Earthquake Commission

statement of intent

1 July 2008 - 30 June 2011

EQC

New Zealand Government

STATEMENT OF INTENT
1 July 2008 - 30 June 2011

This statement is submitted by the Board of the Earthquake Commission in accordance with the Crown Entities Act 2004. It sets out the Board's overall intentions and objectives for the Commission to 30 June 2009 and the two succeeding financial years, as required by the Act.

Michael Wintringham
Chairman

Keith Taylor
Board Member

Date: 24 June 2008

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Statutory functions

EQC is an independent Crown entity with statutory responsibilities set out in section 5 of the Earthquake Commission Act 1993. Those responsibilities are:

(a) To administer the insurance against natural disaster damage provided under this Act:

(b) To collect premiums payable for the insurance provided under this Act:

(c) To administer the Fund and, so far as is reasonably practicable, protect its value, including by the investment of money held in the Fund:

(d) To obtain reinsurance in respect of the whole or part of the insurance provided under this Act:

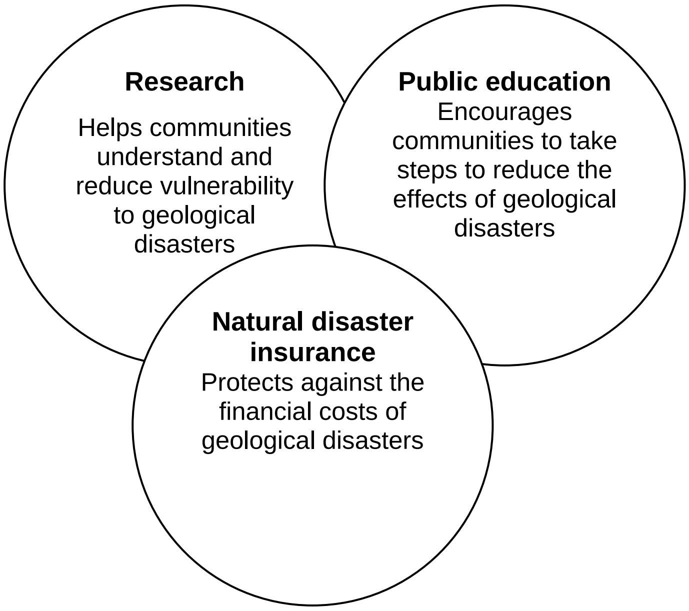
(e) To facilitate research and education about matters relevant to natural disaster damage, methods of reducing or preventing natural disaster damage, and the insurance provided under this Act:

(f) Such other functions as may be conferred on it by -
   (i) This Act or any other Act; or
   (ii) The Minister, by written notice to the Commission after consultation with the Commission.

In plain language, EQC's responsibilities are to:

- Provide insurance of residential property against loss or damage caused by earthquake, volcanic eruption, hydrothermal activity, tsunamis and natural landslips, to properties insured against fire in accordance with the Earthquake Commission Act 1993. There is also limited cover provided for land loss by any of the above hazards plus storm or flood.
- Administer the Natural Disaster Fund (the Fund), including its investment and reinsurance.
- Facilitate research and education about matters relevant to natural disaster damage and its mitigation.

EQC believes there is a synergy among its three core functions – insurance scheme, research and public education – and they are all essential if New Zealand is to manage the risk of geological disasters effectively.



- Public education enables people to take practical steps to make their homes safer against earthquakes or other disasters. This reduces the impact of disasters on people's lives and affects insurance payout levels.
- The occurrences of natural disasters in New Zealand and overseas provide opportunities for new research and for capturing attention to the message of home safety.
- Research output is used to inform risk management and risk reduction by: guiding land use, building design and construction, disaster readiness and recovery planning. Research based computer models aid decisions about responses to disasters and planning for possible future events, including the pricing of the New Zealand risk by the world's reinsurance companies.

Ministerial Direction

Under section 12 of the Earthquake Commission Act, the Minister of Finance may give written directions in relation to the Commission's functions under the Act.

A Ministerial Direction taking effect as of 1 November 2001 sets out requirements for how the Commission should invest and manage the Natural Disaster Fund, and when the Commission should consult with the Minister of Finance.

Reporting to the Minister

Each quarter EQC will provide Treasury with a report on the performance of the Natural Disaster Fund's investments, and each month an Income Statement of the Commission, including explanations of significant budget variances. Any matters that might affect EQC's ability to carry out its statutory functions or meet the requirements of Ministerial Directions made under the Act will be reported.

Under the terms of the Ministerial Direction of 1 November 2001, the Commission is also required to consult with the Minister of Finance in the following circumstances:

- if it intends to modify the statement of investment policies, standards, and procedures to any substantive degree.
- if it intends to modify the portfolio composition from the following:
    - NZ Government securities;
    - up to a maximum of 35 percent of the market value of the Fund in global equities; and
    - up to a maximum of $250 million of New Zealand bank bills.
- if it forms the intention to cover its pre-disaster currency exposures.
- in the event of a major natural disaster likely to involve claims on the Commission in excess of $250 million, before liquidating any part of the investment portfolio of the Fund apart from the holdings of New Zealand bank bills.

In addition, if the Commission considers at any time that any provision in this direction is inconsistent with another provision in this direction or any other direction under Section 12 of the Earthquake Commission Act 1993 or any provision under that Act it shall advise the Minister of that inconsistency.

Process in relation to acquisitions

EQC is exempted from the restrictions on financial transactions set out in sections 161 to 165 of the Crown Entities Act, which relate to acquisition of securities, borrowing, offering guarantees or indemnities, and derivative transactions.

EQC is bound by:

- sections 96 to 102 of the Crown Entities Act 2003 in relation to acquisition of subsidiaries, shares or other holdings; and
- the Ministerial Direction of 1 November 2001 in relation to investment and management of the Natural Disaster Fund.

Under the Ministerial Direction of 1 November 2001, EQC is required to have a Statement of investment policies, standards and procedures, and must consult with the Minister if it intends to modify the Statement to any substantive degree.

Managing organisational health

EQC's most important organisational asset is the expertise and experience of its staff. EQC takes pride in having a healthy working environment, and invests sensibly in training and retaining its employees. EQC enjoys a low staff turnover but, to the extent possible for an organisation of 20 staff from several diverse disciplines, long-term succession planning is also undertaken so that expertise can be replaced when staff eventually move on.

New Zealanders rely on EQC to provide efficient claims assessment and settlement in the aftermath of a disaster. EQC has to be prepared to deliver on its statutory functions regardless of where and when a natural disaster strikes. Consequently, some of the challenges facing EQC as an employer are:

- the need to adjust to substantially increased demands on capacity at short notice; and
- the need for staff to work away from home and families under stressful situations.

Additionally, EQC needs to maintain expertise in the management of insurance, reinsurance and investments, as well as technical expertise in disaster response.

For these reasons, organisational health and capacity are of strategic importance to EQC. EQC addresses organisational capacity and readiness to respond to crisis both through good management practices and also through the Catastrophe Response Programme.

EQC has put in place contingency plans for the situation where New Zealand is affected by a major catastrophe, providing for expansion of organisational size at short notice. At its Wellington offices, EQC has extra office space available for immediate expansion of staff numbers. In the event that Wellington is affected by a catastrophe, EQC has established stand-by headquarters in a second location (Manukau City) that can be brought up to capacity within hours.

All of EQC's computer systems are replicated, so that a Wellington earthquake will not bring down its systems.

EQC has formalised back-up responsibilities for its staff so that if any staff member is incapacitated, there is at least one other staff member who can pick up their responsibilities. EQC has also established arrangements with human resources firms to provide temporary staff if required, and standing contracts with loss adjusters and other sources of claims servicing expertise to provide services as required.

Human resources policies

EQC takes its role as a good employer of 20 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 non-work issues are affecting work performance.

Operating environment

Disaster Recovery

The most significant factor in EQC's operating environment is the risk of earthquake, volcanic eruption, hydrothermal activity, tsunamis and natural landslips. Most of the Commission's activities involve the management of this risk through insurance, education and research. Ultimately, EQC's performance will be judged by its ability to provide adequate claims settlements efficiently following natural disasters, although it is not possible accurately to anticipate their occurrence or severity.

EQC has sufficient staff to provide routine services. Without extensive planning and preparation, a large disaster could overwhelm these permanent resources. EQC has pioneered extensive planning to enable it to cope with any reasonably foreseeable natural catastrophe. This activity is called EQC's Catastrophe Response Programme (CRP). Its aims are to:

- Get adequate resources of people, equipment and consumables deployed, including siting in the region of the disaster.
- Set up and maintain the necessary communications and IT systems.
- Establish and maintain liaison with other organisations like territorial authorities, Civil Defence and insurance companies.
- Manage and meet public expectations.
- Get claims settled fairly and expeditiously.

In recent years, the CRP has been tested in real situations, although none has provided the challenge of a large disaster. The largest event (Gisborne) produced 5,000 claims; an earthquake in one of New Zealand's larger cities could generate tens of thousands of claims.

A feature of EQC's response to recent disasters has been its cooperation with other government agencies to provide a rapid and coordinated response to catastrophe. EQC is working with the Civil Defence and Emergency Management Groups set up by regional authorities after the passing of the Civil Defence and Emergency Management Act 2002, so that areas of mutual interest, such as planning, mitigation and recovery, can be tackled jointly.

Protection of the Natural Disaster Fund

The Natural Disaster Fund is invested in accordance with a Ministerial direction, issued following consultation with EQC, that allows a maximum of 35% in overseas equities and the rest in fixed interest government and bank securities. Within this framework, EQC has an obligation to invest the Fund on a prudent, commercial basis, and in doing so, manage and administer the Fund in a manner consistent with best practice portfolio management, maximising return without undue risk to the Fund as a whole, and avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

How EQC will discharge these obligations and responsibilities is set out in a Statement of Investment Policies, Standards and Procedures (SIPSP), which is reviewed annually and sent to the Minister for approval. The SIPSP contains a statement of EQC's investment beliefs to guide the management and administration of the assets of the Natural Disaster Fund in a consistent manner that reflects the views of the Board, the Statement of Intent and the Ministerial Direction under which EQC operates. The SIPSP also contains details of EQC's investment objectives and policies, including asset allocation at a strategic level, targeted returns and security of investments.

EQC passively manages its investments in New Zealand Government Stock and in forty percent of its overseas equity portfolio. EQC considers that active management of its offshore equities will in the long run add value (after costs) and has contracted five investment managers to cover the various styles of investing, for the remaining sixty percent of its offshore equity portfolio. EQC also utilises domestic and international securities custodians to hold assets on its behalf and report on how managers are complying with their guidelines.

The Board is aware that the Government wishes EQC to have regard for responsible investment, i.e. to supporting good corporate governance practices and to understanding the impact on long term returns of a company's environmental, social and governance policies. EQC has signed the United Nations Principles for Responsible Investing, which provide a menu of possible actions for incorporating responsible investment issues into the mainstream of decision making and ownership practices. Guided by these, EQC has developed its Responsible Investment Policy, Standards and Procedures, which set out the commission's policies and principles and how it will implement them.

The Crown is the ultimate risk-taker for EQC's liabilities. EQC transfers a substantial part of its risk away from the Crown through reinsurance – the process by which insurers spread their liabilities throughout the worldwide insurance market.

Reinsurance is used to make up the capital requirement to meet a maximum loss that is within the realms of probability (e.g. a magnitude 7.4 earthquake on the Wellington fault) and to provide a margin above this to cope with closely occurring disasters or very unlikely events. The purpose of reinsurance is also to control volatility in shorter term claims costs. Reinsurance strengthens EQC's ability to meet its obligations to insured home owners.

EQC has three strategies to minimise reinsurance costs:

- Forward purchasing some of the reinsurance it requires to partially protect the Crown from significant volatility in reinsurance prices.
- Taking a consistent approach to the market and its participants, signalling intentions well in advance, and providing full disclosure with information of high quality, to stabilise premium levels.
- Providing reinsurers with analyses from its own earthquake hazard/dynamic financial analysis suite of computer programs, called Minerva, to ensure that up to date, New Zealand specific underwriting information is considered.

EQC does not expect its reinsurance premium rates to vary greatly during the period of 2008 to 2010 provided the current strategy is maintained and the incidence of global disasters does not worsen significantly in terms of insurance industry losses. However, the increase in residential building costs over recent years worsens EQC's first-loss position (because EQC is more likely to pay out higher settlements) and therefore increases the extent of the risk transfer to reinsurers, which in turn could result in pressure to increase premiums.

Technological advances

As in many areas of activity, new technology and research are improving EQC's ability to understand hazards and opening opportunities for new and better monitoring systems. EQC has invested heavily in monitoring technology that provides it with more accurate and immediate information about possible seismic and volcanic events. The Commission has taken a leading role in, and largely funds, the *GeoNet* project – a hazard monitoring network for New Zealand that can help to give warning of tsunamis and volcanic activity, provide early information about seismic events once they have occurred, and – perhaps most importantly – allow scientists to learn much more about the geological processes that may threaten the safety of people.

Technology has also made it possible for EQC's claims to be processed in a location that is safe from the disasters that could affect New Zealand – the Commission has contracted an Australian-based firm to carry out this work with adequate controls and oversight by New Zealand-based staff.

EQC's new Claims Management System is a web-based application that integrates other applications like the building costs database, web-based information transfer and document scanning/management. The new system enables access to claims information from any internet portal to those with the necessary authorisations. It is intended that this include claimants themselves, once the system has been fully proven.

EQC has renewed its partnership with Aon Re Services (Australia) for the development and maintenance of the earthquake hazard model, Minerva. Plans for further improvements include extending the model's application to other perils like tsunami and fire following earthquake.

Social context

New Zealanders' vulnerability to disasters can be reduced by becoming better informed about the risks faced and taking steps to better control those risks. Two of EQC's functions under the Act address, respectively, learning more about the risks and informing New Zealanders how they can make their homes safer. The latter function presents some challenges:

- The plethora of social marketing messages the public receives.
- Changing and multiplying channels through which the public can access information and entertainment.
- The widening range of "residential buildings" in New Zealand, some presenting new and different risks (for example, high rise apartment blocks).
- Rapidly evolving attitudes to risk in the public's perception of such issues as climate change, global warming and coastal development.
- Widening cultural and ethnic diversity.

These fast-moving developments are accompanied by an equally rapid evolution of public expectations which, if not managed, have the ability to confuse and damage an organisation.

The study of natural hazards and how to make communities safer from them is an international one in which New Zealand has shown leadership. EQC encourages with funding, the participation of New Zealand experts in international conferences and working parties, and enables fact-finding trips to areas affected by recent disasters.

Policy context

The insurance cover provided in the Earthquake Commission Act dates from 1993, including the monetary amounts for the maximum sums insured and claims excesses. The insurance concepts of the 1993 Act were based on those of the original legislation of 1944. Although the scheme has worked well, the basis of the Government's involvement in natural disaster mitigation and recovery requires periodic review to ensure that it continues to reflect what modern New Zealand society prefers. In recent times, influenced by the aftermath of disasters that have occurred both at home and overseas, public expectations of government action and assistance have changed quite dramatically. Striking the balance between meeting and managing these expectations is now a challenge for all government agencies involved in disaster response and recovery.

Claims against EQC are paid out of the Natural Disaster Fund. If the assets of the Commission (including its reinsurance programme) are not sufficient to meet its liabilities, the Minister shall 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 determines. The Government's short- and long-term financial goals assume no serious set-back for the economy caused by natural disasters. It is now generally accepted that – whatever the cause – the world is in an era of climate change, and it is also becoming recognised that seismicity seems to follow a cyclic pattern. Three serious earthquakes occurred in New Zealand during the period 1848-1863; four occurred between 1929-1942, and there has been little activity since then. *GeoNet* is providing data that will better inform scientists, and their increasing understanding of the seismic behaviour of the plate boundary on which New Zealand sits combined with financial and economic analyses will better inform the assumptions on which governments base their plans.

A benchmark of importance to government planning is a sustainable size for the Natural Disaster Fund. Given the liabilities presented by the insurance scheme and expenditure incurred to perform EQC's other functions, by some prudent measure an optimal Fund size can be estimated. Assuming no large disasters in the meantime, this limit could now well be within a medium term planning horizon.

The Government has expressed a broad aim to implement a policy platform which improves the social and economic wellbeing of New Zealanders. The Government also wishes to encourage home ownership. Affordable disaster insurance protection for homes supports these aims, as does a response plan for the fair and efficient settlement of claims following a disaster. EQC has proposed improvements to the statutory insurance scheme, including adjusting the monetary provisions, making the insurance of land more even-handed, and extending the notice time for reporting claims.

In the longer term, EQC proposes a more fundamental reassessment of EQC's role in community recovery, taking account of the needs of modern New Zealand communities and government's responsibility to meet those needs.

Delivering outcomes

EQC's activities are guided by its statutory functions, as set out in section 5 of the Earthquake Commission Act. All of the functions carried out by EQC contribute to two broad government outcomes:

- Safer communities and rapid recovery from natural disasters.
- Efficient management of the Crown's assets and liabilities.

In the view of the Commission, EQC's contributions to these two outcomes are complementary and of equal importance. The Crown's liability for welfare payouts after a natural disaster will be increased if New Zealanders are unprepared for the disaster, and decreased if New Zealanders have taken effective steps to prepare for the disaster as a result of EQC's public education activities. By helping to improve the safety and preparedness of New Zealand communities, EQC is also helping to mitigate the Crown's liability in case of a disaster.

Outcome 1: Safer communities and rapid recovery from natural disasters

In the medium and long terms, EQC's goal is to use research and education to contribute to the improvement in the safety of New Zealanders by increasing their knowledge of, and preparedness for, natural disasters.

EQC's vision for New Zealand includes:

- A population that:
  - has a realistic appreciation of the geological hazards that affect them;
  - is well educated about methods of reducing or preventing disaster damage;
  - is aware of the part EQC plays in securing them against damage to their homes and personal property and of the importance of having adequate insurance on their personal property.
- A society in which the adoption of mitigation measures is widespread.
- A research community that can provide New Zealanders with the best evidence for mitigating or reducing damage from geological disasters, and a natural hazards monitoring network that provides reliable warning of tsunamis and volcanic eruptions, early information about events that have occurred, and the capacity for international class research.

EQC's activities are also directed towards ensuring that in the event of a natural disaster New Zealanders can receive prompt assessment of damage to their property and early settlement of claims. To this end, EQC maintains a Catastrophe Response Programme that aims to ensure that EQC can meet its commitments following even the worst foreseeable disaster.

Other government agencies have a significant shared interest in this outcome. In particular, the Ministry for Civil Defence and Emergency Management plays a leadership role in preparing for and responding to natural disasters. The Civil Defence and Emergency Management Act (2002), supports principles which are relevant to EQC's area of operations:-

- A framework for comprehensive emergency management leading to community resilience and continuity.
- Integration of the functions of mitigation, preparedness, response and recovery.
- A model for an integrated emergency management system by which the activities of the various agencies are co-ordinated and consistent.
- Escalation of response from local through regional to national in accordance with the need. EQC's planning also follows a scaling design.

One of EQC's functions under the Earthquake Commission Act is 'To 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'. EQC's leadership of the *GeoNet* project in association with GNS Science and co-funding of the "It's Our Fault" project to reassess the hazard presented by the earthquake faults in the Wellington region support the Government's goal of building safer communities.

<table>
<tr><th colspan="5">Outcome: Safer communities and rapid recovery from natural disasters</th></tr>
<tr><td colspan="2">Impact: Having a catastrophe response programme that delivers adequate claims handling capacity.</td><td>Impact: Sustaining capability and completing research in order to reduce the risk of the hazards EQC insures against.</td><td colspan="2">Impact: 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.</td></tr>
<tr><td>Output: Claims handling and the Catastrophe Response Programme.
(Output Class 1)</td><td>Output: 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.
(Output Class 2)</td><td>Output: Public education about seismic hazards and methods of reducing or preventing seismic disaster damage.
(Output Class 3)</td><td>Output: Public education about EQC's role and the importance of having adequate insurance on their residential and personal property.
(Output Class 3)</td><td>Output: Policy advice assistance on natural disaster damage, methods of reducing or preventing natural disaster damage, and government response to disasters.
(Output Class 4)</td></tr>
</table>

Outcome 2: Efficient management of the Crown's assets and liabilities

Under the Earthquake Commission Act, EQC is required to administer the Natural Disaster Fund, protecting its value, and to administer the insurance against natural disaster that is provided by the Act.

In the medium term, EQC's goals are to:

- build up and sustain sufficient capacity to meet the obligations on EQC that will follow from a natural disaster; and
- manage the insurance scheme efficiently.

These goals link closely with the Government's long-term outcome of efficient management of the Crown's assets and liabilities, and EQC will work with Treasury to ensure that EQC's outputs support this government outcome.

EQC's contribution will include policy advice to the Government on how best to manage the Crown's liability for natural disaster insurance and improve the efficiency of the insurance scheme. It will also include efficient administration and management of the scheme within the parameters set by the Government, including Ministerial Directions under section 12 of the Act.

<table>
<tr><td colspan="6">Outcome: Efficient management of the Crown's assets and liabilities</td></tr>
<tr><td colspan="3">Impact: Building and sustaining adequate financial capacity to meet obligations</td><td colspan="3">Impact: Efficiently conducting the insurance against natural disaster under the Earthquake Commission Act</td></tr>
<tr><td colspan="2">Output: Policy advice on relevant risk management issues, management of the Natural Disaster Fund to maximise its return without taking undue risks, and terms and conditions of the insurance.
(Output Class 4)</td><td colspan="2">Output: Administration of the insurance against natural disaster damage provided under the Act including the collection of the premiums payable. (Earthquake Commission Act Section 5(a) and (b)).
(Output Class 5)</td><td colspan="2">Output: Administration of the Natural Disaster Fund and, so far as is reasonably practicable, protection of its value, including by the investment of money held in the Fund and by obtaining reinsurance. (Earthquake Commission Act Section 5(c) and (d)).
(Output Class 5)</td></tr>
</table>

Operating intentions and 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.

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Description

The EQC insurance scheme provides compensation to the extent of the cost of repairing or replacing property damaged by an insured peril, up to the maximum amounts set out in the Act. The procedure is commenced by the registration of a claim by the owner of damaged property. The claim then goes through a handling process to establish entitlement and amount, and settlement is made.

Catastrophe events make EQC prone to sudden surges in claims activity. In years when there is no significant event, EQC can expect to receive a few thousand claims but there could be tens of thousands of claims following a single major catastrophe.

To manage the potential for this wide variation of claim numbers, EQC has an extensive Catastrophe Response Programme for securing the services and facilities it anticipates it will need to handle claims efficiently. EQC's catastrophe response is effected mainly through external organisations on agreed terms. EQC documents its expectations of each organisation and controls performance through agreed standards of service.

The Programme features out-sourcing claims administration to an organisation that is capable of expanding and contracting the required resources as necessary. An added safeguard is that this service operates from Brisbane, so is immune from the effects of any New Zealand disaster.

The programme itself, and many aspects of the response EQC will make to a disaster, are supported by several computer applications that provide analysis and insight. These include the Claims Management System, the Minerva earthquake hazard model, and the Logjam systems dynamics model.

Operating Environment

The rate of settlement of claims following a natural event is dependant upon the resources that can be marshalled to investigate and handle the claims. EQC has identified possible bottlenecks in claims settlement relating to EQC's area of responsibility. These constraints will affect even quite localised events and in a large disaster, could stretch out a community's recovery over several years.

A Catastrophe Response will be successful if:

- All claimants were able to lodge claims with EQC within the statutory period.
- Claims were settled within a time frame acceptable to the public and in accordance with the Earthquake Commission Act.
- Claims were settled to standards of individual and overall fairness acceptable to the public.
- Essential office services were maintained at a level commensurate with a standard of operational efficiency acceptable to the Board.
- The welfare of staff has been attended to so that the risks of over-long working hours and excessive stress have been avoided.

EQC's challenges and risks	EQC's response
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).
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. • Retain a cadre of loss adjusters on a guaranteed minimum income.
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.

Operating intentions and performance measures for Output class 1: Claims handling and the Catastrophe Response Programme

What EQC will do	Why EQC will do it	Targets
Ensure that the Catastrophe Response Programme will respond adequately in the event of a major catastrophe.	Following a major catastrophe, it will not be possible to set up systems for managing claims handling without planning. EQC must try to ensure its systems are prepared for major disasters.	• The Programme's plans and schedules to maintain its currency are adhered to (e.g. schedules for document maintenance, testing and training). • Surveys of claimants show that settlement times and standards remain acceptable to a majority of claimants (The December 2007 survey shows satisfaction with settlement time at 82% and overall satisfaction with the service at 84%) • An external review of the Catastrophe Response Programme is completed by 30 June 2009 and any recommendations for meeting best world practice are considered and implemented where appropriate.
Manage EQC's challenges and risks as described in the previous table		EQC has responded to its risks and challenges as described in the previous table.

Output Class 2: Research

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Through its advocacy of, and investment in, science and engineering research, EQC contributes to natural hazard risk assessment and disaster reduction in New Zealand. 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.

EQC will fund research that contributes to one or more of the following four research themes and associated topic areas:

- Hazard source characterisation - To improve the detection and characterisation of geological hazards, for accurate assessment of likelihood, magnitude and vulnerabilities.
- Time varying hazard and risk assessment - To improve the scientific basis for hazard forecasting and the pricing of New Zealand risks.
- Advanced engineering solutions - Technologies and decision support tools to improve risk performance in the built environment and the public processes for establishing safety goals.
- Disaster readiness and recovery - Improved understanding of the socioeconomic consequences of hazards and the measures required to reduce the vulnerability of New Zealand communities.

Description

In order to improve understanding and mitigation of natural disaster damage, EQC fosters relevant research in the fields of earth science, civil engineering, architectural design, building technologies, social science and emergency management. EQC is one of few public agencies that both *invests* in research capabilities and *purchases* research outputs to meet national needs in critical areas of research and application.

Research capabilities are supported through:

- Sponsorship of faculty teaching positions at the universities of Canterbury (earthquake engineering), Victoria (seismology) and Massey (social science);.
- Sponsorship of Fulbright NZ to enable scholarships in studies related to natural disasters and their effects on communities to be pursued by outstanding New Zealand students in the USA;
- Financial support for the University of Auckland Institute of Earth Science and Engineering;
- Directly commissioned research;
- Scholarships and grants for postgraduate student research; and
- The design, operation and maintenance of the *GeoNet* hazard monitoring system – a major research equipment facility.

EQC also assists the wider dissemination of relevant research results and experience through sponsorship of selected technical publications, meetings and conferences. EQC supports reconnaissance missions that assess the impact of natural disasters abroad and the potential application of observed recovery or mitigation measures to New Zealand conditions. EQC actively engages with central and local government and private sector organisations, to identify mutual needs for information and opportunities to apply research toward shared outcomes. These initiatives, together with ongoing support for the improvement of building codes and best practice guidelines (facilitated through Standards NZ), contribute to the growth of intellectual capital and the retention of unique expertise for natural hazard risk assessment and risk management in New Zealand.

Operating Environment

Research is facilitated through *biennial* and *student* grant programmes (the latter to support postgraduate student research at universities) which are contestable and required to meet standards of open science review.

The design, implementation and operation of a national hazard monitoring and warning system *GeoNet* is funded at the level of ~$8 million annually under a 10-year agreement (commenced in 2001) with the Crown Research Institute, GNS Science. All data generated by *GeoNet* are made freely available. *GeoNet* underpins civil defence readiness and will inform EQC's and the country's disaster response and recovery planning following any large earthquake or volcanic eruption.

EQC from time to time purchases research to address specific operational needs. New findings in hazard research are incorporated into EQC's hazard assessment model, Minerva, which in turn informs assessments of liability for financial protection purposes and analyses the likely results of actual and scenario events.

Advances in understanding seismic behaviour and the wealth of data available from *GeoNet* have together made opportune new assessments of hazards in our two largest conurbations. EQC is providing funding support of up to 50% of the cost of the "It's Our Fault" project, a six year collaboration of scientific institutions led by GNS Science to reassess the earthquake and tsunami hazard in the Wellington region. Other funding is being provided by Wellington City Council and ACC. EQC is also working with other parties to scope a project that will re-evaluate the volcanic risk in Auckland.

EQC's Challenges and Risks	**EQC's Response**
There is significant variability in land-use planning and practice throughout New Zealand (a strategic review of *GeoNet* in 2004 identified this as an issue).	EQC is supporting the development of hazard risk management standards following the structure of NZ4360.
Sustenance of national capacity for timely and high quality science research for risk assessment and mitigation.	EQC has a long term contract with GNS Science for the support for the national hazard monitoring system *GeoNet* and also funds research to address areas of critical need. EQC also supports capability building through its funding of the: Leicester Steven Lectureship in Engineering at Canterbury University Institute of Earth Science and Engineering at Auckland University EQC Fellowship in Natural Hazards Planning at Massey University EQC Fellowship in Seismic Studies at Victoria University
Achieving a desired return on the investment of research funds	EQC controls transaction costs and encourages collaboration across enterprise boundaries.
Transforming research outputs to social outcomes	EQC's comprehensive approach to research support aligns with the strategic intent of other agencies working towards these shared outcomes.
Enabling the intensive research opportunity presented by disasters, at home and overseas.	EQC's decision and funding systems will remain sufficiently robust and flexible to respond to urgent needs.

Operating intentions and performance for Output class 2: Research

What EQC will do	Why EQC will do it	Targets
Invest in high quality and relevant research projects that contribute to understanding geological hazards, the built environment, and natural disaster readiness and recovery.	The knowledge derived from this research will help to alleviate the impact of natural hazard events and improve ability to recover from them.	The planned programme of investment in research for the year to 30 June 2009 is accomplished, with each project either meeting agreed targets and milestones or obtaining a peer review of at least "satisfactory".
Encourage the transfer and uptake of research to achieve social outcomes and utilise relevant research in EQC's own operations.	EQC's research investment will pay dividends if it contributes to safer communities and reduces the pricing of New Zealand risk by global reinsurance companies.	• 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. • EQC supports the Hazards Risk Management Standard project led by Standards NZ.
Invest in the development and maintenance of geophysical risk assessment and mitigation research capacity, in New Zealand.	This will help to ensure that the necessary research capability is maintained to meet particular New Zealand needs.	• The university funding programmes meet contracted requirements for teaching, research and public activities • 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.
Organise an international review of GeoNet to ensure it is achieving the purposes for which it is being funded by EQC, is still world class and is maintaining international standards. The review will also consider possible structures for ongoing funding after the current contract between EQCand GNS Science expires in 2011.	EQC signed a ten year agreement with GNS Science in 2001 for the development, operation, maintenance and funding of GeoNet. It was resolved that New Zealand, as a country sitting astride two of the Earth's tectonic plates, needed a hazard monitoring network that was as good as anywhere in the world.	Review completed by 30 June 2009, with recommendations about future funding.

Output Class 3: Public education

<table>
<tr><td colspan="5">Outcome: Safer communities and rapid recovery from natural disasters</td></tr>
<tr><td colspan="2">Impact: Having a catastrophe response programme that delivers adequate claims handling capacity.</td><td>Impact: Sustaining capability and completing research in order to reduce the risk of the hazards EQC insures against.</td><td colspan="2">Impact: 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.</td></tr>
<tr><td>Output: Claims handling and the Catastrophe Response Programme.

(Output Class 1)</td><td>Output: 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.

(Output Class 2)</td><td>Output: Public education about seismic hazards and methods of reducing or preventing seismic disaster damage.

(Output Class 3)</td><td>Output: Public education about EQC's role and the importance of having adequate insurance on their residential and personal property.

(Output Class 3)</td><td>Output: Policy advice assistance to Treasury on natural disaster damage, methods of reducing or preventing natural disaster damage, and government response to disasters.

(Output Class 4)</td></tr>
</table>

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."

This output class also indirectly contributes to the Government's 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.

Description

EQC sponsors major permanent exhibitions on seismic hazards at the Museum of New Zealand Te Papa Tongarewa and Auckland War Memorial Museum. These popular exhibitions publicise information about damage mitigation in the home. In addition, the Commission routinely sponsors other public exhibitions to raise awareness of natural disaster issues and the role of EQC, and educate the public about ways to mitigate the effects of natural disasters.

In order to reach a wide section of the population and induce long-term change in social attitudes to disaster preparedness, EQC makes use of social marketing campaigns about the geological hazards with which New Zealanders live and their vulnerability to these hazards. Small degrees of attitudinal change could have a significant effect on New Zealand's disaster preparedness: there are often quite simple steps to make homes and their contents safer from damage.

EQC's social marketing campaigns to date have been largely targeted at the "Earthquake Zone" (the central region) because it is the area of highest vulnerability. In the medium-term, and in order to minimise the effects of the other natural disasters insured by EQC, the Commission is expanding the target audience to all New Zealanders, with marketing varying depending on the predominant natural hazard in each risk region.

Operating environment

EQC’s social marketing and education messages are delivered in an environment that is characterised by several challenges and risks requiring well-researched responses. These are set out in the following table:

EQC's challenges and risks	EQC's response
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.
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.
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.
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.
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.

Operating intentions and performance for Output class 3: Public education

EQC will continue its public education efforts by working with partners who have similar public education responsibilities, for example museums, schools, the Ministry of Civil Defence and Emergency Management, the Ministry of Education and Crown Research Institutes GNS Science and NIWA.

What EQC will do	Why EQC will do it	Targets
Publicise the geological hazards with which New Zealanders live, their vulnerability to these disasters, and ways of reducing that vulnerability.	If New Zealanders are prepared for disasters, they increase their and the community's resilience and also reduce the Crown's liability under the Act.	**The percentage of New Zealand households that have taken preventive steps to mitigate natural disaster damage has increased in the year to 30 June 2009. (At 1 April 2008, 45% of those polled)
Publicise the role EQC has in responding to natural disasters and place this in the context of the total community recovery effort.	Misunderstanding or misrepresentation of EQC's role following a disaster event will hamper the Commission's response, delay the settlement of claims and affect community recovery.	**The percentage of New Zealanders who understand EQC's role has increased in the year to 30 June 2009. (At 1 April 2008, 64% of those polled)
Encourage New Zealanders to insure their homes against fire.	Homes that are not insured against fire are not covered by EQC's insurance, and EQC is not able to help them recover in the event of a natural disaster.	**Public understanding of the insurance under the Act has increased in the year to 30 June 2009 as shown by evaluation of social marketing efforts. (At 1 April 2008, 64% of those polled).
Manage EQC's challenges and risks as described in the previous table		EQC has responded to its risks and challenges as described in the previous table.

** as measured by a market survey conducted on a quarterly basis

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.*

<table>
<tr><th colspan="5">Outcome: Safer communities and rapid recovery from natural disasters</th></tr>
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<table>
<tr><th colspan="3">Outcome: Efficient management of the Crown's assets and liabilities</th></tr>
<tr><td colspan="2">Impact: Building and sustaining adequate financial capacity to meet obligations</td><td>Impact: Efficiently conducting the insurance against natural disaster under the Earthquake Commission Act</td></tr>
<tr><td>Output: Policy advice on relevant risk management issues, management of the Natural Disaster Fund to maximise its return without taking undue risks, and terms and conditions of the insurance.
(Output Class 4)</td><td>Output: Administration of the insurance against natural disaster damage provided under the Act including the collection of the premiums payable. (Earthquake Commission Act Section 5(a) and (b)).
(Output Class 5)</td><td>Output: Administration of the Natural Disaster Fund and, so far as is reasonably practicable, protection of its value, including by the investment of money held in the Fund and by obtaining reinsurance. (Earthquake Commission Act Section 5(c) and (d)).
(Output Class 5)</td></tr>
</table>

Description

EQC has a strategic role in promoting, through the provision of robust policy advice to decision-makers, the adoption of policies that help to build safer communities and contribute to the efficient management of the Crown's assets and liabilities.

EQC operates in at least three highly specialised fields: hazard mitigation, disaster insurance and funds investment. In order to ensure that its policy advice is robust, accurate and evidence-based EQC invests in world-leading research into disaster management, mitigation and recovery. It also invests in staff who have expertise in the fields of insurance, reinsurance, research and funds investment.

Operating environment

EQC's monitoring department is The Treasury, which is responsible to the Minister of Finance for monitoring advice relating to EQC. The Treasury can expect to be consulted by EQC during the preparation of any policy advice relating to EQC's statutory functions or finances.

A number of government departments carry responsibilities for people and homes affected by natural disasters, for example Housing New Zealand Corporation and Ministry of Social Development. EQC can assist these departments in the development of the relevant policy.

EQC is one of the Crown Financial Institutions (CFIs) and maintains a liaison with the others. Some policy areas lend themselves to a joint or collaborative approach.

One initiative being pressed by EQC is for a coordinated approach to be adopted in dealing with the needs of families made homeless by a natural disaster.

EQC manages a large insurance scheme that covers most New Zealand residential properties. Any proposed changes to the coverage of the scheme or the way it is managed are likely to have significant effects for the insurance market in New Zealand and may also have effects for local and central government.

Operating intentions and performance for Output class 4: Policy advice

EQC will work closely with Treasury, MCDEM, GNS Science, local government and other agencies to identify policy gaps or issues relating to its statutory functions and ensure that the Government is fully informed of any risks or opportunities that require addressing.

EQC will encourage the adoption of evidence-based policy in fields that relate to its statutory functions and will provide the Minister and Treasury with policy advice on matters related to its statutory functions as required.

What EQC will do	Why EQC will do it	Targets
Provide prompt and robust advice to the Minister, The Treasury, and other government agencies as required.	This output will help to strengthen the Government's understanding of risks and vulnerabilities that could affect the resilience of New Zealand communities, the effectiveness of recovery from natural disaster and the Crown's assets and liabilities.	All requests for participation in policy preparation are met to the satisfaction of the Minister or departments concerned and are 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. This output class reflects EQC's functions as set out in section 5(1)(b), (c) and (d) of the Act.

<table>
<tr><th colspan="4">Outcome: Efficient management of the Crown's assets and liabilities</th></tr>
<tr><td colspan="2">Impact: Building and sustaining adequate financial capacity to meet obligations</td><td colspan="2">Impact: Efficiently conducting the insurance against natural disaster under the Earthquake Commission Act</td></tr>
<tr><td>Output: Policy advice on relevant risk management issues, management of the Natural Disaster Fund to maximise its return without taking undue risks, and terms and conditions of the insurance.

(Output Class 4)</td><td colspan="2">Output: Administration of the insurance against natural disaster damage provided under the Act including the collection of the premiums payable. (Earthquake Commission Act Section 5(a) and (b)).

(Output Class 5)</td><td>Output: Administration of the Natural Disaster Fund and, so far as is reasonably practicable, protection of its value, including by the investment of money held in the Fund and by obtaining reinsurance. (Earthquake Commission Act Section 5(c) and (d)).

(Output Class 5)</td></tr>
</table>

Description

Premium is collected on behalf of the Commission by insurance companies via the fire insurance policies they issue or renew. Spot checks are made by EQC on insurance company records and audit reports are obtained on the integrity of their computer systems. A help facility is also available for the computation of correct premiums.

The investment of the Fund is controlled through a Statement of Investment Policies, Standards and Procedures, which is approved by the Minister. EQC appoints several international funds management companies to manage its global equities portfolio, and has appointed custodians to administer both the domestic and off-shore portfolios.

To date, both the investment and reinsurance strategies have been predicated on the need to grow the Fund. The fortuity of few disaster events has enabled the Fund to grow to a size that now prompts consideration of its optimal or sustainable balance. This is an amount that, with reinsurance, would provide an acceptable probability of being sufficient to meet all EQC's liabilities. A decision on this amount and its achievement would influence EQC's reinsurance and investment strategies.

EQC places a large reinsurance programme with reinsurance companies and Lloyd's syndicates. This cover protects the Fund against a payout that would threaten its viability following a major natural disaster. The programme is placed through, and with advice from, reinsurance brokers.

Operating environment

EQC receives premium from insurance companies or their agencies that issue fire insurance policies in New Zealand. There are also a few cases of cover being issued direct by the Commission under section 22 of the Act, where fire insurance is not held.

Inflation in building costs (labour and materials) which has been in double figures per annum for several years, is a direct driver of EQC's risk. This risk increases proportionately with the inflation figure, the maximum sum insured having only a minor influence because most of the repair costs EQC faces through its claims settlements are within this cap. Thus EQC's overall liability, risk to the Natural Disaster Fund and reinsurance premiums are increasing with no commensurate increase in its premium income.

The Fund's investments, besides cash and bank bills, are non-tradable New Zealand government stock and overseas publicly-traded equities. Returns are therefore influenced by fixed interest rates on the domestic financial market, the performance of overseas share markets and the value of the New Zealand dollar. Under an agreement with Treasury, EQC can sell back to the Debt Management Office its government stock at pre-disaster values (i.e. EQC has a free put option with the DMO).

EQC does not carry a currency hedge on its overseas equity portfolio because it takes the view that it would be required to liquidate these assets, apart from routine portfolio rebalancing, only following an event large enough to itself affect the value of the New Zealand dollar. If EQC wished to hedge the currency risk, it would be required to consult the Minister.

In a manner congruous with CFI's, EQC is required to administer its funds in a manner consistent with avoiding prejudice to New Zealand's reputation as a responsible member of the world community. Whilst each CFI is an independent body, EQC supports and participates in collaborative servicing and resource provision, in order to place each CFI in a position to make its own decisions. EQC has completed its own Responsible Investment Policy, Standards and

Procedures and has become a signatory to the United Nations Principles for Responsible Investment document.

EQC manages the Natural Disaster Fund in an environment that is characterised by a number of risks and challenges over which it has little or no control. Limitations on allowable asset classes and the ratio of onshore : offshore balances are also constraints, set by Ministerial direction after consultation with EQC. In order to meet these risks and challenges, the following responses are planned:

EQC's challenges and risks	EQC's response
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.
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.
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. • 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.

Operating intentions and performance for Output class 5: Management of the Natural Disaster Fund

What EQC will do	Why EQC will do it	Targets
Place a reinsurance programme for the protection of the Natural Disaster Fund and review it annually to ensure it continues to provide optimum value and achieves the objectives set for it.	Reinsurance strengthens EQC's ability to meet its obligations to insured home owners. It distributes part of the catastrophe risk away from New Zealand to protect the Fund and the Crown against the full economic impact of a natural disaster in New Zealand.	The reinsurance programme reduces the net risk to the Natural Disaster Fund and the Crown. Computer modelling shows the reinsurance programme for 2007/8 year reduces the risk of the Fund falling to zero in any year by 80% and of falling below $2m in any one year by 50%, compared to having no reinsurance in place.
Invest the Natural Disaster Fund in accordance with the Ministerial Direction that came into force on 1 November 2001	EQC is tasked with protecting the value of the Natural Disaster Fund, which is a significant national resource. It seeks to maximise the value of the fund without taking undue risks.	• Investment performance achieves targets set in the SIPSP. • EQC has complied with its asset allocation strategy and investment managers have complied with their agreements • EQC's investment management costs are in line with international peers • EQC has managed and administered the Fund in a manner consistent with best practice portfolio management, maximising return without under risk to the Fund as a whole
Avoid prejudice to New Zealand's reputation as a responsible member of the world community	EQC is accountable for actions arising from its Responsible Investment Policy.	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.
Ensure that correct premiums are being paid by insurance companies.	Insurance companies are required by law to pay premiums to EQC. This money goes into the Natural Disaster Fund, providing us with the resources to meet the cost of natural disasters.	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.

Manage EQC's challenges and risks as described in the previous table.		EQC has responded to its risks and challenges as described in the previous table.

Prospective financial statements

The budget for the 2008/9 financial year shows (in relation to the previous year's budget):

- Income increasing by 1.6%
- Total expenditure increasing by 4.6%
- Surplus of $394 million (2008 - $390 million)
- Capital expenditure of $4.37 million (2008 - $4.74 million)

Explanations for changes in expenditure levels follow.

Following last year's review of EQC's reinsurance arrangements, by which part of the risk carried by the Commission is transferred to overseas insurance providers, the next step in achieving a larger programme attaching at a higher level of risk is recognised in this budget. Reinsurance premiums are budgeted at $38.75 million compared to $37 million in 2007/8.

Administration expenses are budgeted to increase by 4%, mostly because of an expected substantial change in lease costs after a rent review due this year.

Investment costs include the proposed purchase of risk management tools and benchmarking exercises. To assist investment cost comparisons, equity manager fees have now been separately identified and salary and overheads costs relating to investments have been transferred from the administration budget. In the 2008/9 budget, these administration costs include an extra analyst position provided for in accordance with the investment resource strategy the Commission has decided upon.

Catastrophe response plan costs include additional training costs for both staff and external human resources in connection with the introduction of a new claims management system. This increase is offset by decreases spread over a number of other areas.

In accordance with EQC's strategy decided in 2006, the research budget has been increased by over 9%. This represents a non-repeating increase in the level of EQC's facilitation of research and the Commission aims to hold its research costs at approximately 3% of premium revenue in future.

This research expenditure does not include the GeoNet project. Expenditure under GeoNet represents depreciation and operating expenditure and is budgeted in line with the original agreement with GNS Science.

The public education budget has been prepared in line with the Commission's aims to improve disaster risk mitigation and general catastrophe education. The 2008/9 budget results from a return to an expenditure level of about 4% of EQC's premium income from last year's lower figure. This is because 2007/8 was used as a time of review and research into effective ways to communicate the EQC message.

The number of loss adjusters on retainer is set to increase from ten budgeted for in 2007/8 to eighteen plus the number negotiated with the larger loss adjusting firms. This item is now budgeted separately from the CRP expenses because these retainers are set off against fees actually earned and otherwise unbudgeted.

Capital expenditure
77% of the capital expenditure budget is related to the GeoNet project and in accordance with the work planned for 2008/9. Other capital expenditure relates to enhancements to the new claims management system, some new IT equipment, enhancement to EQC's computer models and for furniture and fittings.

Schedule of key performance measures for the three year period 2008-2011:

Output Class 1: Claims handling and the Catastrophe Response Programme

Having a Catastrophe Response Programme that delivers adequate claims handling capacity.

Measure: In the event of a major catastrophe, EQC's response is in accordance with the programme.

Budget implications: Extended and revised training for external resources to use EQC's new claims management system should ensure more efficient claims handling.

Output Class 2: Research

Investment in high quality and relevant research projects that contribute to understanding geological hazards, the built environment, and natural disaster readiness and recovery.

Measure: The planned annual programmes of research facilitation are accomplished.

Budget implications: EQC expects that the proposed expenditure levels will be maintained as its research strategy is implemented. A new taxation regime for R&D is aimed to increase private enterprise expenditure in this area and EQC may be encouraged to apply leverage in order to improve outcomes for New Zealand.

Output Class 3: Public Education

New Zealanders are better informed on the geological hazards with which they live, their vulnerability to these disasters, and ways of reducing that vulnerability.

Measure: New Zealanders' knowledge of these hazards, and mitigation measures, have increased in the three years.

Budget implications: As new plans and strategies are employed, EQC expects expenditure to increase to at least 2006 year levels, albeit carefully controlled to achieve good value and successful outcomes.

Output Class 4: Policy Advice

Advice to government and departments or ministries is well-founded and provided within timelines.

Measure: EQC has participated in any review of its insurance scheme or other activities to assess its suitability to meet government responsibilities to New Zealanders affected by a natural disaster.

Budget implications: None of significance

Output class 5: Management of the Natural Disaster Fund

Reinsurance and investment programmes are in place to protect the value of, and minimise the risk to, the Fund.

Measure: The net risk to the Natural Disaster Fund and the Crown is reduced.

Budget implications: Full implementation of the larger reinsurance programme initiated in 2007 entails increased expense of about $1.75 million this year, and a similar amount next year, after which costs will reflect reinsurance market movements or EQC's reaction to them. Investment expenses will move in line with the balance of the Natural Disaster Fund.

Summary Statement of Accounting Policies for the year ended 30 June 2009

Reporting Entity

The Earthquake Commission ("the Commission") is a Crown Entity as defined by the Crown Entity's 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 prospective financial statements is the year ended 30 June 2009. These prospective financial statements were approved by the Board on 27 March 2008.

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 and in preparing an opening NZ IFRS balance sheet as at 1 July 2006 for the purposes of the transition to NZ IFRS.

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.

Assumptions that have significant effect on the prospective financial statements and estimates with a significant risk of material adjustment in the next year are discussed in the attached disclosures

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
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 that "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 and Statement of Cash Flows are exclusive of GST. The Balance Sheet is also exclusive of GST, except for payables and receivables 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 & 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. Financial assets are derecognised if the Commission's contractual rights to the cash flows from the financial assets 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.

Instruments 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 investments 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.

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.

Other
Subsequent to initial recognition, other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

Premiums Receivable
Premiums receivable are stated at their cost less impairment losses.

Trade and Other Payables
Trade and other payables are stated at cost.

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.

Cash

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.

Receivables

Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Receivables issued with duration less than 12 months are recognised at their nominal value, unless the effect of discounting is material. Allowances for estimated irrecoverable amounts are recognised in the Income Statement when there is objective evidence that the asset is impaired.

Property, Plant & Equipment

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

GNS Science administers the design, engineering, operation and maintenance of New Zealand's geological hazard monitoring system (GeoNet) under a ten-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*	9-12 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	9 years

Impairment of Non-financial Assets
The carrying amounts of the Commission's assets are reviewed at each balance date to determine whether there is any objective evidence of impairment.

An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses directly reduce the carrying amount of assets and are recognised in the income statement.

Impairment of Receivables
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). Receivables with a short duration are not discounted.

Impairment losses on an individual basis are determined by an evaluation of the exposure on each outstanding receivable account. All individual receivables that are considered significant are subject to this approach.

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, 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 assets 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 that arises from past events, and 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.

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.

Cost Allocation
Expenditure of the Commission is allocated across its four main functions, the Catastrophe Response programme, research, education and investment management. Expenditure is allocated to these functions by directly attributing costs as far as possible and by the apportionment of indirect costs based on the number of persons 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 by the organisation.

Related Parties

Transactions with other Crown entities entered into on an “arms 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 arms 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 statement of comprehensive income will enable readers to analyse changes in equity resulting from non-owner changes separately from transactions with the Crown in its capacity as “owner”. The revised standard gives the Commission 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 in two separate statements (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 is yet to decide whether it will prepare a single statement of comprehensive income or a separate income statement followed by a statement of comprehensive income.

Prospective Income Statement for the year ending 30 June 2009

		2009 Budget $(000)
Net Earned Premiums	86,918	
Outwards Reinsurance Premium Expense	(38,750)	
Net Premium Revenue		**48,168**
Claims Expense		**(9,567)**
Surplus/(Deficit) from Underwriting Activities		**38,601**
Public Education	(4,112)	
Research (excluding Geo-net)	(3,022)	
GeoNet Programme	(7,698)	
Total Other Operating Costs		**(14,832)**
Investment Income	389,310	
Investment Costs	(8,819)	
Investment Income Net of Costs		**380,491**
Crown Underwriting Fee		**(10,000)**
Net Surplus/(Deficit)		**394,260**

Prospective Statement of Changes In Equity for the year ending 30 June 2009

	2009 Budget $(000)
Natural Disaster Fund	
Opening Balance	5,556,025
Total recognised income and expense for the period	394,260
Closing Balance	**5,950,285**

Prospective Balance Sheet as at 30 June 2009

		2009 Budget $(000)
Natural Disaster Fund		
Capitalised Reserves	1,500,000	
Retained Profits	4,450,285	
Total Equity		**5,950,285**
Current Assets		
Cash & Cash Equivalents	28,230	
Investments	5,963,713	
Premiums Receivable	18,306	
Prepayments	6,229	
Property, Plant and Equipment	14,452	
Intangible Assets	2,305	
Total Assets		**6,033,235**
Current Liabilities		
Trade and Other Payables	3,276	
Provision for Employee Entitlements	167	
Outstanding Claims Liability	34,862	
Unearned Premium Liability	44,645	
Total Liabilities		**82,950**
Net Assets		**5,950,285**

Prospective Statement of Cashflows as at 30 June 2009

	2009 Budget $(000)	
Cashflows From Operating Activities		
Cash was provided from:		
Premiums received	86,559	
Dividends received	30,000	
Interest received	251,935	
		368,494
Cash was applied to:		
Outward reinsurance	38,750	
Crown underwriting fee	10,000	
Claims	9,567	
Employees and other operating expenses	13,043	
Geonet operating expenses	5,543	
Research grants	2,334	
		79,237
Net cash inflow/(outflow) from operating activities		**289,257**
Cashflows From Investing Activities		
Cash was provided from:		
Maturity or sale of Investments		451,000
Cash was applied to:		
Purchase of investments	732,278	
Purchase of fixed assets	3,473	
Purchase of Intangibles	500	
		736,251
Net cash inflow/(outflow) from investing activities		**(285,251)**
Net increase/(decrease) in cash held		**4,006**
Add opening cash brought forward		**24,224**
Ending cash carried forward		**28,230**

Disclosures in relation to prospective financial statements

1) Major assumptions underlying the prospective financial statements

Return on Global equity investments of 8.6% per annum

90 day Treasury Bill yields of 5.4% per annum.

Government Stock and 90 day bank bill yields of 6.2% per annum

Claims costs directly related to the occurrence of major events and the claims they produce, have not been forecast.

Growth in the residential housing stock of 2% per annum.

No change in Government policy in respect of Crown Fees, Taxation or Dividend.

Reinsurance costs increase by $1.75 million due to the purchase of more reinsurance cover.

The number of loss adjusters in EQC's contractor scheme is 18 plus the number negotiated with the larger loss adjusting firms.

2) Purpose of prospective financial statements

These prospective financial statements have been prepared for internal management purposes and for inclusion in the Statement of Intent.

3) Degree of uncertainty attaching to prospective financial statements

(a) The assumed returns for investments (provided by investment advisers) are based on long run returns. Over the short-term, the actual returns achieved can be significantly different.

(b) No estimate for claims, or costs directly associated with them, has been made, due to the high level of uncertainty in any estimate.

4) Factors that may lead to material difference between prospective financial statements and the actual financial results prepared in future reporting period.

(a) The occurrence of earthquakes or other natural disasters covered by EQC will significantly impact on future actual financial statements.

(b) Movements in international equity markets and domestic fixed interest market will significantly impact on future actual financial statements.

(c) Movements in the New Zealand dollar against other currencies (particularly the USD) will significantly impact on future actual financial statements.

Cautionary Note

Actual financial results achieved for the period covered are likely to vary from the information presented, and the variations may be material.

Responsibility and Approval

The prospective financial statements were approved by the Board of EQC on 27 March 2008.

The Board of EQC is responsible for the prospective financial statements presented, including the appropriateness of the assumptions underlying the prospective financial statements and all other required disclosures.

Actual financial results are not incorporated in the prospective financial statements. EQC does not intend to update the prospective financial statements subsequent to presentation.

FRS42

These prospective financial statements comply with FRS42.

Statement of Service Performance for the year ending 30 June 2009

Output Class	Revenue	Expenditure
1: Claims handling and the Catastrophe Response Programme	Nil	$9.6million
2: Research	Nil	$10.7million
3: Public Education	Nil	$4.1million
4: Policy Advice	Nil	Nil
5: Management of the Natural Disaster Fund	$476.2	$57.6million