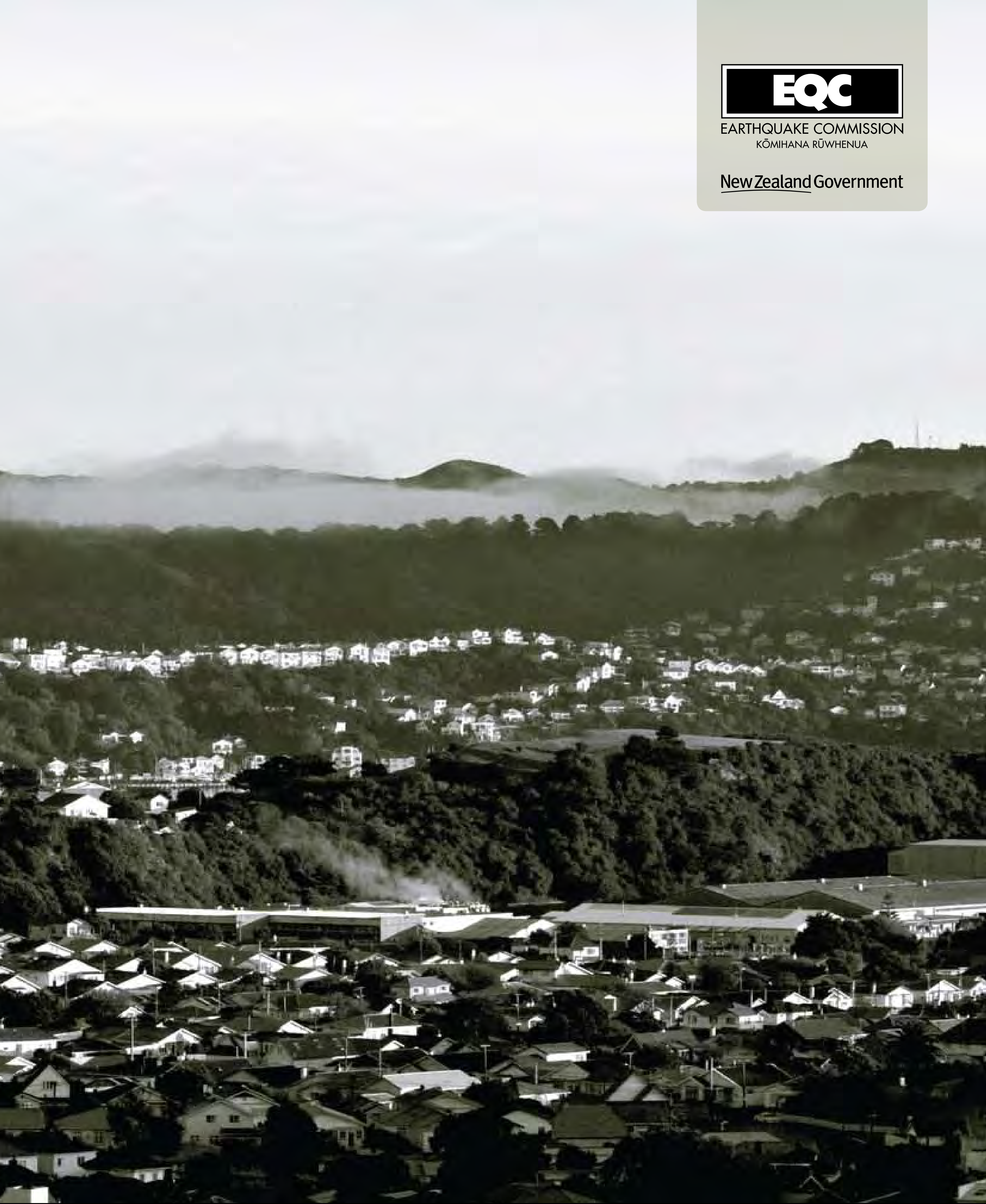
EQC
EARTHQUAKE COMMISSION
KŌMIHANA RŪWHENUA

New Zealand Government



Annual Report

2008–2009

Contents

2008–09 Highlights

It's Our Fault Research Project Findings

Findings from the *It's Our Fault* research project indicate that the chance of a large earthquake occurring on the Wellington Fault (greater than magnitude 7.5) is significantly lower than previously thought. EQC is a major sponsor of the project, along with the Wellington City Council and ACC. It is led by GNS Science and involves researchers from NIWA and Victoria University.

Catastrophe Response Programme Review

In March a panel of experts in relevant fields was convened to review the Catastrophe Response Programme. The panel confirmed that the programme will achieve its objectives at least for events up to a moderate size (at least 10 times larger than anything EQC has been required to face to date). The panel's recommendations are being worked through.

Claims Management System

Customisation of the new claims management system, to meet EQC's special requirements, was made during the year by IBM and Eagle Technology. Their work won an international award for innovative software use.

Virtual Field Trip

EQC's schools activities were expanded to include a series of three virtual field trips for secondary schools over three years. The programme gives students an understanding of the work of the geosciences community and an awareness of career opportunities within Earth Science. Encouraging more people into the discipline will help build understanding of the forces that have created New Zealand and thereby reduce its vulnerability to the natural disasters that those forces can produce.

GeoNet Review

The second strategic review of the GeoNet project confirmed that GeoNet has delivered on the original proposal of March 2000, and in some cases exceeded requirements. Its cautious, staged roll-out of equipment has been a wise approach to ensuring the long-term stability of the networks and data collected.

Natural Disaster Fund

In the volatile investment markets of the year, EQC's mix of Government stock, Treasury bills/bank bills and unhedged global equities has served to mitigate the risk inherent in any one market and the Commission has ended the year in surplus.

Chairman's Report

For those charged with the governance responsibilities of financial institutions, and particularly for those with responsibility for others' money, the last two years have been difficult to say the least.

EQC has custody of the Natural Disaster Fund, around $5.6 billion of public money. This is intended to meet a substantial part of the rebuilding costs following a major earthquake, or other natural catastrophe, in New Zealand, an event which will certainly happen at some time.

At the beginning of the last financial year the Fund was $5.54 billion. At 30 June 2009, the Fund stood at $5.57 billion. Several factors helped us maintain the value of the Fund despite financial market turmoil, and the very large loss of value in international equities in particular.

Diversification was a major contributor. Losses in our international equity portfolio were offset by rises in the value of our holdings of New Zealand Government stock. The $963 million in international equities under active management at 30 June this year was spread across five managers, whose variety of investment "styles" also helped spread risk.

Remaining unhedged allowed declines in the value of our foreign currency denominated equity holdings to be offset, in part, by a weakened New Zealand dollar.

It would be unreasonable to omit luck as a factor in our performance. The offsetting movements could have moved in ways which exacerbated the losses on our international equities. That point accepted, diversification remains one of our primary safeguards against dramatic movements in the value of the Fund.

During the year, the Board reconfirmed its commitment to a form of active management of our international equity portfolio as the best way to ensure long-term growth in the value of the Fund. Consistent with that decision, the Board agreed also that the balance of our international equity portfolio remaining in a passive investment fund should be placed under active management.

In the current circumstances, that was not a decision that was lightly taken. Three accompanying decisions were also taken. A further manager would be appointed, bringing the total active managers to six. Within the portfolio the allocation of funds between managers would be rebalanced to ensure that the Fund was not overly exposed to the performance of any one manager. Finally the timing of the move from passive to active management would, as far as possible and as far as the Board could judge, be taken at a time when the major and unprecedented volatility in the markets had eased. At the time of publication of this report, the new manager has been appointed and arrangements are largely in place to give effect to these decisions, but the final allocation of the portfolio to fully active management has not yet taken place.

The Board has also reconfirmed its commitment to principles of responsible investment. EQC has joined with three other Crown financial institutions (ACC, New Zealand Superannuation Fund and Government Superannuation Fund) and contributes financially to the Responsible Investment Unit of the New Zealand Superannuation Fund. This arrangement should ensure better informed decisions by the Board on matters related to responsible investment, a more whole-of-Government approach to such matters and, in some instances, the ability to exert more leverage on companies in which our managers invest to reinforce the Government's expectations in this regard.

The change of Government in 2008 required EQC, like other government organisations, to prepare a briefing for its new Minister. Such briefings can provide an opportunity for an operational or organisational stock-take. In EQC's case it was an opportunity to address some aspects of the scheme, based in statute, which have proved problematic or even inequitable.

These include some long-standing inequities in land cover; the three-month time limit for reporting claims; the unwieldy and potentially disputatious provisions for insuring long-term accommodation for the elderly; the insurance of multiple use buildings; and the level of excess. These are now part of our work programme.

There have been changes in the Board since EQC's last annual report. Tim McGuinness, Carole Durbin and Wyn Hoadley completed their terms as Board members. Linda Robertson and Giselle McLachlan have joined the Board. Keith Taylor, already a board member, has been appointed Deputy Chairman.

EQC has been fortunate in the quality of appointees as Commissioners. I record my thanks to those who served with me, and welcome our new members. I thank all Board members for their contribution and support.

2009 will be significant in EQC history. David Middleton has been the only General Manager and Chief Executive of EQC since it was established by statute in 1993 as a successor to the Earthquake and War Damage Commission. He has decided to step down after 17 years in these roles.

It is difficult to overstate the contribution he has made: to New Zealand's financial preparedness for a natural disaster; to the effectiveness, and recognition of that effectiveness, of EQC as an organisation to serve the interests of the Government and people of New Zealand; and in the international recognition of EQC's unique and much-admired role and performance.

He has served successive Governments well. He has supported me, and three chairmen before me. He has served many Board members to help make the organisation what it is today.

I take this opportunity, with the Board, to thank him publicly and wish him every success in the next stage of his career.

I thank all staff of EQC. It is a privilege to be their Chairman.

Michael Wintringham
Chairman

Chief Executive's Report

The means by which EQC plans to cope with a large and sudden influx of claims following a natural disaster, the Catastrophe Response Programme, has developed and improved over the course of the last decade or more. In March, a panel of experts in relevant fields was convened to review the Catastrophe Response Programme, and the way it has been practised, to provide confidence that the programme will achieve its objectives and to make recommendations for any required improvements.

The panel was able to affirm that the programme will achieve its objectives at least for events up to a moderate size (at least 10 times larger than anything EQC has been required to face to date). The panel made recommendations relevant to the continuous improvement of the programme and these are being worked through.

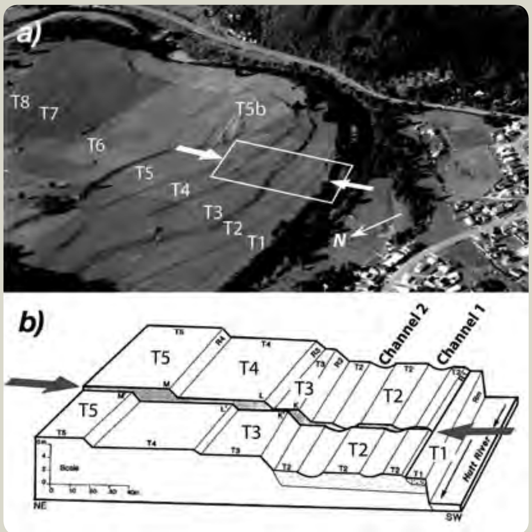
Following a full tender process, EQC adopted a replacement claims management system in March 2008 that was part of a commercial package providing a full insurance company record system. Because EQC has special requirements, the programme needed extensive customisation by IBM and Eagle Technology this year and their work won an international award for innovative use of the software.

Throughout the year, EQC has carried out extensive training of all system users including external contractors who are now able to access claims records direct through the internet. The new claims management system represents a step up in the quality of the service EQC is able to provide its claimants.

During the year the most comprehensive study of Wellington's earthquake risk to date was continued by GNS Science and its sub-contractors. The objective of the *It's Our Fault* project is to position Wellington as a more resilient city with a deeper understanding of the likelihood, nature and possible impacts of its earthquakes. The major sponsors of the work are ACC, Wellington City Council and EQC. The project has produced an important shift in our understanding.

The timing of any earthquake is a matter of probability – it could happen tomorrow. But the latest results from this research indicate the chance of having a large (greater than magnitude 7.5) Wellington Fault earthquake is significantly lower than previously thought. These are preliminary results which require confirmation by testing and review but they indicate that smaller or more distant earthquakes may be more important to plan for. Whilst still damaging, the smaller area affected means that communities and infrastructure would be able to recover more quickly if proper preparation is in place. The project is programmed to run for another three years.

EQC lays off part of the financial risk of large disasters to the global reinsurance market. International reinsurers have been affected by limitations on access to capital and the result worldwide has been a tendency for increasing prices. Despite this, EQC negotiated favourable renewal terms (no increase on the previous year on a risk adjusted basis), trading on the natural advantage of remoteness from other potential disaster sites in the world. The Commission also benefited from the long-term relationships forged over the past 20 years, familiarity with our account resulting from regular personal contact, and the superior information EQC is able to provide its reinsurers. In the volatile investment markets of the year, EQC's mix of Government stock, Treasury bills/bank bills and unhedged global equities has served to mitigate the risk inherent in any one market and the Commission has ended the year in surplus.



Young terraces and channels of the Hutt River, now abandoned, are cut and offset by the Wellington Fault (denoted by the white arrows) near Te Marua, Upper Hutt. Channels 1 & 2 are displaced sideways by about five metres across the Wellington Fault. These channels have been radiocarbon dated and are no older than 370 years. This indicates that the most recent rupture of the Wellington Fault is younger than this, and resulted in five metres of sideways slip. Older terrace edges and channels are displaced by multiples of about five metres, indicating that older Wellington Fault ruptures have also resulted in about five metres of sideways slip per rupture.

Findings from the *It's Our Fault* project. (Courtesy of GNS Science)

Claims Handling and Catastrophe Response

The Commission received 4,492 claims during the year. This was fewer than 2007-08 when more than 9,000 claims were lodged, many of them from the December 2007 magnitude 6.8 earthquake centred near Gisborne.

This year a single severe storm swept over the country from the north in late July and there was one significant damage-causing earthquake in August. The storm generated 893 claims for which EQC paid out $20 million. EQC set up support centres in the three places most affected – Auckland, Wellington and Blenheim. The earthquake occurred near Hastings and generated 1,380 claims for a payout of $1.98 million. EQC set up a support centre in Napier for this event.

The success of working through local support centres was a feature of the year and followed from the experience gained from the Gisborne earthquake.

Administration of the Scheme

The Commission has a programme of checking insurance company records and reports from external auditors to ensure the integrity of premium payments from insurance companies. For the 12 months to 30 June 2009 we received eight external audit opinions, none of which was qualified.

Research

The Earthquake Commission fosters research and public education in relevant areas of natural hazards science and engineering. EQC also encourages the transfer of this science into practice, providing a connection between scientific progress and resilience within the community.

Twenty-two projects supported by EQC were completed during the 2008-09 year, ranging from research into factors that govern the size and frequency of earthquakes and volcanic eruptions in New Zealand, to improved methods for earthquake-resistant design and approaches to land-use planning in areas of slope instability.

Other highlights include the *It's Our Fault* study mentioned earlier and recent findings from New Zealand's geological hazard monitoring system, GeoNet, a collaboration between LINZ, GNS Science and EQC.

Before the launch of GeoNet in 2001 we did not know that the collision of tectonic plates beneath New Zealand gives rise not only to earthquakes as we know them, but also "slow earthquakes" in which energy is released without severe shaking over weeks or months. To date eight such slow-slip earthquakes have been identified, with earthquake-equivalent magnitudes of 6.5 to 7. New Zealand scientists are now working with Japanese and North American counterparts at the forefront of this science to understand the implications of these phenomena for earthquake hazard estimates.

The GeoNet project itself was reviewed by an expert panel during the year with the specific purpose of assessing developments to date and current fitness for purpose. The reviewers concluded: "GeoNet has delivered on the original proposal in March 2000, and in some cases exceeded requirements. Its cautious, staged roll-out of equipment has been a wise approach to ensuring the long-term stability of the networks and data collected."

And further: "EQC has shown unique leadership for GeoNet in providing the backbone for other agencies to extend so that New Zealand has a leading edge, integrated hazard monitoring network."

The EQC-initiated science review of the Auckland Volcanic Field by GNS Science and the University of Auckland, begun last year, has continued. The overall aim is to improve the basis for long-term planning and management of volcanic risk in New Zealand's largest city. Very satisfactory progress has been made.

Public Education

An increasing emphasis on targeted public education activities was a feature of the year, with a focus on schools in particular.

A highlight was a new initiative for secondary schools involving modern teaching technology. EQC has employed education material specialists, Heurisko, to create a series of three virtual field trips for secondary schools over three years. The first – to the Auckland Volcanic Field – was carried out late in the year. A qualified teacher visited the location, supporting interaction between classes of students and experts. The programme gives students an understanding of the work of the geosciences community and an awareness of career opportunities within Earth Science. Encouraging more people into the discipline will help build understanding of the forces that have created New Zealand and thereby reduce its vulnerability to the natural disasters that those forces can produce.

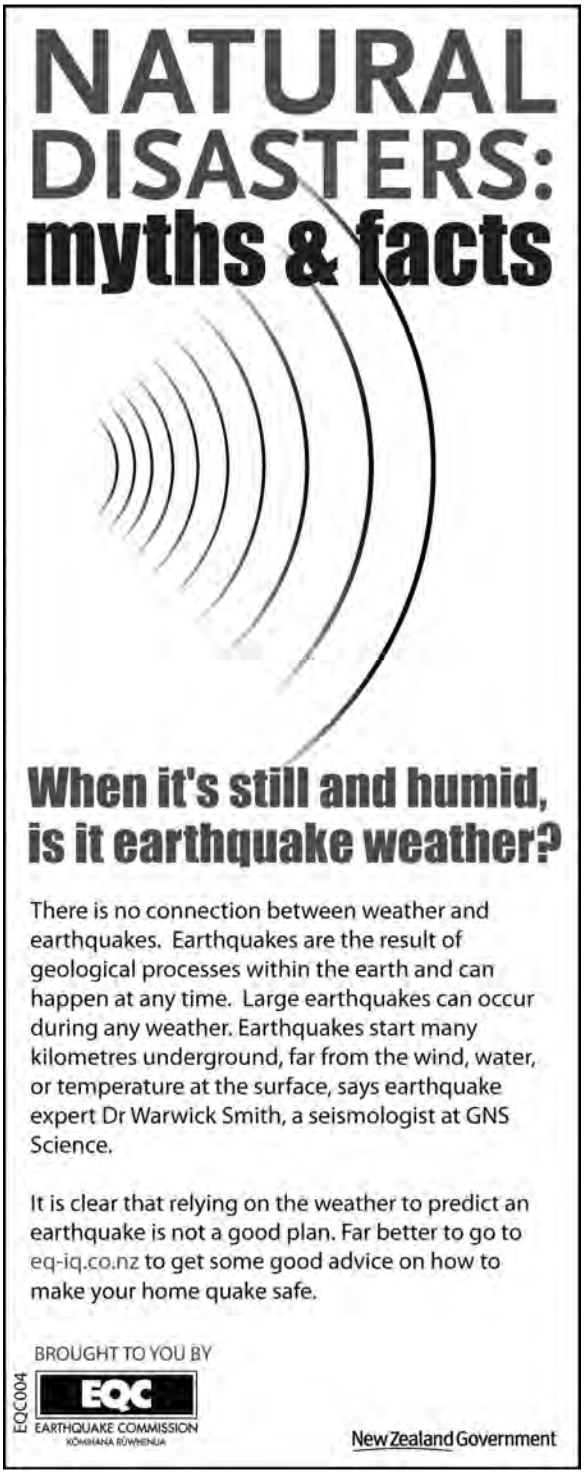
EQC also carried out a regional schools exercise – *Is Your Place Quake Safe?* – the ninth in a series starting in 1999. This time the programme covered primary schools in the Nelson/Tasman area. The exercise not only educates but allows EQC to gather information on actual and likely household earthquake mitigation.

At Te Papa, EQC sponsors a schools programme that brings groups of pupils to the museum. Similarly, EQC supported a schools programme at the Hawke's Bay Museum and Art Gallery.

A series of press and internet advertisements featuring natural disaster myths and facts was commenced in February. The advertisements examine common beliefs about natural disasters and provide the facts, supported by a relevant expert. They also encourage people to take action to prevent natural disaster damage to their homes.

Te Papa repeated its successful *Earth Rocks* earthquake awareness weekend in October and EQC again participated and provided support. EQC also supported a travelling road show called *Tephra Trouble* which visited centres in the North Island and Christchurch to communicate knowledge on volcanic hazards and their potential impact on New Zealand.

The first edition of a new electronic and print newsletter – *Research Review* – was produced during the year. The focus of the newsletter is on what is new in natural disaster research and extends EQC's commitment to foster research and education in relevant areas of natural hazards science and engineering.



An example from the series of natural disaster myths and facts advertisements begun during the year.

Other activity included a series of feature articles on recent natural disaster history and EQC's claims and payouts. Each article was customised to a particular region. EQC also continued its regular activities such as the newsletters *Rumblings* and *Rū Whenua* and the display stand programme.

One of New Zealand's volcanoes – Mt Taranaki. (Courtesy of GNS Science)

Managing the Natural Disaster Fund

The Natural Disaster Fund grew by $36 million to $5.57 billion during the year, an increase of 0.6 percent over last year's total at balance date.

A severe fall in international share markets detracted from the value of EQC's offshore equities, despite the fall in the New Zealand dollar contributing 12.5 percent to the return.

After the deduction of management fees, active equity managers underperformed the MSCI world benchmark by 2.0 percent. The past year was one of severe dislocation in share markets and accordingly most active managers struggled under the conditions. There was no change to the Fund's structure and asset allocation during the year.

Reflecting the recessionary conditions both locally and overseas, domestic short-term interest rates plunged, reducing EQC's cash returns. The Reserve Bank's Official Cash Rate was 8.3 percent at the beginning of the year, and then rapidly fell to an historic low of 2.5 percent. As a consequence, bank deposits (RCDs) and Treasury bills produced declining income, with a combined return of 5.9 percent.

The average yield of New Zealand Government stock (NZGS) fell from 6.4 percent (30 June 2008) to 5.4 percent (30 June 2009), increasing the capital value of the bond portfolio. EQC's total returns for NZGS and inflation-indexed bonds, of an exceptionally high 9.8 percent and 11.9 percent respectively, were in line with the indices.

Approximately 67 percent of EQC's portfolio is invested in NZGS and inflation-indexed bonds, and as at 30 June EQC held 11 percent of NZGS and 23 percent of inflation-indexed bonds on issue.

ASSET CLASS	ACTUAL RETURN	BENCHMARK/TARGET RETURN
NZ Government stock	9.8%	9.8%
NZ Government inflation-indexed bonds	11.9%	11.9%
Bank bills (registered certificates of deposit)/Treasury bills	5.9%	5.9%
Passive global equities	-16.6%	-17.2%
Active global equities	-19.2%	-17.2%
Total Portfolio*	**1.2%**	**1.3%**

* The target return for the total portfolio is 1% plus the NZGS index return, over a rolling 10-year period. The structure has not been in place long enough to compare 10-year returns. For the five years to 30 June 2009, the actual portfolio return was 5.0% versus the target of 7.7%.

EQC is responsible for managing and administering the Natural Disaster Fund in a manner that ensures:

- best practice portfolio management,
- maximisation of returns without undue risk to the Fund as a whole, and
- avoidance of prejudice to New Zealand's reputation as a responsible member of the world community.

As a signatory to the United Nations Principles for Responsible Investment, the Commission acknowledges internationally agreed standards for responsible corporate behaviour and employs the principles to guide its investment decisions.

During the year EQC became part of a formal working relationship with other Crown financial institutions to ensure it has the resources and information necessary to engage effectively with investee companies on responsible investment matters and to fulfill EQC's obligation to avoid prejudice to New Zealand's reputation.

The Commission has instructed its investment managers to exclude from its portfolio investments in companies engaged in the manufacture of cluster munitions and nuclear weapons. These exclusions follow the earlier exclusion of companies involved in the manufacture of anti-personnel mines and cigarettes and tobacco.

David Middleton
Chief Executive

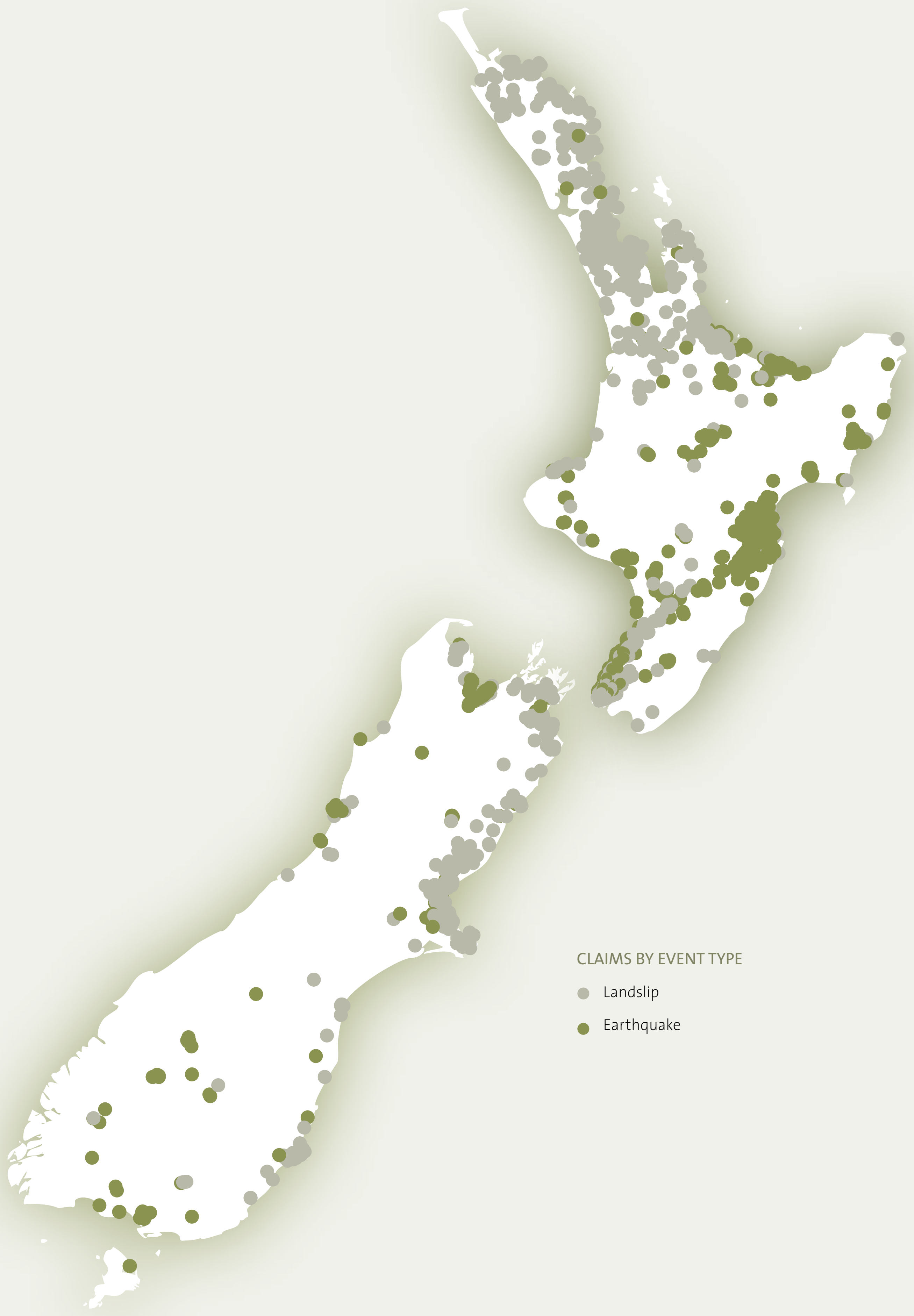
Natural Disaster Claims Locations

FOR CLAIMS ARISING IN THE FINANCIAL YEAR

	2008–2009		2007–2008		AVERAGE OF PRIOR 5 YEARS	
	NO. OF CLAIMS	PAYMENTS (000)	NO. OF CLAIMS	PAYMENTS (000)	NO. OF CLAIMS	PAYMENTS (000)
Earthquake	2,265	$2,835	8,149	$28,398	2,423	$6,774
Landslip	2,226	$40,932	1,307	$17,965	1,554	$21,575
Hydrothermal Activity	1	$0	3	$0	2	$43
Volcanic Eruption	0	$0	0	$0	0	$0
Total	4,492	$43,767	9,459	$46,363	3,979	$28,392

Note:

Financial statements disclose claims payments made and incurred in the financial year, so figures are different from those in this table.


CLAIMS BY EVENT TYPE
Landslip
Earthquake

Research Projects Completed

Acceptable inter-storey drift limits for buildings at ultimate limit states

S Uma, A King – GNS Science
T Holden, D Bell – Connell Wagner

(EQC funded project 06/513)

Building regularity for simplified modelling

G MacRae, B Deam – University of Canterbury

(EQC funded project 06/514)

Earthquake resistant design of tied-back retaining structures

K McManus – Pacific Geotech Ltd

(EQC funded project 06/517)

Seismic moment tensor solutions from GeoNet data to provide a moment magnitude scale for New Zealand

E Robertson – GNS Science

(EQC funded project 06/522)

Accelerogram-scaling procedures for near-fault motions

J Zhang, G McVerry – GNS Science

(EQC funded project 06/523)

Establishing a spatiotemporal benchmark for ongoing crustal stress monitoring in the Southern Taupo Volcanic Zone

S Sherburn, J Townend, R Arnold, L Woods – GNS Science

(EQC funded project 08/550)

Geophysical characterisation of the Alpine Fault within the Haast Valley

A Gorman – University of Otago

(EQC funded project 08/551)

Magma ascent during eruptions at Mt Ngauruhoe: Insights from xenolith fluid inclusions

G Kilgour, F Della Pasqua, G Jolly – GNS Science

(EQC funded project 08/553)

Age constraints on unstable landforms at a near-fault site in Central Otago, New Zealand: Groundwork for validation of seismic hazard models

M Stirling, A Zondervan, R Norris, D Ninis – GNS Science

(EQC funded project 08/555)

Continued development of the New Zealand Earthquake Forecast Testing Centre

M Gerstenberger, D Rhoades, M Stirling – GNS Science
R Brownrigg – Victoria University of Wellington
A Christophersen – ETH-Zurich

(EQC funded project 08/557)

A grid-based facility for large-scale cross-correlation of continuous seismic data

J Townend, Y Behr, K Buckley, M Savage, J Hine – Victoria University of Wellington

(EQC funded project 08/559)

Clarifying why people take fewer damage mitigation actions than survival actions: How important is cost?

J McClure, R Fischer, A Charleson, M Spittal – Victoria University of Wellington

(EQC funded project 08/560)

Disposal of debris following urban earthquakes: Guiding the development of comprehensive pre-event plans

D Johnston, L Dolan, W Saunders, C Killeen, B Glavovic, I McIntyre, R van Schalkwyk, J Cousins, J Becker – Joint Centre for Disaster Research – GNS Science/Massey University

(EQC funded project 08/562)

Development of multi-channel analysis of surface waves (MASW) for characterising the internal structure of active fault-zones as a predictive method of identifying the distribution of ground deformation

B Duffy, J Campbell, M Finnemore – University of Canterbury

(EQC funded project 07/U537)

Improving the identification of volcanic deformation in GPS arrays

A Peltier – GNS Science

(EQC funded project 07/U539)

Extension of hidden Markov models and development of probability forecasts for regional earthquake occurrence (Also: Development of earthquake probability forecasts from a hidden Markov model: An example from the Killini region, Greece)

K Orfanogiannaki – National Observatory of Athens
D Vere-Jones – Victoria University of Wellington and Statistics Research Associates
D Harte – Statistics Research Associates

(EQC funded project 08/TV563)

Building a geochemically-constrained time-varying eruption hazard forecasting model for Mt Taranaki

S Cronin, M Turner, M Bebbington – Volcanic Risk Solutions, Massey University

(EQC funded project 08/TV565)

Enhancement of the EEPAS model for long-range earthquake forecasting

D Rhoades – GNS Science
F de Oliveira, P Somerville – Risk Frontier, Sydney
H Thio – URS, Pasadena

(EQC funded project 08/TV567)

Scaling law and repeat times for Ruapehu volcanic events

A Jolly, S Sherburn – GNS Science

(EQC funded project 08/TV568)

Development of tests for long-term earthquake ground motion forecasts in New Zealand

M Stirling, M Gerstenberger – GNS Science

(EQC funded project 08/TV569)

Time varying hazards research programme

M Gerstenberger – GNS Science

(EQC funded project 08/TV570)

Predicted and actual performance of masonry parapets in the 2007 Gisborne earthquake

E Blaikie, R Davey – Opus International Consultants Ltd

(EQC funded project 07/SP8)

2008–09 Financial Statements

Audit report

TO THE READERS OF THE EARTHQUAKE COMMISSION'S FINANCIAL STATEMENTS AND STATEMENT OF SERVICE PERFORMANCE FOR THE YEAR ENDED 30 JUNE 2009

The Auditor-General is the auditor of the Earthquake Commission (the Commission). The Auditor-General has appointed me, John O'Connell, using the staff and resources of Audit New Zealand, to carry out the audit. The audit covers the financial statements and statement of service performance included in the annual report of the Commission for the year ended 30 June 2009.

Unqualified Opinion

In our opinion:

- The financial statements of the Commission on pages 17 to 38:
  - comply with generally accepted accounting practice in New Zealand; and
  - fairly reflect:
    - The Commission's financial position as at 30 June 2009; and
    - the results of its operations and cash flows for the year ended on that date.
- The statement of service performance of the Commission on pages 39 to 43:
  - complies with generally accepted accounting practice in New Zealand; and
  - fairly reflects for each class of outputs:
    - its standards of delivery performance achieved, as compared with the forecast standards outlined in the statement of forecast service performance adopted at the start of the financial year; and
    - its actual revenue earned and output expenses incurred, as compared with the forecast revenues and output expenses outlined in the statement of forecast service performance adopted at the start of the financial year.

The audit was completed on 21 September 2009, and is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Board and the Auditor, and explain our independence.

AUDIT NEW ZEALAND
Mana Arotake Aotearoa

Basis of Opinion

We carried out the audit in accordance with the Auditor-General's Auditing Standards, which incorporate the New Zealand Auditing Standards.

We planned and performed the audit to obtain all the information and explanations we considered necessary in order to obtain reasonable assurance that the financial statements and statement of service performance did not have material misstatements, whether caused by fraud or error.

Material misstatements are differences or omissions of amounts and disclosures that would affect a reader's overall understanding of the financial statements and statement of service performance. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

The audit involved performing procedures to test the information presented in the financial statements and statement of service performance. We assessed the results of those procedures in forming our opinion.

Audit procedures generally include:

+ determining whether significant financial and management controls are working and can be relied on to produce complete and accurate data;
+ verifying samples of transactions and account balances;
+ performing analyses to identify anomalies in the reported data;
+ reviewing significant estimates and judgements made by the Board of Commissioners;
+ confirming year-end balances;
+ determining whether accounting policies are appropriate and consistently applied; and
+ determining whether all financial statement and statement of service performance disclosures are adequate.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements and statement of service performance.

We evaluated the overall adequacy of the presentation of information in the financial statements and statement of service performance. We obtained all the information and explanations we required to support our opinion above.

Responsibilities of the Board of Commissioners and the Auditor

The Board is responsible for preparing the financial statements and statement of service performance in accordance with generally accepted accounting practice in New Zealand. The financial statements must fairly reflect the financial position of the Commission as at 30 June 2009 and the results of its operations and cash flows for the year ended on that date. The statement of service performance must fairly reflect, for each class of outputs, the Commission's standards of delivery performance achieved and revenue earned and expenses incurred, as compared with the forecast standards, revenue and expenses adopted at the start of the financial year. The Board's responsibilities arise from the Crown Entities Act 2004 and the Earthquake Commission Act 1993.

We are responsible for expressing an independent opinion on the financial statements and statement of service performance and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001 and the Crown Entities Act 2004.

Independence

When carrying out the audit we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the Institute of Chartered Accountants of New Zealand.

Other than the audit, we have performed additional assurance work over expenditure incurred in the processing of claims. Other than the audit, and this assignment, we have no relationship with or interests in the Commission.

John O'Connell

John O'Connell
Audit New Zealand
On behalf of the Auditor-General
Wellington, New Zealand

Income Statement

FOR THE YEAR ENDED 30 JUNE 2009

	(NOTES)	ACTUAL 2009 $(000)	BUDGET 2009 $(000)	ACTUAL 2008 $(000)
Gross earned premiums	1	86,398	86,918	85,658
Outward reinsurance premium expense		(37,673)	(38,750)	(36,289)
NET EARNED PREMIUM REVENUE		**48,725**	**48,168**	**49,369**
CLAIMS EXPENSE	2, 3, 5, 16	**(58,297)**	**(9,567)**	**(66,848)**
(DEFICIT) SURPLUS FROM UNDERWRITING ACTIVITIES		**(9,572)**	**38,601**	**(17,479)**
Public education		(2,708)	(4,112)	(2,746)
Research (excluding GeoNet)		(2,843)	(3,022)	(2,178)
GeoNet programme		(7,594)	(7,698)	(7,437)
TOTAL OTHER OPERATING COSTS	3	**(13,145)**	**(14,832)**	**(12,361)**
Investment income	4, 5	76,795	389,310	188,350
Investment costs	3	(8,444)	(8,819)	(7,998)
INVESTMENT INCOME NET OF COSTS		**68,351**	**380,491**	**180,352**
Crown underwriting fee		(10,000)	(10,000)	(10,000)
NET SURPLUS FOR THE YEAR		**35,634**	**394,260**	**140,512**

Statement of Movements in Equity

FOR THE YEAR ENDED 30 JUNE 2009

	(NOTES)	ACTUAL 2009 $(000)	BUDGET 2009 $(000)	ACTUAL 2008 $(000)
Natural Disaster Fund				
Opening balance as at 1 July	6	5,535,468	5,556,025	5,394,956
Net surplus for the year		35,634	394,260	140,512
TOTAL RECOGNISED REVENUE AND EXPENSES FOR THE YEAR (OPERATING SURPLUS)		**35,634**	**394,260**	**140,512**
CLOSING BALANCE AS AT 30 JUNE		**5,571,102**	**5,950,285**	**5,535,468**

The Statement of Accounting Policies and Notes form part of and should be read in conjunction with these financial statements.

Balance Sheet

AS AT 30 JUNE 2009

	(NOTES)	ACTUAL 2009 $(000)	BUDGET 2009 $(000)	ACTUAL 2008 $(000)
Natural Disaster Fund				
Capitalised reserves	6	1,500,000	1,500,000	1,500,000
Retained surplus	6	4,071,102	4,450,285	4,035,468
TOTAL EQUITY		**5,571,102**	**5,950,285**	**5,535,468**
Assets				
Cash and cash equivalents	7	9,392	28,230	12,983
Investments	5, 11, 12	5,612,613	5,963,713	5,584,619
Premiums receivable	8	17,434	18,306	17,567
Other receivables	9	0	0	671
Prepayments	10	6,405	6,229	6,106
Property, plant and equipment	13	14,232	14,452	13,029
Intangible assets	14	2,738	2,305	2,558
TOTAL ASSETS		**5,662,814**	**6,033,235**	**5,637,533**
Liabilities				
Trade and other payables	15	4,902	3,276	5,326
Provision for employee entitlements		216	167	219
Outstanding claims liability	16	8,901	34,862	19,116
Unearned premium liability	16	44,693	44,645	44,404
Unexpired risk liability	5, 16	33,000	0	33,000
TOTAL LIABILITIES		**91,712**	**82,950**	**102,065**
NET ASSETS		**5,571,102**	**5,950,285**	**5,535,468**

The Statement of Accounting Policies and Notes form part of and should be read in conjunction with these financial statements.

Statement of **Cash Flows**

FOR THE YEAR ENDED 30 JUNE 2009

	(NOTES)	ACTUAL 2009 $(000)	BUDGET 2009 $(000)	ACTUAL 2008 $(000)
Cash flows from operating activities				
Cash was provided from:				
Premiums		86,821	86,559	85,878
Interest received		247,962	251,935	244,748
Dividends received		44,780	30,000	31,525
Net cash flow from GST		970	0	0
Other		0	0	142
Cash was disbursed to:				
Outward reinsurance		(37,864)	(38,750)	(37,016)
Crown underwriting fee		(10,000)	(10,000)	(10,000)
Claims		(68,512)	(9,567)	(72,829)
Employees and other operating expenses		(11,901)	(13,043)	(10,714)
GeoNet operating expenses		(5,372)	(5,543)	(5,354)
Research grants		(2,352)	(2,334)	(1,632)
Net cash flow to GST		0	0	(963)
NET CASH INFLOW FROM OPERATING ACTIVITIES	5, 23	**244,532**	**289,257**	**223,785**
Cash flows from investing activities				
Cash was provided from:				
Maturity and sales of investments		600,035	451,000	30,138
Disposal of property, plant and equipment		0	0	15
Cash was applied to:				
Purchase of investments		(843,977)	(732,278)	(245,209)
Purchase of property, plant and equipment		(3,677)	(3,473)	(3,021)
Purchase of intangibles		(504)	(500)	(2,318)
NET CASH OUTFLOW FROM INVESTING ACTIVITIES		**(248,123)**	**(285,251)**	**(220,395)**
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS		**(3,591)**	**4,006**	**3,390**
Add opening cash and cash equivalents brought forward		12,983	24,224	9,593
ENDING CASH AND CASH EQUIVALENTS CARRIED FORWARD		**9,392**	**28,230**	**12,983**

"Net cash flow from/to GST" represents the net GST paid to or received from the Inland Revenue Department. GST cash flow has been presented on a net basis as the gross amounts do not provide meaningful information for financial statement purposes.

The Statement of Accounting Policies and Notes form part of and should be read in conjunction with these financial statements.

Reporting Entity

The Earthquake Commission ("the Commission") is a Crown Entity as defined by the Crown Entities Act 2004 and is domiciled in New Zealand. As such, the Commission's ultimate parent is the New Zealand Crown.

The Commission's primary objective is to provide compensation to New Zealand residential property owners following a natural disaster as opposed to that of making a financial return. Accordingly, for purposes of New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS), it has chosen to designate itself a public benefit entity.

The reporting period covered by these financial statements is the year ended 30 June 2009. These accounts were approved by the Board on 21 September 2009.

Basis of Preparation

Measurement Base

The measurement base applied is historical cost modified by the revaluation of certain assets and liabilities as identified in this Statement of Accounting Policies.

Functional and Presentation Currency

These financial statements are presented in New Zealand dollars, which are the functional currency of the Commission and are rounded to the nearest thousand dollars.

Statement of Compliance

These financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice. They comply with NZ IFRS and other applicable financial reporting standards, as appropriate for public benefit entities. The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

Judgements and Estimations

The preparation of financial statements in conformity with NZ IFRS requires judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised (if the revision affects only that period) or in the period of the revision and future periods (if the revision affects both current and future periods).

Critical Judgements in Applying Accounting Policies

Assumptions that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in the following notes:

Note 11 – Investments

Note 16 – Claims Liabilities.

Significant Accounting Policies

Insurance

Premium Income

Premium income is recognised using the 24ths rule to approximate the contract period over which the premiums are earned. Premiums not earned in the Income Statement at balance date are disclosed in the Balance Sheet as unearned premiums. Premiums receivable are reported net of applicable discounts.

Insurance Recoveries

Reinsurance and non-reinsurance recoveries received or receivable are recognised as revenue in the Income Statement.

Reinsurance

Premiums ceded to reinsurers are recognised by the Commission as reinsurance expense in profit or loss from the attachment date over the period of indemnity of the reinsurance contract, in accordance with the expected pattern of the incidence of risk.

Claims

Claims expenditure includes claims settlements and claims handling costs.

Claims Liability and Unearned Premium Liability

The outstanding claims liability is recognised at balance date as the central estimate of the present value of the expected future payments for claims incurred to balance date, with an additional risk margin to allow for the inherent uncertainty in the central estimate.

At balance date, the Commission assesses the adequacy of the unearned premium liability. Where the current estimate of the present value of the expected future cash flows relating to future claims arising from the rights and obligations under current insurance contracts, plus an additional risk margin, exceeds the value of the unearned premium, the deficiency will be recognised in profit or loss and recorded in the Balance Sheet as unexpired risk liability.

Assets Backing Insurance Liabilities

All assets of the Commission back its insurance liabilities in accordance with section 13(3) of the Earthquake Commission Act 1993, which states: "All money in bank accounts established by the Commission, and all investments and other assets of the Commission, shall be deemed to form part of the Fund."

Grants

The Commission provides discretionary grants for earthquake research and research dissemination.

Discretionary grants are those where the Commission has no obligation to award on receipt of the grant application and are recognised as expenditure when the performance criteria, on which approval of the grant was based, are met.

Foreign Currency

Transactions in foreign currencies are initially translated at the foreign exchange rate at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation, at year-end exchange rates, of monetary assets and liabilities denominated in foreign currencies, are recognised in the Income Statement, except when deferred in equity when hedge accounting is applied.

Taxation

The Commission is exempt from the payment of income tax in terms of the Income Tax Act 2004. Accordingly, no charge for income tax has been provided for.

Goods and Services Tax (GST)

The Income Statement, Statement of Movements in Equity, Statement of Cash Flows, and commitments note are exclusive of GST. The Balance Sheet is also exclusive of GST, except for trade payables and premiums receivable, which are GST inclusive.

The amount of GST owing to or from the Inland Revenue Department at balance date, being the difference between output GST and input GST, is included in payables or receivables as appropriate.

Investments

Interest

Interest income is accrued using the effective interest rate method.

Dividend

Dividend income from investments is recognised when the Commission's rights as a shareholder to receive payment have been established.

Realised Gains and Losses

Income from investments includes realised gains and losses on all investments, including currency gains and losses, and gains and losses on the sale of investments.

Unrealised Gains and Losses

Income from investments includes unrealised gains and losses on all investments, including currency gains and losses.

Financial Instruments

Non-derivative Financial Instruments

Non-derivative financial instruments comprise investments in equity and debt securities, premiums receivable, cash and cash equivalents, and trade and other payables.

Non-derivative financial instruments at fair value through profit or loss are recognised initially at fair value. Instruments not at fair value through profit or loss are recorded at fair value plus attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the Commission becomes a party to the contractual provisions of the instrument. A financial asset is derecognised if the Commission's contractual rights to the cash flows from the financial asset expire or if the Commission transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular way purchases and sales of financial assets are accounted for at trade date, i.e. the date that the Commission commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Commission's obligations specified in the contract expire or are discharged or cancelled.

Financial Assets at Fair Value Through Profit or Loss

An instrument is classified as at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Commission manages such instruments and makes purchase and sale decisions based on their fair value. Upon initial recognition, attributable transaction costs are recognised in profit or loss when incurred. Subsequent to initial recognition, financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

Cash and Cash Equivalents

Cash and cash equivalents comprise cash balances, cash in transit and bank call deposits. The carrying amount of cash and cash equivalents approximates their fair value.

Investments

All investment assets held by the Commission back insurance liabilities and are therefore designated at fair value through profit or loss.

Fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active, fair values for initial recognition and, where appropriate, subsequent measurement are established by using valuation techniques.

Receivables

Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Receivables are recognised initially at fair value, being the present value of estimated future cash flows. They are subsequently measured at amortised cost using the effective interest rate method, less any impairment losses. Receivables with duration of less than 12 months are not discounted.

Impairment losses are assessed by an evaluation of the recoverable amount. The recoverable amount of the Commission's receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets). All individual receivables that are considered significant are subject to this approach. The impairment charge is recognised in the Income Statement.

Other Financial Assets

Other non-derivative financial assets are measured at fair value and subsequently measured at amortised cost using the effective interest method, less any impairment losses.

Trade and Other Payables

Payables are non-derivative financial liabilities with fixed or determinable payments that are not quoted in an active market. Payables are recognised initially at fair value, being the present value of estimated future cash flows. They are subsequently measured at amortised cost using the effective interest rate method. Payables with duration of less than 12 months are not discounted.

Derivative Financial Instruments

The Commission uses derivative financial instruments to hedge its exposure to foreign exchange risks arising from investment activities. In accordance with its treasury policy, the Commission does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are recognised initially at fair value, and transaction costs are expensed immediately. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The gain or loss on re-measurement to fair value is recognised immediately in profit or loss.

Hedging

The Commission has not elected to apply hedge accounting to any derivatives for the period ending 30 June 2009.

Property, Plant and Equipment

Overview

Property, plant and equipment are recorded at cost less accumulated depreciation and accumulated impairment losses.

Additions

The cost of an item of property, plant and equipment is recognised as an asset only when it is probable that future economic benefits or service potential associated with the item will flow to the Commission and the cost of the item can be measured reliably.

Where an asset is acquired at no cost, or for a nominal cost, it is recognised at fair value when control over the asset is obtained.

Disposals

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount of the asset. Gains and losses are included in the Income Statement.

Subsequent Costs

Costs incurred subsequent to initial acquisition cost are capitalised only when it is probable that the future economic benefits or service potential associated with the item will flow to the Commission and the cost of the item can be measured reliably.

The costs of day-to-day servicing of property, plant and equipment are recognised in the Income Statement as they are incurred.

GeoNet Assets

GNS Science administers the design, engineering, operation and maintenance of New Zealand's geological hazard monitoring system (GeoNet) under a 10-year agreement with the Commission. The services performed by GNS Science include the purchase, testing, installation and commissioning of capital equipment on behalf of the Commission.

The GeoNet assets, comprising buildings, computer equipment and other equipment, remain the property of the Commission at all times and are included in the Commission's property, plant and equipment in the Balance Sheet.

Realised gains and losses arising from disposal of property, plant and equipment are recognised in the Income Statement in the period in which the transaction occurs.

Depreciation

Depreciation is charged on a straight-line basis at rates calculated to allocate the cost or valuation of an item of property, plant and equipment, less any estimated residual value, over its estimated useful life. Typically, the estimated useful lives of different classes of property, plant and equipment are as follows:

Furniture and equipment	10 years
Leasehold improvements*	8–12 years
Motor vehicles	5 years
Computer and other electronic equipment	3 years
GeoNet buildings (mostly shelters)	25 years
GeoNet computer equipment	3 years
GeoNet equipment other than computer equipment	8 years

* The cost of leasehold improvements is capitalised and amortised over the unexpired period of the lease or the estimated remaining lives of the improvements, whichever is shorter.

Intangible Assets

Intangible assets are recorded at cost less accumulated amortisation and accumulated impairment losses.

Research and Development

Expenditure on research activities, undertaken with the prospect of gaining new scientific knowledge or understanding, is recognised in profit or loss when incurred. The Commission does not undertake development of new products or processes other than software referred to below.

Software Acquisition and Development

Software development expenditure is capitalised only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Commission intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalised includes the cost of materials, direct labour, and overhead costs that are directly attributable to preparing the asset for its intended use. Other development expenditure is recognised in profit or loss when incurred.

Capitalised software development expenditure is measured at cost less accumulated amortisation and accumulated impairment losses.

Intangible assets are amortised on a straight-line basis over the following useful lives:

Acquired computer software licenses	1–3 years
Claims management system	8–9 years

Impairment of Non-financial Assets

The carrying amounts of the Commission's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. For intangible assets that are not yet available for use, the recoverable amount is estimated at each reporting date.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in profit or loss.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. Value in use is depreciated replacement cost for an asset where the future economic benefits or service potential of the asset are not primarily dependent on the asset's ability to generate net cash inflows and where the Commission would, if deprived of the asset, replace its remaining future economic benefits or service potential.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Leases

Operating leases, where the lessor substantially retains the risks and rewards of ownership, are recognised in a systematic manner over the term of the lease. Lease incentives received are recognised evenly over the term of the lease as a reduction in rental expense.

Liabilities

The Commission recognises a liability when there is a present obligation (legal or constructive) as the result of a past event, it is probable that expenditure will be required to settle the obligation, and a reliable estimate can be made of the obligation. Where the timing or amount of the obligation is uncertain the obligation is recognised as a provision.

Employee Entitlements

Employee entitlements to salaries and wages, annual leave, long service leave and other similar benefits are recognised in the Income Statement when they accrue to employees. Employee entitlements to be settled within 12 months are reported at their undiscounted nominal value. The liability for long service leave is calculated based on the present value of likely future entitlements accruing to staff, based on years of service, years to entitlement, the likelihood that staff will reach entitlement and contractual entitlements information.

Other Liabilities and Provisions

Other liabilities and provisions are recorded at the estimated fair value of the expenditure required to settle the obligation. Liabilities and provisions to be settled beyond 12 months are recorded at their discounted value. The increase in a discounted provision due to the passage of time is recognised as a finance cost.

Contingent Liabilities

A contingent liability is recognised when a possible obligation arises from past events, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Commission. A contingent liability is also recognised when a present obligation arising from past events is not recognised because it is not probable that settlement of the obligation will result in a cost to the Commission, or the amount of the obligation cannot be measured with sufficient reliability.

Changes in Accounting Policies

Accounting policies are changed only if the change is required by a standard or interpretation, or otherwise provides more reliable and more relevant information. There have been no accounting policy changes in the 2009 financial statements.

Commitments

Future payments are disclosed as commitments at the point a contractual obligation arises, to the extent that there are equally unperformed obligations.

Comparatives

When presentation or classification of items in the financial statements is amended or accounting policies are changed voluntarily, comparative figures are restated to ensure consistency with the current period unless it is impracticable to do so.

Budgets

The budget figures are derived from the Statement of Intent as approved by the Board at the beginning of the financial year. The budget figures have been prepared in accordance with NZ IFRS, using accounting policies that are consistent with those adopted by the Commission for the preparation of the financial statements.

When presentation or classification of items in the financial statements is amended or accounting policies are changed voluntarily, budget figures are restated to ensure consistency with the current period unless it is impracticable to do so.

Superannuation Scheme

Defined Contribution Scheme

Obligations for contributions to the KiwiSaver and the State Sector Retirement Savings Scheme are accounted for as defined contribution superannuation schemes and are recognised as an expense in the Income Statement as incurred.

Cost Allocation

Expenditure of the Commission is allocated across its four main functions: claims, research, education, and investment management. Expenditure is allocated to these functions by directly attributing costs as far as possible and by the apportioning of indirect costs based on the number of full time equivalents employed in each function.

Segment Reporting

The Commission is not required to provide segment reporting as it is a public benefit entity. Nevertheless, information is presented for material economic activities undertaken.

Related Parties

Transactions with other Crown Entities entered into on an arm's-length basis are excluded from the definition of related party transactions on the basis of the exemption provided to public benefit entities. Any transactions not conducted on an arm's-length basis will be disclosed in the financial statements.

Standards, Amendments and Interpretations Issued that are not yet effective and have not been early adopted

NZ IAS 1 Presentation of Financial Statements (revised 2007) replaces NZ IAS 1 Presentation of Financial Statements (issued 2004) and is effective for reporting periods beginning on or after 1 January 2009. The revised standard requires information in financial statements to be aggregated on the basis of shared characteristics and introduces a Statement of Comprehensive Income. The Commission will have the option of presenting items of income and expense and components of other comprehensive income either in a single Statement of Comprehensive Income with subtotals, or as a separate Income Statement followed by a Statement of Comprehensive Income.

The Commission intends to adopt this standard for the year ending 30 June 2010 and will use a single Statement of Comprehensive Income.

Notes to the Financial Statements

FOR THE YEAR ENDED 30 JUNE 2009

1 PREMIUMS

	ACTUAL 2009 $(000)	BUDGET 2009 $(000)	ACTUAL 2008 $(000)
Gross premiums	88,905	89,546	88,313
Less discount	(2,218)	(2,251)	(2,213)
	86,687	**87,295**	**86,100**
Unearned premium opening	44,404	44,268	43,962
Unearned premium closing	(44,693)	(44,645)	(44,404)
	(289)	**(377)**	**(442)**
GROSS EARNED PREMIUMS	**86,398**	**86,918**	**85,658**

Premium income represents premiums collected and paid to the Commission by insurance companies and brokers. In accordance with Section 24 (2) of the Earthquake Commission Act 1993, the Commission receives declarations provided by insurance companies and brokers that all premiums collected have been returned to the Commission. It also contracts external auditors of insurance companies and brokers to review and report on those companies' internal controls and accounting systems so far as they are related to the Commission's premiums.

2 CLAIMS EXPENSE

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Current year	57,637	68,828
Prior years	660	(1,980)
	58,297	**66,848**

Current claims relate to risks borne in the current financial year. Prior years' claims adjustments arise when the actual number or value of claims settled differs from estimates at the previous year's balance date or from a re-assessment of the estimated liability for prior years' claims that remain unsettled at current balance date.

3 EXPENDITURE

	ACTUAL 2009 $(000)	BUDGET 2009 $(000)	ACTUAL 2008 $(000)
Advertising and publicity	1,061	2,443	1,270
Amortisation of intangibles	324	343	98
Fees to auditor			
Audit of the financial statements	86	83	82
Assurance services provided by auditor	18	15	9
Audit fees for NZ IFRS transition	0	0	11
Catastrophe response programme	4,876	6,623	4,359
Commissioners' fees	187	159	168
Communication and computer costs	223	311	268
Consultants	887	833	639
Contributions to defined contribution schemes	66	70	68
Depreciation	2,447	2,387	2,174
Grants for earthquake research	2,252	2,425	1,666
GNS Science GeoNet operating costs	5,263	5,438	5,406
Investment and custodial expenses – third party	7,205	7,370	7,074
Office rental	458	397	318
Salaries and wages	2,083	2,238	2,035
Sponsorships	1,103	1,120	1,149
Other expenses	804	963	807
TOTAL OPERATING EXPENDITURE EXCLUDING REINSURANCE	**29,343**	**33,218**	**27,601**
Claims settlements and direct settlement costs*	**50,543**	**0**	**59,606**
TOTAL EXPENDITURE EXCLUDING REINSURANCE	**79,886**	**33,218**	**87,207**

* The claims figure reported in the Income Statement includes indirect claims administration costs and therefore differs from the claims settlement figure shown above. The Commission does not budget for the settlement of claims due to their unpredictable nature.

4 INVESTMENT INCOME

	ACTUAL 2009 $(000)	BUDGET* 2009 $(000)	ACTUAL 2008 $(000)
Global equities			
– Equity (losses) gains	(529,167)	106,480	(269,055)
– Foreign exchange gains	179,685	0	103,213
– Dividend income	45,333	30,000	31,706
	(304,149)	**136,480**	**(134,136)**
NZ Government stock			
– Price revaluation gains	144,743	5,247	77,037
– Interest and discount income	213,765	221,364	209,211
	358,508	**226,611**	**286,248**
Other short-term investments			
– Interest income	22,436	26,219	36,238
INVESTMENT INCOME	**76,795**	**389,310**	**188,350**

* Budgeted investment income is based on projected medium-term (5 year) asset returns.

5 MAJOR BUDGET VARIANCES

(a) Investment Income
Investment income is less than budgeted due to volatility in global equity markets resulting from the global credit crisis. This has been partially offset by a weakening in the New Zealand dollar relative to other currencies and a reduction in yields on New Zealand Government stock.

(b) Claims Expense
The budget provided only for the costs of operating the catastrophe response programme. However, claims costs for the year include landslip claims arising from the storms in July 2008 and those arising from the Hastings earthquake in August 2008.

(c) Investments
The value of equity investments was substantially affected by the global credit crisis referred to under (a) above.

(d) Unexpired Risk Liability
An unexpired risk liability was established as at 1 July 2006 as a result of applying the liability adequacy test. The preparation of the 2009 budget preceded the establishment of this provision.

(e) Operating Cash Flows
The net cash inflow from operating activities is lower than budget due to the cost of claims referred to in (b) above.

6 NATURAL DISASTER FUND

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Issued capital		
CAPITALISED RESERVES	**1,500,000**	**1,500,000**
Retained surplus		
Balance as at 1 July	4,035,468	3,894,956
Net surplus for the year	35,634	140,512
RETAINED SURPLUS AS AT 30 JUNE	**4,071,102**	**4,035,468**
CLOSING BALANCE OF THE NATURAL DISASTER FUND	**5,571,102**	**5,535,468**

Capitalised Reserves
Issued capital 1,500,000,000 ordinary shares of $1.00 each deemed to have been issued and paid up in full from the Fund on 1 October 1988.

Commission Solvency
The Commission has a contingent exposure to major disasters in excess of its current level of assets. In the event of the Commission's liabilities exceeding its assets (including reinsurance) the Crown, under Section 16 of the Earthquake Commission Act 1993, is obliged to provide, by way of grant or advance, sufficient funds to meet the shortfall.

Capital Management
The Commission's capital is its equity, which comprises retained surpluses and capitalised reserves. Equity is represented by net assets.

The Commission is subject to the financial management and accountability provisions of the Crown Entities Act 2004, which impose restrictions in relation to borrowings, acquisition of securities, issuing guarantees and indemnities and the use of derivatives.

The Commission manages its equity by prudently managing revenues, expenses, assets, liabilities, investments, and general financial dealings to ensure it effectively achieves its objectives and purpose, whilst remaining a going concern.

7 CASH AND CASH EQUIVALENTS

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Cash in bank accounts	**9,392**	**12,983**

8 PREMIUMS RECEIVABLE

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Balance as at 30 June	**17,434**	**17,567**

Insurance companies and brokers are required to pay premiums within two months of the month in which they become payable in respect of residential policies. Premiums receivable represent these outstanding premiums.

Based on past experience no provision for doubtful debts is necessary and the carrying amount of premiums receivable approximates fair value.

9 OTHER RECEIVABLES

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
GST receivable	**0**	**671**

10 PREPAYMENTS

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Prepaid reinsurance asset as at 1 July	6,106	5,564
Deferral of reinsurance premiums on contracts entered into during the period	6,405	6,106
Earnings of reinsurance premiums on contracts entered into during previous periods	(6,106)	(5,564)
PREPAID REINSURANCE AS AT 30 JUNE	**6,405**	**6,106**

Premiums on reinsurance contracts are paid three months in advance and are released to the Income Statement from the date of attachment in accordance with the expected pattern of risk.

11 INVESTMENTS

Section 12 of the Earthquake Commission Act 1993 and Section 103 of the Crown Entities Act 2004 give the Minister of Finance authority to issue directions to the Commission.

A direction from the Minister of Finance was issued on 1 November 2001 permitting investments to be held in New Zealand Government securities (New Zealand Government stock, inflation-indexed stock and Treasury bills), New Zealand bank securities (maximum $250 million) and global equities up to a maximum of 35% of total investments. All investments in New Zealand Government securities are issued by the Reserve Bank and are only tradable with the New Zealand Debt Management Office (NZDMO).

At 30 June 2009 the fair values and concentrations of the Commission's investments were as follows:

	2009 FAIR VALUE $(000)	2009 % OF TOTAL INVESTMENT	2008 FAIR VALUE $(000)	2008 % OF TOTAL INVESTMENT
NZ Government stock	3,240,375	57.7	3,114,093	55.8
NZ Government inflation-indexed stock	509,038	9.1	474,517	8.5
NZ Government Treasury bills	4,989	0.1	154,110	2.7
TOTAL GOVERNMENT SECURITIES	**3,754,402**	**66.9**	**3,742,720**	**67.0**
NZ BANK SECURITIES	**249,094**	**4.4**	**247,290**	**4.4**
Global equities – active	963,127	17.2	955,073	17.1
Global equities – passive	645,990	11.5	639,536	11.5
TOTAL GLOBAL EQUITIES	**1,609,117**	**28.7**	**1,594,609**	**28.6**
TOTAL INVESTMENTS	**5,612,613**	**100.0**	**5,584,619**	**100.0**
Current	927,320	16.5	864,425	15.5
Non-current	4,685,293	83.5	4,720,194	84.5
	5,612,613	**100.0**	**5,584,619**	**100.0**

12 INVESTMENT RISKS

Interest Rate Risk

Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The Commission's investments in Government stock, Treasury bills and New Zealand bank securities expose it to interest rate risk.

The Commission passively manages its Government stock portfolio. This means that the portfolio is exposed to an interest rate risk identical to the New Zealand Government stock index.

In the event of a major catastrophe, the NZDMO has agreed to buy back the Commission's Government stock at pre-disaster prices.

The Commission's investments have the following average market yields and durations:

	2009 YIELD	2009 DURATION	2008 YIELD	2008 DURATION
NZ Government stock	4.45%	3.39 yrs	6.69%	3.38 yrs
NZ Government inflation-indexed stock	3.34%	5.90 yrs	4.00%	6.63 yrs
NZ Government Treasury bills	2.59%	31 days	7.67%	27 days
NZ bank securities	2.75%	47 days	8.57%	46 days

Fair Value Interest Rate Risk Sensitivity

A 50 basis point increase in interest rates would decrease the surplus at balance date by $67,280,839 (2008 $65,536,254). A 50 basis point decrease would increase the surplus by $69,350,554 (2008 $67,663,348).

Cash Flow Interest Rate Risk

The Commission does not invest in variable rate instruments, and is therefore not subject to cash flow interest rate risk.

Global Equities' Market Price Risk

The Commission is exposed to price volatility and exchange rate fluctuations on its global equity investments.

Managing market pricing risks associated with global equities is achieved by maintaining a tracking error against the benchmark index of not more than 0.5% per annum for passive investments. Active global equity managers are allowed a larger tracking error, but are subject to other constraints. These include their aggregated individual company exposures being limited to 5% of funds invested in global equities, investment restricted to 5% of a company's market capitalisation, and restrictions on industry and country exposures (including a restriction on the country universe) to limit sector over-exposure. Holdings in illiquid securities are restricted or prohibited. The multi-manager style also enables a diversification of risk.

The fair values of equity investments are determined by reference to published price quotations on the world markets.

The Commission does not currently hedge currency translation exposures arising through investments in global equities as global equities will only be liquidated when the Commission is faced with a major natural disaster. At the time this policy was adopted, both the Reserve Bank and the Commission's investment advisers were of the opinion that in such an event the most likely scenario is for the New Zealand dollar to depreciate and inflation to rise. This would result in an increase in the Commission's liabilities but also an increase in the value of the Commission's unhedged global investments.

The Commission's global equity investments are concentrated in the following currencies:

	2009	2008
EURO	17%	18%
GBP	10%	9%
USD	49%	48%
JPY	10%	10%
Other	14%	15%
	100%	**100%**

Price Risk Sensitivity
A 5% increase in the value of the New Zealand dollar at balance date would reduce the surplus by $76,624,610 (2008 76,001,939). A 5% decrease in the value would increase the surplus by $84,690,358 (2008 $84,002,143).

A 5% increase in the MSCI World Index at balance date would increase the surplus by $80,445,840 (2008 $79,730,367). A 5% decrease in the index would reduce the surplus by $80,455,840 (2008 $79,730,367).

Credit Risk
The Commission is exposed to the credit risk of a bank defaulting on an investment. The Commission reduces credit risk by investing funds only in securities issued by approved New Zealand banks that have a short-term credit rating of A-1 or higher from Standard and Poor's. Exposure to any one bank with a rating of less than A-1+ is restricted to a maximum of 15% of total bank securities, but for banks with a rating of A-1+, the exposure may be extended to 25%. No collateral is held by the Commission in respect of bank balances or short-term securities due to the credit rating of financial institutions with whom the Commission transacts business. At balance date the Commission held short-term securities with five registered banks. The maximum exposure at balance date was $249,071,700 (2008 $247,295,595).

The Commission holds cash with the National Bank. This bank is part of the Crown Retail Deposit Guarantee Scheme and so deposits held with the National Bank are guaranteed by the Crown up to $1,000,000.

Liquidity Risk
The Commission's financial liabilities consist of claims payable and other trade payables. It is expected that all claims and trade payables outstanding at balance date will be settled within 12 months (2008 12 months).

The Commission's liquidity risk is the risk of having insufficient liquid funds available to meet claims and trade and other payables as they fall due. To manage this risk, the Commission retains a cash allocation of 7% of investments. Cash is invested in either bank securities or Treasury bills for periods up to 92 days. Bank securities' maturity dates are spread to ensure that at least $80 million is available each month to meet operational requirements.

All other investments are highly liquid and can be sold in a relatively short time-frame to meet any operational requirements. The average durations until maturity are shown earlier in this note.

13 PROPERTY, PLANT AND EQUIPMENT AND DEPRECIATION

	FURNITURE & FITTINGS $(000)	LEASEHOLD IMPROVEMENTS $(000)	COMPUTER EQUIPMENT $(000)	MOTOR VEHICLES $(000)	GEONET BUILDINGS $(000)	GEONET COMPUTER EQUIPMENT $(000)	GEONET OTHER EQUIPMENT $(000)	TOTAL PROPERTY PLANT & EQUIPMENT $(000)
2009 Cost								
At 1 July 2008	320	119	708	49	728	1,455	17,469	**20,848**
Additions	21	0	83	59	0	234	3,292	**3,689**
Disposals	0	0	(131)	(28)	0	(86)	(31)	**(276)**
At 30 June 2009	341	119	660	80	728	1,603	20,730	**24,261**
Accumulated depreciation								
At 1 July 2008	211	31	576	14	128	1,165	5,694	**7,819**
Depreciation charge	24	11	91	13	28	217	2,063	**2,447**
Disposals	0	0	(131)	(12)	0	(78)	(16)	**(237)**
At 30 June 2009	235	42	536	15	156	1,304	7,741	**10,029**
CARRYING AMOUNTS AT 30 JUNE 2009	**106**	**77**	**124**	**65**	**572**	**299**	**12,989**	**14,232**
2008 Cost								
At 1 July 2007	313	114	753	48	728	1,372	14,707	**18,035**
Additions	7	5	92	21	0	134	2,762	**3,021**
Disposals	0	0	(137)	(20)	0	(51)	0	**(208)**
At 30 June 2008	320	119	708	49	728	1,455	17,469	**20,848**
Accumulated depreciation								
At 1 July 2007	188	20	614	14	97	988	3,922	**5,843**
Depreciation charge	23	11	99	10	31	228	1,772	**2,174**
Disposals	0	0	(137)	(10)	0	(51)	0	**(198)**
At 30 June 2008	211	31	576	14	128	1,165	5,694	**7,819**
CARRYING AMOUNTS AT 30 JUNE 2008	**109**	**88**	**132**	**35**	**600**	**290**	**11,775**	**13,029**

14 INTANGIBLE ASSETS

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Computer software		
Cost		
At 1 July	2,656	0
Additions	504	2,656
Disposals	0	0
At 30 June	3,160	2,656
Accumulated amortisation		
At 1 July	98	0
Amortisation charge	324	98
Disposals	0	0
At 30 June	422	98
CARRYING AMOUNT 30 JUNE	**2,738**	**2,558**
Software under development		
Cost		
At 1 July	0	338
Additions	0	2,318
Transfer to software cost	0	(2,656)
CARRYING AMOUNT 30 JUNE	**0**	**0**

15 TRADE AND OTHER PAYABLES

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Trade payables	1,058	1,526
Tax on reinsurance	1,356	1,380
GST payable	293	0
Accruals	2,195	2,420
	4,902	**5,326**

Creditors and other payables are non-interest bearing and are normally settled on 30-day terms, therefore the carrying value of creditors and other payables approximates their fair value.

16 CLAIMS LIABILITIES

The Commission covers the following types of hazard: earthquake, natural landslip, volcanic eruption, hydrothermal activity and tsunami, as well as fire caused by any of the above. There is generally no significant delay between the occurrence of such events and the reporting of claims, and claims are usually settled within 12 months of being reported.

At balance date, the Commission recognises a liability in respect of outstanding claims, including amounts in relation to unpaid reported claims, claims incurred but not reported (IBNR), claims incurred but not enough reported (IBNER) and costs including claims handling costs. The Commission also assesses the adequacy of the unearned premium liability.

The Earthquake Commission Act 1993 requires all claims to be reported within three months of an event, and given the reporting time-frame from balance date, the key area of estimation risk is therefore IBNER. The volatility of IBNER is partially mitigated by the maximum settlement amounts of $20,000 for personal property and $100,000 for dwellings. However, claims in relation to residential land are not subject to a monetary limit and are therefore subject to greater volatility.

Actuarial estimates for claims liabilities for the 2008 year were made by Melville Jessup Weaver, led by Janet Lockett, a Fellow of the New Zealand Society of Actuaries. In determining the actuarial estimate, the actuary relied upon information supplied by the Commission and was satisfied as to the nature, sufficiency and accuracy of the information provided.

Actuarial calculations were not performed for 2009 as there were no significant disaster events in the second half of the year, and thus the number and total value of outstanding claims at balance date was very low. Accordingly it was considered that the benefit of calculating actuarial adjustments would not justify the cost, as such adjustments would be immaterial.

Outstanding Claims Liability

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Outstanding claims liability		
Central estimate of claims reported at balance date	7,271	15,568
Claims handling costs	1,295	2,872
Risk margin	335	676
GROSS OUTSTANDING CLAIMS LIABILITY	**8,901**	**19,116**
Current	7,556	14,307
Non-current	1,345	4,809
	8,901	**19,116**
Risk margins applied	3.9%	3.9%
Reconciliation of movement in outstanding claims liability		
Outstanding claims liability at 1 July	19,116	25,097
Add claims expense recognised in the Income Statement	58,297	66,848
Less claims payments during the year	(68,512)	(72,829)
OUTSTANDING CLAIMS LIABILITY AT 30 JUNE	**8,901**	**19,116**

To estimate outstanding claims for the 2008 year an approach based on statistical analyses of historical claims development was used. This approach assumes that the past claims development patterns will be repeated in the future.

Adjustments were made for factors that might distort the underlying statistics, and allowances were made where appropriate for changes or uncertainties that might cause the cost of settling claims to increase or decrease in comparison to earlier years.

The risk margin adopted by the Commission is intended to secure an adequacy level of 75%, which is the minimum level required by the Australian Prudential Regulations Authority, Prudential Standard GPS 210.

No discount factor or inflation factor was applied to the calculation as claims are generally settled within one year.

Unearned Premium Liability and Unexpired Risk Liability

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Unearned premium liability		
Unearned premium liability at 1 July	44,404	43,962
Deferral of premiums on contracts written in the period	44,693	44,404
Earning of premiums written in previous periods	(44,404)	(43,962)
UNEARNED PREMIUM LIABILITY AT 30 JUNE	**44,693**	**44,404**

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Unexpired risk liability		
UNEXPIRED RISK LIABILITY AT 30 JUNE	**33,000**	**33,000**

Legislation recognises that EQC's premiums may be inadequate to meet its liabilities in any one year by enabling it to set aside any annual surplus free of tax in the Natural Disaster Fund and, in the case of a very severe catastrophe (that exceeds both the Fund and reinsurance recoveries) by providing for a Crown Guarantee. The Commission currently has the capability to cover a 1-in-1000-year event with an estimated value of up to $8.1 billion before having to call on the Crown Guarantee.

Whilst the ability of EQC to meet its claims liabilities is therefore in no doubt, the Commission is required to perform a liability adequacy test to determine whether the carrying amount of the unearned premium liability is sufficient to cover estimated future claims relating to existing contracts.

This test and the resulting liability adjustment are performed solely to ensure compliance with *NZ IFRS 4 – Insurance Contracts*. As this standard is intended for general insurers and does not provide for the Commission's unique circumstances, the result should not be read as an accurate indicator of the adequacy of its premiums.

The liability adequacy calculation is based on the central estimate of the costs expected to arise annually from minor events, obtained from historical data, plus a risk margin intended to lift this to a level approximating 75% adequacy. Added to this is an amount equivalent to the central estimate of the potential future outcomes from earthquake events costing greater than $50 million and extending to very severe but extremely rare events, taking into account the projected frequencies at which such events may occur.

As a result of this test, an unexpired risk liability of $33 million was established as at 1 July 2006, calculated as follows:

		1 JULY 2006 $(000)
Unexpired risk liability		
UNEXPIRED RISK LIABILITY		**33,000**
Calculation of deficiency		
Unearned premium liability		43,962
Central estimate of present value of expected future cash flows arising from future claims on general contracts issued	(77,400)	
Risk margin	(7,600)	
Gross deficiency		(85,000)
Present value of expected future cash inflows arising from reinsurance recoveries on future claims on general contracts issued		7,500
NET DEFICIENCY		**(33,538)**

This calculation has not been re-performed for the 2009 year as there have been no significant changes to the underlying assumptions.

17 INSURANCE RISKS

The Commission must accept exposure to claims for the natural catastrophes as specified in the Earthquake Commission Act 1993 and therefore may not seek to reduce its claims exposure by diversification of its business over classes of insurance or geographical region. The premium level is set by the Earthquake Commission Regulations 1993 and does not differentiate between risk types, nor is it adjusted in response to the level of claims expected or incurred.

Reinsurance Programme
The Commission limits its exposure to a very large-scale natural disaster through the purchase of reinsurance with the objectives of:

- Minimising the overall cost to secure mandated protection to New Zealand homeowners;
- Implementing a reinsurance programme that provides stability over time against reasonably foreseeable events;
- Providing flexibility in the reinsurance agreement terms and conditions should the Crown determine a different risk profile under the natural disaster insurance scheme;
- Minimising the risk of default amongst reinsurers by limiting its exposure to any one reinsurer or related group of reinsurers, and considering only those companies that provide high security, based on credit rating information from the public domain augmented by intelligence from the Commission's broker investment analysis, and gathered through internal investigations.

Crown Underwriting Fee
It is recognised that the Fund plus reinsurances may not be sufficient to cover claims arising from a major urban catastrophe and/or other losses and costs. In those events the Crown would be called upon to meet any shortfall, under Section 16 of the Earthquake Commission Act 1993. This states: "If the assets of the Commission (including the money for the time being in the Fund) are not sufficient to meet the liabilities of the Commission, the Minister of Finance shall, without further appropriation than this section, provide to the Commission out of public money such sums by way of grant or advance as may be necessary to meet the deficiency upon such terms and conditions as the Minister of Finance determines."

Pursuant to Section 17 of the Earthquake Commission Act 1993, the Commission is required to pay fees to the Crown as determined by the Minister of Finance. The Minister of Finance has determined that $10 million be paid for the year ended 30 June 2009 (2008 $10 million).

Interest Rate and Credit Risk
No direct exposure to interest rate risk results from the financial assets or liabilities arising from insurance or reinsurance contracts. Financial assets and liabilities arising from insurance or reinsurance contracts are stated in the Balance Sheet at the amount that best represents the maximum credit risk exposure at balance date. There are no significant concentrations of credit risk.

Research and Education
The Commission seeks to indirectly reduce the extent of claims incurred, by the dissemination of research and through public education programmes.

18 CONTINGENT LIABILITIES AND ASSETS

At balance date, the Commission had no contingent liabilities (2008 nil) or contingent assets (2008 nil).

19 CATEGORIES OF FINANCIAL ASSETS AND LIABILITIES

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Financial assets at fair value through profit or loss		
Government securities	3,754,402	3,742,720
New Zealand bank securities	249,094	247,290
Global equities	1,609,117	1,594,609
	5,612,613	**5,584,619**
Loans and receivables		
Cash and cash equivalents	9,392	12,983
Premiums receivable	17,434	17,567
	26,826	**30,550**
Financial liabilities measured at amortised cost		
Trade and other payables	(4,902)	(5,326)
Outstanding claims liability	(8,901)	(19,116)
	(13,803)	**(24,442)**

20 COMMITMENTS

Computer Bureau Services Contract

In 2007, the Commission entered into a services contract for the provision of a computer system for claims handling, processing and allocation.

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Operating Commitment		
(a) Not later than one year	1,921	1,848
(b) Later than one year and not later than two years	1,921	1,848
(c) Later than two years but not later than five years	5,762	5,544
(d) Later than five years	5,122	6,776
TOTAL COMPUTER BUREAU SERVICES COMMITMENT	**14,726**	**16,016**

Reinsurance Contracts

The Commission has signed contracts for reinsurance in the international market. The contracts are for terms ranging from one year to three years.

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Operating Commitment		
(a) Not later than one year	38,403	37,487
(b) Later than one year and not later than two years	23,186	21,787
(c) Later than two years but not later than five years	12,432	9,628
(d) Later than five years	0	0
TOTAL REINSURANCE COMMITMENTS	**74,021**	**68,902**

GNS Science

The Commission has signed a contract with GNS Science for the development and implementation of a seismic monitoring and reporting network (GeoNet).

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Capital Commitment		
(a) Not later than one year	3,170	3,358
(b) Later than one year and not later than two years	3,747	2,908
(c) Later than two years but not later than five years	0	3,262
(d) Later than five years	0	0
Operating Commitment		
(a) Not later than one year	5,600	5,438
(b) Later than one year and not later than two years	5,572	5,644
(c) Later than two years but not later than five years	0	5,880
(d) Later than five years	0	0
TOTAL GNS SCIENCE COMMITMENTS	**18,089**	**26,490**

Te Papa Tongarewa, Museum of New Zealand

In 2008, the Commission signed a contract with Te Papa for sponsorship. The sponsorship relationship is linked to the *Awesome Forces* and *Quake Braker* exhibitions at Te Papa, which provide a mechanism to communicate the Commission's key messages to a broad audience and meet its educational and research objectives.

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Operating Commitment		
(a) Not later than one year	500	750
(b) Later than one year and not later than two years	500	500
(c) Later than two years but not later than five years	500	1,000
(d) Later than five years	0	0
TOTAL TE PAPA TONGAREWA, MUSEUM OF NEW ZEALAND COMMITMENT	**1,500**	**2,250**

Auckland War Memorial Museum

In 2005, the Commission signed a five year contract with the Auckland War Memorial Museum for sponsorship of the *Volcanoes* exhibition. The sponsorship relationship provides a mechanism to communicate the Commission's key messages to a broad audience and meet its educational, research, and promotional objectives. The contract will be reviewed in the 2010 financial year.

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Operating Commitment		
(a) Not later than one year	0	300
(b) Later than one year and not later than two years	0	0
(c) Later than two years but not later than five years	0	0
(d) Later than five years	0	0
TOTAL AUCKLAND WAR MEMORIAL MUSEUM COMMITMENT	**0**	**300**

Research Grants

Future research grants approved by the Board.

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Operating Commitment		
(a) Not later than one year	1,142	1,766
(b) Later than one year and not later than two years	675	1,036
(c) Later than two years but not later than five years	300	913
(d) Later than five years	0	0
TOTAL RESEARCH GRANT COMMITMENTS	**2,117**	**3,715**

Building Leases

The Commission has a non-cancellable long-term lease on premises in Wellington. The annual lease payments are subject to three-yearly reviews. The amounts disclosed below as future commitments are based on the current rental rates.

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Operating Commitment		
(a) Not later than one year	508	508
(b) Later than one year and not later than two years	508	508
(c) Later than two years but not later than five years	1,524	1,524
(d) Later than five years	1,482	1,990
TOTAL BUILDING LEASE COMMITMENT	**4,022**	**4,530**

Claims Management Services

The Commission has entered into an agreement with Gallagher Bassett Services Pty Ltd for the provision of claims management services.

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Operating Commitment		
(a) Not later than one year	870	870
(b) Later than one year and not later than two years	0	870
(c) Later than two years but not later than five years	0	0
(d) Later than five years	0	0
TOTAL CLAIMS MANAGEMENT SERVICES COMMITMENT	**870**	**1,740**

Other Operating Commitments

The Commission has entered into agreements for the provision of equipment and services that are used in its day-to-day operations.

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Operating Commitment		
(a) Not later than one year	727	1,126
(b) Later than one year and not later than two years	0	583
(c) Later than two years but not later than five years	0	0
(d) Later than five years	0	0
TOTAL OTHER OPERATING COMMITMENTS	**727**	**1,709**

21 RELATED PARTY TRANSACTIONS

The Earthquake Commission is a Crown Entity of the New Zealand Government and all significant transactions with the Crown result from Ministerial directions given under the Earthquake Commission Act 1993 or Section 103 of the Crown Entities Act 2004.

The Commission enters into numerous transactions with other Crown agencies, tertiary institutions and state-owned enterprises on an arm's-length basis. Where those parties are acting in the course of their normal dealings with the Commission, related party disclosures have not been made for transactions of this nature.

During the year, the Commission received services from a company whose directors are close relatives of key management personnel. Payments for services in 2009 totalled $73,817 (2008: $66,587). The terms and conditions of this contract are no more favourable than the Commission would have adopted if there were no relationship to key management personnel. This contract ended during the year.

Key Management Personnel Compensation

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Salaries and other short-term employee benefits	**1,007**	**943**

Key management personnel for the 2009 and 2008 years include all Commissioners, the Chief Executive and three senior managers.

22 DISCLOSURES

Employee Remuneration

The number of employees whose total remuneration for the financial year was in excess of $100,000, in $10,000 bands, is as follows:

$(000)	2009	2008
100–110		1
110–120	2	2
130–140	1	
150–160		1
160–170	1	1
170–180	1	
190–200		1
200–210	1	
260-270		1
280-290	1	

The Chief Executive's total remuneration is in the $280,000-$290,000 band (2008: $260,000-$270,000 band).

Commissioners' Remuneration

Commissioners' fees paid during the year were as follows:

	FEES – 2009 ($)	FEES – 2008 ($)
MC Wintringham	46,400	41,900
KB Taylor (i)	24,167	20,950
TP McGuinness (ii)	2,513	20,950
CB Durbin (iii)	19,333	20,950
RJ Hooper	23,200	20,950
WN Hoadley	23,200	20,950
GT Muriwai	23,200	20,950
LM Robertson (iv)	21,267	0
GA McLachlan (v)	3,867	0
TOTAL	**187,147**	**167,600**

No additional remuneration was paid to Commissioners.

(i) Appointed as Deputy Chairman 1 May 2009

(ii) Retired from Board 9 August 2008

(iii) Retired from Board 30 April 2009

(iv) Appointed to Board 10 August 2008

(v) Appointed to Board 1 May 2009

Indemnity and Insurance Disclosure

The Commission has provided a deed of indemnity to each Board member in relation to certain activities undertaken in the performance or intended performance of the Commission's functions.

The Commission effected and maintained "Directors' and Officers' Liability" and "Professional Indemnity" insurance cover during the financial year, in respect of the liability or costs of any Board member, or employee.

23 RECONCILIATION OF OPERATING SURPLUS TO NET CASH FLOW FROM OPERATING ACTIVITIES

	ACTUAL 2009 $(000)	ACTUAL 2008 $(000)
Net surplus for the year	35,634	140,512
Add non-cash items:		
Depreciation and amortisation	2,771	2,272
	2,771	**2,272**
Add (less) movements in other working capital items:		
Decrease (increase) in premiums receivable	133	(222)
Decrease (increase) in other receivables	671	(671)
(Increase) in prepaid reinsurance	(299)	(542)
Decrease (increase) in interest accrued	7,556	(2,763)
(Decrease) increase in provision for employee entitlements	(3)	36
(Decrease) in trade payables	(423)	(8)
(Decrease) in outstanding claims	(10,215)	(5,981)
Increase in unearned premium	289	442
	(2,291)	**(9,709)**
Add (less) items classified as investing activity:		
Discount income and investment price revaluations	208,391	90,713
Loss (gain) on disposal of property, plant and equipment	27	(3)
	208,418	**90,710**
NET CASH INFLOW FROM OPERATING ACTIVITIES (GST EXCLUSIVE)	**244,532**	**223,785**

24 CREDIT RATING

The Commission has been assigned an insurer financial strength rating of AAA (extremely strong) as accorded by international rating agency Standard & Poor's on 25 September 2008.

25 EVENTS AFTER THE BALANCE SHEET DATE

There were no significant events after the Balance Sheet date.

Statement of Service Performance

Output Class 1: Claims handling and the Catastrophe Response Programme

This output class comprises the maintenance of EQC's state of readiness to meet the requirements of the Crown for the compensation of residential property owners following a natural disaster and the incorporation of this readiness, so far as is possible, into normal daily operations.

It contributes to the impact of *Having a catastrophe response programme that delivers adequate claims handling capacity* and through that to the Government's outcome of *Safer communities and rapid recovery from natural disasters.*

Performance targets and results

1. The programme's plans and schedules to maintain its currency are adhered to (e.g. schedules for document maintenance, testing and training).

Achieved. *Plans and schedules adhered to and all training and exercises undertaken.*

2. Surveys of claimants show that settlement times and standards remain acceptable to a majority of claimants.

Achieved. *Satisfaction with settlement time – 68% and overall satisfaction with the service – 80%.*

3. An external review of the Catastrophe Response Programme is completed and any recommendations for meeting best world practice are considered and implemented where appropriate.

Achieved. *Review completed in May. Recommendations being worked through, with regular progress reports made to the Board.*

4. EQC has responded to its risks and challenges as described in the following table.

EQC'S CHALLENGES AND RISKS ASSET CLASS	EQC'S RESPONSE	RESULTS
An ability to assess rapidly the requirements of an EQC response to a natural disaster occurrence.	Maintain computer applications that provide the analysis and insights to enable the necessary assessments and decisions to be made (EQC has an earthquake hazard and analysis model, a systems dynamics model and a web-based claims management system).	**Achieved.** *Computer applications maintained and enhanced. Models used as basis for calculating event responses. Claims system operational as at March 2008.*
Limited numbers of loss adjusters, engineers, valuers and other specialists required to process claims.	Secure agreements with loss adjusting firms and other service providers, in Australia and New Zealand, for the provision of specified numbers of people in a disaster.	**Achieved.** *Agreements in place with New Zealand and Australian loss adjusting firms for the provision of specified numbers of people in a disaster. Training of other specialists undertaken.*
	Retain a cadre of loss adjusters on a guaranteed minimum income.	**Achieved.** *Eighteen loss adjusters and estimators on contract. New entrant scheme under development.*
EQC's ability to quantify the amount needed to repair damage could be hampered by the effect on construction costs of post-event demand surge.	Fund research into the likelihood and extent of post-event demand surge and its possible effect on EQC's claims costs.	**Achieved.** *A study of post-event demand surge has been commissioned, with a report due in late 2009.*

Output Class 2: Research

This output class includes research in fields relevant to natural disaster damage, methods of reducing or preventing natural disaster damage, and the insurance provided under the Earthquake Commission Act.

Through its advocacy of, and investment in, science and engineering research, EQC contributes to natural hazard risk assessment and disaster reduction in New Zealand. The Commission's research activities contribute to the impact of *Sustaining capability and completing research in order to reduce the risk of the hazards EQC insures against*. By contributing to a reduction in hazard risk, the research helps to reduce the Crown's liabilities and protect its assets and helps to make New Zealand communities safer from natural disasters. Research into construction and engineering methods can also have economic spin-offs and contribute to a knowledge-driven economy.

Performance targets and results

1. The planned programme of investment in research for the year is accomplished, with each project either meeting agreed targets and milestones or obtaining a peer review of at least "satisfactory".

Achieved. *Twenty-two research projects were completed during the year, all within agreed budgets and timeframes. Peer reviews received to date are all satisfactory or above.*

2. Results of research funded by EQC are disseminated to the research, planning, construction and recovery sectors within two months of completion of satisfactory peer review, and there is evidence of a satisfactory rate of transfer into practice.

Achieved. *Results of completed research have been disseminated and the rate of application by recipients appears satisfactory.*

3. EQC supports the Hazards Risk Management Standard project led by Standards New Zealand.

Partially achieved. *Discussions have been held with key stakeholder groups to develop the scope and intended application framework for a natural hazard risk management standard.*

4. The university funding programmes meet contracted requirements for teaching, research and public activities.

Achieved. *EQC's university-based teaching and scholarship programmes have contractual arrangements specifying EQC's requirements and these have been fulfilled.*

5. The GeoNet project meets contracted requirements intended to keep it up-to-date and providing a high level of service in data provision and hazard warning.

Achieved. *The development and roll-out of GeoNet continues on time and on target. The workplan for 2009/10 has been received and approved. All service level requirements for GeoNet's operation have been fulfilled.*

6. GeoNet review completed by 30 June, with recommendations about future funding.

Achieved. *The GeoNet strategic review was completed with international input. The dominant conclusions of the review are that the current scope and performance under the GeoNet contract are excellent. A strategic plan for the future direction of GeoNet has been received.*

Output Class 3: Public education

This output class has two elements:

+ Public education about seismic hazards and methods of reducing or preventing seismic disaster damage,
+ Public education about EQC's role and the importance of having adequate insurance on residential and personal property.

These outputs reflect EQC's functions under Section 5(1)(e) of the Earthquake Commission Act: "Facilitate research and education about matters relevant to natural disaster damage, methods of reducing or preventing natural disaster damage, and the insurance provided under this Act." They contribute to the impact of *Improving levels of knowledge and activity of New Zealanders to make their homes safer from natural perils, understand EQC's role and take out adequate insurance.*

In turn, this impact contributes directly to the Government's outcome of *Safer Communities* and indirectly to the outcome of *Efficient management of the Crown's assets and liabilities*, because the Crown's fiscal risk is reduced as more households take precautions against damage from seismic events.

Performance targets and results

1. The percentage of New Zealand households that have taken preventive steps to mitigate natural disaster damage has increased in the year to 30 June.

Achieved. *The independent Nielsen quarterly surveys show that disaster mitigation activity (as indicated by levels of secured hotwater cylinders, tall furniture and foundations) has increased by 2.2 percentage points from 45.3% to 47.5% over the course of the year.*

2 The percentage of New Zealanders who understand EQC's role has increased in the year to 30 June.

Achieved. *The Nielsen surveys show that the percentage of New Zealanders who understand EQC's role has increased by 1.4 percentage points during the year, moving from 64.2% to 65.6%.*

3 Public understanding of the insurance under the Act has increased in the year to 30 June as shown by evaluation of social marketing efforts.

The Nielsen surveys show that awareness of EQC's insurance role has decreased by 8 percentage points to 56% over the past year.

4 EQC has responded to its risks and challenges as described in the following table.

EQC'S CHALLENGES AND RISKS	EQC'S RESPONSE	RESULTS
Experience in New Zealand and overseas is that public expectations, including expectations of EQC are developing rapidly.	EQC's communications will be cognisant of public expectations and will endeavour to influence them where appropriate.	**Achieved.** *All form letters in EQC's claims system revised to improve clarity and tone so that claimants have realistic expectations of EQC and its claims handling process.*
Communications methods and habits are changing rapidly.	EQC will use modern ways of communicating its public education messages, including use of new media such as the internet and innovative use of old media such as its exhibitions at Te Papa and Auckland Museum.	**Achieved.** *EQC employed a range of methods with which to communicate its messages, including the internet, press advertising, newsletters, museum exhibitions, feature articles and a reality television programme.*
The public tends to downplay the risk of disasters affecting them and fails to take proper action to prepare.	EQC designs its social marketing efforts with due consideration of the research that has been done into achieving behavioural change in society.	**Achieved.** *Reflecting research that indicates EQC must engage more actively and closely with communities to achieve its goals, a regional public education programme is to be run in Kapiti in early 2009/10.*
The public is swamped with advertising and social marketing messages and EQC's message may not attract attention.	EQC has identified "trigger points" at which its own mitigation message will be particularly apposite to New Zealand families, and "strike while the iron is hot". EQC also seeks to align its message content and timing with that of other agencies tasked with delivering similar home safety advice.	**Achieved.** *Ongoing availability of "Quakesafe Starter Packs" for homebuyers in Masterton.* *Alignment with Civil Defence on the "Aftershock" reality television programme and also in the development of the Kapiti pilot programme.*
The opportunity for grabbing the public's attention provided by the news of a disaster occurrence at home or overseas should be recognised and prepared for.	EQC's decision and funding systems will remain sufficiently robust and flexible to respond to urgent needs.	**Achieved.** *Mitigation advertising carried out following the Sichuan earthquake, the Australian bushfires and the Italian earthquake.*

Output Class 4: Policy advice

This output class includes the provision of policy advice to the Government on issues related to EQC's statutory functions, including:

- Natural disaster damage,
- Methods of reducing or preventing natural disaster damage,
- Government response to disasters,
- Relevant risk management issues,
- Management of the Natural Disaster Fund and protection of its value,
- Terms and conditions of the insurance.

It contributes to all of EQC's impacts, and through them to the Government's outcomes of *Safer Communities and rapid recovery from natural disasters* and *Efficient management of the Crown's assets and liabilities*.

Performance target and result

1. All requests for participation in policy preparation are met to the satisfaction of the Minister or departments concerned and are within agreed timelines.

Achieved. *All Ministerial enquiries during the year were responded to within agreed timelines.*

Output Class 5: Management of the Natural Disaster Fund

This output class involves administration of the Fund, including collection of the premiums payable, and, so far as reasonably practicable, protection of the Fund's value through the investment of money held in the Fund and reinsurance in respect of the whole, or part of the insurance provided under the Act. It reflects EQC's functions as set out in section 5(1)(b), (c) and (d) of the Act and contributes directly to the Government's outcome of *Efficient management of the Crown's assets and liabilities*.

Performance targets and results

1. The reinsurance programme reduces the net risk to the Natural Disaster Fund and the Crown.

Achieved. *Computer modelling shows the reinsurance programme for the 2009/10 year reduces the risk of the Fund falling to zero in any year by 79.5% and of falling below $2 billion in any one year by 53%, compared to having no insurance in place.*

2. Investment performance achieves targets set in the Statement of Investment Policies, Standards and Procedures.

ASSET CLASS	ACTUAL RETURN	BENCHMARK/ TARGET RETURN
NZ Government stock	9.8%	9.8%
NZ Government inflation-indexed bonds	11.9%	11.9%
Bank bills (registered certificates of deposit)/Treasury bills	5.9%	5.9%
Passive global equities	-16.6%	-17.2%
Active global equities	-19.2%	-17.2%
Total Portfolio*	**1.2%**	**1.3%**

* The target return for the total portfolio is 1% plus the NZGS index return, over a rolling 10-year period. The structure has not been in place long enough to compare 10-year returns. For the five years to 30 June 2009, the actual portfolio return was 5.0% versus the target of 7.7%.

3. EQC has complied with its asset allocation strategy and investment managers have complied with their agreements.

Achieved. *This included investing in approved asset classes only, maintaining asset classes within specified ranges, ensuring cash was invested in banks with high credit ratings, receiving compliance and audit reports from custodians and fund managers, and reporting on the Fund to the Board and investment committee.*

4. EQC's investment management costs are in line with international peers.

Achieved. *An international investment benchmarking company employed by EQC shows that EQC's investment management costs are below the median of its international peers.*

5. EQC has managed and administered the Fund in a manner consistent with best practice portfolio management, maximising return without undue risk to the Fund as a whole.

Achieved. *While the Fund's global equity returns were adversely affected by the severe volatility on global markets, best practice portfolio management was maintained and the Fund realised a positive return for the year.*

6. EQC has acted in accordance with its Responsible Investment Policy Standards and Procedures and includes in its annual report comment on the extent to which social, ethical and environmental issues have been considered in EQC's investment process and EQC's proxy voting policy.

Achieved. *EQC has met its responsible investment obligations and the annual report meets these requirements.*

7 EQC has validated the premiums paid to it by insurance companies by completion of the programmes of records checking and external audit, with any qualifications reported in the latter having been investigated and resolved.

Achieved. *The programmes of records checking and external audit were completed. Eight external audit opinions were received and none were qualified.*

8 EQC has responded to its risks and challenges as described in the following table.

EQC'S CHALLENGES AND RISKS	EQC'S RESPONSE	RESULTS
Investment of the Fund to protect its value and maintain standards of international best practice (including with regard to responsible investing), is a complex task requiring specialised knowledge, wide-ranging expertise and constant vigilance.	Employ the necessary expertise on staff to be able to manage and control, with assistance from professional advisers, the custodians, investment managers and other specialists who can ensure required standards are achieved and maintained.	**Achieved.** *EQC employed an additional professional so that the investment team has a full complement of staff with the necessary expertise to carry out its functions.*
Building costs may continue to increase, resulting in higher payouts for EQC, and increased risk to the Fund. The maximum sums insured under the Act have not been adjusted since the Act's inception in 1993, compromising their original purpose.	Press for the maximum sums insured (the "caps") on EQC's cover to be adjusted to account for these inflationary trends and stabilise EQC's liability.	**Achieved.** *The briefing to the incoming Minister included a recommendation to increase the maximum sums insured.*
Reinsurance costs and the financial security of EQC's reinsurers are influenced by external factors like major disasters overseas and the performance of the financial markets.	Manage potential volatility of reinsurance pricing by forward purchasing and, if competitive, alternative risk transfer products.	**Achieved.** *The 2009/10 reinsurance programme continues the three-year tranching arrangement used to manage the volatility of the reinsurance premium levels. No alternative risk transfer products have yet been found to be as effective as current arrangements at achieving EQC's objectives for its reinsurance programme.*
	Manage counterparty credit risk by applying a minimum claims paying ability rating of A (Standard and Poors) over the entire programme, limiting capacity provided by companies rated A-, market surveillance and analysis by EQC's reinsurance brokers, and maintaining the ability under the reinsurance agreements to replace reinsurers on downgrading in some circumstances.	**Achieved.** *At renewal (2009/10), the weighted counterparty risk rating of the reinsurance programme was A+. Capacity of companies rated A- was 5.8%. The 2009/10 treaties retain the clause that allows cancellation by EQC of reinsurers that are downgraded.*

Output Expenditure for the Year Ended 30 June 2009

OUTPUT CLASS	REVENUE	EXPENDITURE	REVENUE BUDGET	EXPENDITURE BUDGET
Claims handling and the Catastrophe Response Programme	Nil	$58.3 million	Nil	$9.6 million
Research	Nil	$10.4 million	Nil	$10.7 million
Public education	Nil	$2.7 million	Nil	$4.1 million
Policy advice	Nil	Nil	Nil	Nil
Management of the Natural Disaster Fund	$163.2 million	$56.2 million	$476.2 million	$57.5 million

Good Employer Compliance

EQC has met all the requirements of its equal employment opportunity policy.

The Commission takes its role as a good employer of 22 staff seriously because human resources are integral to its business. To ensure staff regard EQC as a good employer, the Commission will continue to:

- Demonstrate leadership and vision that articulates EQC's values and the importance of its staff;
- Provide equal employment opportunities for staff (see below);
- Provide opportunities for staff participation in organisational decisions;
- Encourage staff to develop to meet their aims and aspirations through internal and external training, coaching and mentoring;
- Implement an impartial, transparent employment process and equal opportunities to move up, through and out of the organisation in a positive way;
- Provide a comprehensive introduction to the organisation setting out EQC's values and objectives;
- Take account of the need for staff to balance work with the rest of their lives;
- Utilise performance management practices that are transparent and fair;
- Have a transparent, fair, gender neutral remuneration system;
- Provide a working environment that is free from all forms of harassment and bullying and provide safe and fair means of dealing with complaints;
- Provide a healthy and safe workplace, observing OSH requirements at the corporate office and as part of the Catastrophe Response Programme, to ensure temporary field offices and claims sites are safe for the Commission's workers.

As an Equal Employment Opportunities (EEO) employer, EQC is committed to the principle of fair and equal treatment for all its staff.

This means that all its decisions about its staff must be free of unfair discrimination based on colour, race, ethnic or national origin, sex, marital status, religious or ethical belief or disability.

EQC will ensure that it does not discriminate on these grounds in deciding what terms or conditions of work, or fringe benefits, or opportunities for training, promotion or transfer it offers to its staff.

EQC will work towards the removal of any barriers it may have to the employment or advancement of suitably qualified disabled people, should the opportunity arise to take such people onto its staff.

EQC recognises the importance of volunteers contributing to social development, the environment and the economy, and supports staff participating in voluntary community work from time-to-time, while ensuring that professional obligations are met.

EQC has a confidential Employee Assistance Programme, under which any staff member may seek assistance from a contracted external service provider if issues are affecting work performance.

		2008/09	2007/08
Average length of service		8.2 years	7.2 years
Staff turnover		0	5
Total staff at 30 June		22	21*
Gender	Male	12	11
	Female	10	10

*One vacancy existed at 30 June 2008.

Investment Processes – Environmental, Social and Governance Considerations

Principles

The Commission considers that responsible investment decision-making that takes account of environmental, social and governance (ESG) considerations is part of evolving best practice. Responsible investment actions can include engagement, voting, exclusion of certain investments, and/or divestment.

The Commission, at its discretion, and provided that it is consistent with its obligation to invest the Fund on a prudent, commercial basis, may consider other issues arising from the Fund's investments. In doing so, the Commission may take into account factors such as whether the issue is contrary to New Zealand law and New Zealand's international agreements, or is inconsistent with Crown actions.

The Commission is a signatory to the United Nations Principles for Responsible Investment (UNPRI), and acknowledges internationally agreed standards for responsible corporate behaviour and investment. As such, the Commission aims to encourage companies in which it invests to meet internationally agreed standards for responsible corporate behaviour.

Implementation

If companies invested in are found to have corporate practices that breach its responsible investment policy, the Commission will consider engaging with the company either directly or in conjunction with other investors, or taking other shareholder action. The Commission believes that it can, in most instances, have a greater impact on company practices through dialogue with company management in conjunction with others, than through immediate divestment.

As a last resort the Commission may divest of investment in companies that are found to have corporate practices that breach its responsible investment policy.

Investment Managers

The Commission appoints external investment managers to manage portions of the Fund. As part of the selection process the Commission assesses the overall investment management capabilities of candidate managers, including the ability to implement the Commission's requirement to avoid prejudice to New Zealand's reputation as a responsible member of the world community.

Investment managers are required to be vigilant against the effects on companies' long-term performance prospects that could arise from any practices which alienate civilized society including socially and environmentally irresponsible behaviour.

Maintaining open dialogue with investment managers, including in relation to the requirement to avoid prejudice to New Zealand's reputation, is considered to be critical to the achievement of the Commission's objectives.

In addition, consistent with the UNPRI, the Commission encourages its investment managers to integrate ESG factors into evolving research and analysis and to undertake and report on ESG-related engagement. The investment managers report to the Commission on their application of the responsible investment requirements, on a six-monthly basis.

Investment managers are formally instructed of any exclusion or divestment decisions by the Commission.

Exclusions

In line with the obligations and responsibilities of the responsible investment policy, the Commission and its investment managers do not invest the Fund in the following:

- Organisations engaged in the development, production, transfer, possession, acquisition, stockpiling or use of anti-personnel mines, or
- Organisations engaged in the production of cluster munitions, or
- Organisations engaged in the manufacture, simulated testing and/or refurbishment of nuclear explosive devices, or
- Manufacturers of cigarettes and tobacco.

Future Responsible Investment Development

EQC's approach to responsible investment is evolving and the Commission will continue to work with the other New Zealand Crown financial institutions (CFI's) to improve its ability to meet its responsible investment obligations.

All CFI's are required to avoid prejudice to New Zealand's reputation as a responsible member of the world community. CFI's, including EQC, entered into an agreement for sharing responsible investment resources during the year. EQC is participating in a joint CFI process to select a research company to identify companies within the CFI portfolios that may prejudice New Zealand's reputation. A further undertaking will be to develop and implement mechanisms for effective engagement with investee companies.

Proxy Voting Policy

The Commission believes that good corporate governance should maintain a balance between the rights of shareholders on one hand and the needs of the corporate board and management to direct and manage the company's affairs on the other.

Responsible governance should reinforce a culture of integrity and transparency, contribute to the achievement of strategic goals, ensure Board alignment with shareholder interests, reinforce and maintain good business ethics, and recognise environmental and social considerations.

The Commission believes that good corporate governance will also maximise returns to the Fund without undue risk.

Voting rights are important to the Fund for maintaining shareholder oversight of directors and company policies. The Commission will use its voting rights to encourage good corporate governance.

Voting Rights

Pooled Accounts

The Board will retain the right to exercise any vote attached to units held in a pooled account. The right to exercise any vote attached to a share or unit within a pooled account will normally rest with the manager of the account.

Directly held Accounts

Any voting rights attached to any securities that form part of the portfolio shall be exercised by the manager:

- As directed by EQC by written notice to the manager; or
- If no such direction is made, in accordance with the manager's duties and obligations under their agreement and in particular, avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

Statement of Responsibility

THE BOARD IS RESPONSIBLE FOR THE PREPARATION OF THE EARTHQUAKE COMMISSION'S FINANCIAL STATEMENTS AND STATEMENT OF SERVICE PERFORMANCE, AND FOR THE JUDGEMENTS MADE IN THEM.

- The Board and management are responsible for establishing and maintaining a system of internal control designed to provide reasonable assurances as to the integrity and reliability of the financial reporting.
- In the opinion of the Board and management, the annual financial statements for the financial year fairly reflect the financial position and operations of the Commission.

Signed on behalf of the Board:

Chairman

21 September 2009

Commissioner

21 September 2009

Directory

MINISTER IN CHARGE OF THE EARTHQUAKE COMMISSION

The Hon Bill English

COMMISSIONERS

M C Wintringham, CNZM, BA (Hons)
Chairman
Ex officio member of all committees except chairman/deputy chairman expenses committee

K B Taylor, BCA, BSc, FIA (London), FIAA, AFIoD
Deputy Chairman
Member of reinsurance (chair) and investment committees

C B Durbin, BCom, LLB (Hons), FInstD, FAMINZ
(Retired from the Board during the year)

W N Hoadley, QSO, LLB (Hons), MA, DipTchg
(Retired from the Board)

R J (George) Hooper, BE (Hons), PhD, FIPENZ
Member of research (chair) and reinsurance committees

T P McGuinness, BCA
(Retired from the Board during the year)

G A McLachlan, LLB
Member of reinsurance and catastrophe response committees

G T Muriwai, MCom (Hons), CA
Member of audit (chair), investment and chairman/deputy chairman expenses committees

L M Robertson, BCom, Dip Banking, FINFINZ, GAICD, AinstD
Member of investment (chair), chairman/deputy chairman expenses (chair) and audit committees

SENIOR MANAGEMENT

D A Middleton, ANZIIF (Fellow), FCII, MBA, Chartered Insurer
Chief Executive

P R Jacques, BSc, DipMgt, DipAcc, CA, CFIP
Chief Financial Officer

L R Dixon, GradDipBusStuds (Ins Mgt), ANZIIF (Fellow)
Insurance Manager

H A Cowan, PhD
Research Manager

AUDITOR

Audit New Zealand, Wellington
(on behalf of the Controller and Auditor-General)

BANKER

National Bank of New Zealand, Wellington

SOLICITORS

Chapman Tripp, Wellington
DLA Phillips Fox, Wellington

INVESTMENT ADVISOR

Russell Investment Group Ltd, Auckland

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EQC

EARTHQUAKE COMMISSION

KŌMIHANA RŪWHENUA