies often have limited liquidity, it is important to evaluate the future cash needs of the Foundation before a particular strategy is employed.

### Cash & Cash Equivalents

Investments in cash and cash equivalents shall consist of high quality securities with high liquidity and current maturities of one year or less. Permissible investments include:

- U.S. Treasury Bills
- Commercial Paper



- Certificates of Deposit
- Repurchase Agreements
- Agency Discount Notes
- Bank Short-Term Investment Funds (STIF)

## **SELECTION OF MONEY MANAGERS**

Money managers must meet the following minimum criteria:

1. Provide historical performance information calculated on an industry-accepted basis.
2. Provide detailed information on the history of the firm, key personnel and fees.
3. Clearly articulate the investment strategy to be followed and be able to document that the strategy has been adhered to consistently over time.
4. Selected firms shall have no outstanding legal judgments or recent past judgments that reflect negatively upon the firm.
5. Provide copies to Trustees of annual SEC document filings.

## **IMPLEMENTATION ISSUES**

### Policy Compliance

No deviation from this document is permitted without prior, explicit, written permission from the Board. Investment managers who fail to follow these general policies and/or manager specific guidelines as outlined in the Appendix, "Investment Manager Policies and Guidelines", may be terminated.

### Proxy Voting

The Board, as part of its responsibilities, shall have the right to vote any and all proxies in connection with securities held by the Foundation.

The Board may delegate to Investment Managers who invest the Foundation's funds or other appropriate parties the responsibility of voting any or all proxies. The Board and/or its designee, as applicable, have the responsibility to vote solely in the interest of the Foundation and to protect the value of the securities within the portfolio. If proxy voting is delegated to an Investment Manager or other party, the manager or other party must keep detailed records of all proxies and related actions voted and must make an annual report available to the Board or their designee.

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#### Trading Policy

##### **See Note 1 below.**

All fixed-income and equity managers shall have full discretion in trading their respective portfolios.

#### Brokerage Policy

##### **See Note 1 below.**

The Board hereby delegates discretion over the placement and execution of securities transactions to its managers subject to the following provisions.

- **Commission Rates**

Each investment manager will, upon request, be required to provide the Staff with a report showing all brokerage transactions effected for the Foundation portfolio for which the manager has trading responsibilities.

The Custodian shall also provide brokerage commission information to the Staff upon request.

- **Directed Brokerage**

It is the Board's intention that all money managers seek "best execution" when effecting brokerage trades for the Foundation's portfolio. In this regard, money managers should not be "directed" to trade through specific brokerage firms unless there are clear benefits to the Foundation's portfolio, such as a part of one or more commission recapture programs. Furthermore, all money managers, custodians, consultants and other service providers are required to develop and charge their fees on a "hard dollar" basis the Foundation will not pay for services via open-ended directed brokerage arrangements.

- **Commission Recapture**

The Board recognizes that properly executed commission recapture programs can be beneficial to the Foundation. With the advice of the Foundation's Investment Consultant, the Board may enter into certain commission recapture programs. These programs may be offered by various institutional brokerage firms and/or by certain large banks. Should the Foundation enter into any commission recapture program, the Board will control all rebate monies that are due to the Foundation's portfolio. Specifically, the Board may request that these monies be returned to the Foundation's investment portfolio. Optionally, the Board may direct commission recapture vendors to maintain one or more rebate accounts in the Foundation's name and when directed

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by the Board, pay for certain allowable AAPG Foundation services. All commission recapture monies belong to the Foundation.

- Soft Dollars

All transactions effected on behalf of the Foundation will be subject to “best execution”. However, the Board understands that “soft dollar” commissions are allowed under Section 28(e) of the Securities and Exchange Act of 1934 (commonly referred to as the “Safe Harbor” Act). If a manager directs brokerage to effect “soft dollar” transactions, detailed records must be kept and communicated to the Board on an annual basis.

#### Performance Evaluation and Reporting

The Board is aware that the ongoing review and analysis of money managers is just as important as the due diligence implemented during the manager selection process. It is expected that the Board will meet two times per year to review the Foundation’s investment managers relative to managers of like investment style or strategy, relative to appropriate indices and/or other benchmarks, and relative to the manager’s overall contribution to the Foundation’s portfolio. It is the responsibility of the investment consultant to advise the Board when corrective action may be required. It is the Board’s responsibility to take such corrective action which may include replacing a manager at any time deemed appropriate.

Specific performance benchmarks for each manager are outlined in the Appendix Section, “Investment Manager Policies and Guidelines”.

Likewise, the performance of the Foundation’s portfolio will be measured and evaluated against appropriate benchmarks.

## **INVESTMENT POLICY REVIEW**

It is not expected that the Foundation’s Investment Policy Statement will change frequently. In particular, short-term changes in the financial markets should not result in adjustments to these policies. Investment policies will be reviewed each year, however, to determine the continued feasibility of achieving the investment objectives and the appropriateness of the IPS for achieving those objectives.

## **CATASTROPHIC EVENTS REVIEW**

Should a catastrophic event occur (manmade or natural disaster) which the Board believes could impact the foundation portfolio, the Foundation staff will review with the Investment Consultant the status of the Foundation portfolio, and advise the Board of any action which the Investment Consultant recommends as a result of the catastrophic

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event. In the event action is recommended by the Investment Consultant, the Board will meet via teleconference to review the recommendations.

**Notes:**

**Note 1:** *The Board recognizes that due to the size of the Foundation's investment portfolio, it may be advantageous to employ mutual funds and/or other commingled investment vehicles. The Board also recognizes that the policies outlined under certain sections more aptly apply to "separate issue" money managers, that is, to those managers who would develop a separate portfolio of securities specifically for the Foundation. However, to the extent that is reasonable, the Board intends to abide by the policies as outlined.*