



EARTHQUAKE COMMISSION
KŌMIHANA RŪWHENUA

Statement of Investment Policies, Standards and Procedures

(SIPSP)

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High Level Table of Contents

- Introduction 1
 - Overview 1
- Definitions of Key Terms..... 2
- Chapter 1 – Investment Objectives, Philosophy and Principles 3
 - Overview 3
 - Investment Objectives 4
 - Statement of Investment Beliefs..... 5
- Chapter 2 – EQC's General Investment Policies 8
 - Overview 8
 - Eligible Asset Classes and Investments..... 9
 - Approved Bank Accounts.....11
 - Asset Allocation, Operational Ranges and Rebalancing12
 - Measuring Investment Performance.....13
 - Investment Management Structures and Mandates.....14
 - Currency exposure and hedging16
 - Use of Other Derivative Financial Instruments.....17
 - Credit Risks Management.....18
 - Market Risks Management19
 - Voting Rights.....21
 - Reporting Requirements.....22
 - Investment Redemptions and Liquidity.....23
- Chapter 3 – EQC's Responsible Investment Policy24
 - Overview24
 - If a Company is in Breach.....25
 - Responsible Investment Principles26
 - Implementation of Responsible Investment Principles.....27
 - Appendix 1 – UN Principles for Responsible Investment30
 - Appendix 2 – Excluded Investments31
 - Appendix 3 – Minister’s Direction.....32

Detailed Table of Contents

Introduction	1
Overview	1
Governance	1
Earthquake Commission Act 1993.....	1
Ministerial Direction.....	1
obligations	1
Purpose	1
Audience.....	1
Contents	1
Definitions of Key Terms.....	2
Chapter 1 – Investment Objectives, Philosophy and Principles	3
Overview	3
Introduction.....	3
Contents	3
Investment Objectives	4
Introduction.....	4
Best practice.....	4
Safety and availability	4
Diversify.....	4
Improve the real value of the Fund	4
Statement of Investment Beliefs.....	5
Philosophy	5
Strategic asset allocation	5
Higher returns = higher risk	5
Diversification lowers risk	5
Appoint skilful Investment Managers	6
Portfolio risk.....	6
Market timing and tactical asset allocation.....	6
Liquidity of assets	6
Net of costs.....	6
Internal governance	6
External Resources.....	7
Environment, social and governance issues	7
Chapter 2 – EQC's General Investment Policies	8
Overview	8
Introduction.....	8
Review.....	8
Trades in NZ Government Securities.....	8
Responsible Investment	8
Contents	8
Eligible Asset Classes and Investments.....	9
Introduction.....	9
Global Equities.....	9
NZ Fixed Interest	9
NZ Cash	9
Foreign Cash	10
Approved Bank Accounts.....	11
Introduction.....	11
Authorisation to hold and operate accounts	11
Delegation to others	11
Asset Allocation, Operational Ranges and Rebalancing.....	12
Asset allocation and operational ranges	12
Rebalancing.....	12
Measuring Investment Performance.....	13
Introduction.....	13
Benchmarks.....	13
Investment Management Structures and Mandates.....	14
Introduction.....	14
Management of NZ fixed interest and cash.....	14
Management of Global Equities.....	14

Investment management mandates and guidelines	15
Currency exposure and hedging	16
Policy	16
Use of Other Derivative Financial Instruments.....	17
Introduction.....	17
Global Equities.....	17
Fixed Interest and Cash	17
Credit Risks Management.....	18
Introduction.....	18
NZ Fixed Interest	18
NZ Cash	18
Foreign cash.....	18
Market Risks Management	19
Introduction.....	19
NZ Fixed Interest	19
NZ Cash	19
Global Equities – passive	19
Global Equities – active.....	19
Country exposure.....	19
Active management structure.....	20
Portfolio sector weights	20
Total mandate exposure.....	20
Illiquid limits	20
Voting Rights.....	21
Pooled accounts	21
Directly held accounts	21
Reporting Requirements.....	22
Introduction.....	22
Reporting by EQC Management.....	22
Statement of Compliance	22
Reporting by Custodian.....	22
Investment Redemptions and Liquidity.....	23
Natural disaster liquidity	23
Other liquidity.....	23
Chapter 3 – EQC's Responsible Investment Policy	24
Overview	24
What this policy applies to.....	24
Contents	24
If a Company is in Breach.....	25
Introduction.....	25
Dialogue with company	25
Shareholder influence	25
Divest investment.....	25
Responsible Investment Principles	26
Introduction.....	26
About the UN PRI	26
International codes and standards.....	26
Implementation of Responsible Investment Principles.....	27
Introduction.....	27
Shareholder activities.....	27
Monitoring.....	27
Analysis	27
Engagement	28
Investment Managers.....	28
Corporate governance and voting.....	29
Sovereign securities.....	29
Exclusion and divestment.....	29
Transparency and reporting	29
Appendix 1 – UN Principles for Responsible Investment	30
Appendix 2 – Excluded Investments	31
Appendix 3 – Minister's Direction.....	32

Introduction

Overview

Governance

The Earthquake Commission (EQC) is a Crown Entity acting under the Earthquake Commission Act 1993. Under this Act EQC has responsibility for the Natural Disaster Fund (the Fund).

The investments of the Fund are governed by the:

- Earthquake Commission Act 1993
- Crown Entities Act 2004, and
- Ministerial Direction.

Earthquake Commission Act 1993

This Statement acknowledges and incorporates the specific financial goals and obligations of EQC as specified by the Earthquake Commission Act 1993 (the Act). In particular, Sections 5(1)(a) and (c) of the Act address two key financial goals for EQC:

To administer the insurance against natural disaster damage provided under this Act.

To administer the Fund and, as far as is reasonably practicable, to protect its value, including by the investment of money held in the Fund.

The Commission also recognises that the Minister of Finance previously had the power under Section 12 of the Act, and now has the power under Section 103 of the Crown Entities Act 2004 (and in accordance with Section 12 of the Act), to give directions for the investment of the Fund taking account of the Crown's wider financial interests.

Ministerial Direction obligations

EQC must invest the Fund on a prudent, commercial basis.

In doing so, EQC must manage and administer the Fund 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.

Purpose

The purpose of this Statement of Investment Policies, Standards and Procedures (SIPSP) is to clearly state the obligations and how EQC will meet the requirements of the governance bodies listed above.

The Investment Manager Agreements (IMA's) include clauses that directly relate to this SIPSP.

Audience

The intended audience for this SIPSP includes:

- EQC Board
- EQC Investment Committee
- EQC Chief Executive and staff
- Audit NZ, who audit EQC, and
- The Treasury.

Contents

This document contains the following.

Topic	See Page
Definitions of Key Terms	2
Chapter 1 – Investment Objectives, Philosophy and Principles	3
Chapter 2 – EQC's General Investment Policies	8
Chapter 3 – EQC's Responsible Investment Policy	24

Definitions of Key Terms

Terms

The following key terms are used in this document.

Term	Definition
Approved bank	A bank with which EQC is permitted to operate a bank account: <ul style="list-style-type: none"> • under section 158 of the Crown Entities Act 2004, or • in accordance with any Ministerial authorisation currently in force (see the 'Approved Bank Accounts' topic on page 11 of Chapter 2).
EQC	Earthquake Commission as defined by the Earthquake Commission Act 1993.
Global Equities	Investments in securities as defined in the 'Eligible Asset Classes' topic on page 9 of Chapter 2.
Minister	Minister of Finance, as responsible Minister for the Earthquake Commission.
Ministerial Direction	Direction given by the Minister in accordance with the Act and/or the Crown Entities Act 2004. This includes the direction given by the Minister pursuant to Section 12 of the Act that came into effect on 1 November 2001.
NZ Cash	Investments in short term investments (less than one year) including: <ul style="list-style-type: none"> • Treasury Bills, and • Bank 'Bills' (RCDs, Bank Bills, Term Deposits). <p>NZ Cash as defined in this document excludes funds held on call or in the current account for working capital requirements.</p>
NZ Fixed Interest	Investments in NZ Government Stock and NZ Inflation Indexed Bonds as issued by the New Zealand Government or Reserve Bank of New Zealand.
NZ Government Securities	Investments in any NZ Government issued securities, including: <ul style="list-style-type: none"> • NZ Government Stock • NZ Inflation Indexed Bonds, and • NZ Treasury Bills.
NZ Government Stock	Investments in NZ Government-issued Stocks and Bonds, but excluding NZ Government-issued Inflation Indexed Bonds.
NZX	New Zealand Stock Exchange.
NZX Indices	Market standard indices currently released by NZX. <p>These were formerly released by CSFB and known as the CSFB Indices.</p>

Chapter 1 – Investment Objectives, Philosophy and Principles

Overview

Introduction

Investment objectives listed in this topic are subject to Ministerial Direction.

EQC has developed the Statement of Investment Beliefs (described in this topic) to ensure investment values that relate to these objectives are:

- communicated
 - aligned, and
 - understood across EQC.
-

Contents

This chapter contains the following topics.

Topic	See Page
Investment Objectives	4
Statement of Investment Beliefs	5

Investment Objectives

Introduction	The current investment objectives that EQC needs to ensure are in this topic.
Best practice	Maintain the safe-keeping of assets in accordance with best practice.
Safety and availability	Ensure as far as possible at all times the safety and availability of the Fund. This is in order to meet all claims on EQC taking account of and in conjunction with other financial risk management alternatives available to EQC.
Diversify	<p>Subject to Ministerial Direction, diversify the Fund's investment portfolio, thereby</p> <ul style="list-style-type: none"> • increasing both EQC's and the Crown's options for financing natural disaster claims • diversifying away from assets which values are correlated to disaster events • achieving a better investment/liability profile match, and • accessing international investment expertise.
Improve the real value of the Fund	<p>The 'real value' of the Fund excludes cash held as working capital.</p> <p>Improve the real value of the Fund over the medium term utilising a mixture of assets designed to:</p> <ul style="list-style-type: none"> • achieve an average rate of return of at least 1% p.a. over the Crown's cost of borrowing over a rolling ten year period • subject the Fund to no more than 1 chance in 4 that over a rolling ten year period the annual rate of return will be less than Crown's cost of borrowing, and • ensure that there is no more than 1 chance in 30 of the Fund incurring an investment return of less than negative 2% in any one financial year. <p><i>(This clause will be amended as agreed with Treasury in November 2003, if confirmed by Ministerial Direction change.)</i></p> <p>Note: The Crown's cost of borrowing is measured by movement in the NZX Government Stock Index.</p>

Statement of Investment Beliefs

Philosophy

EQC believes that successful investment organisations must develop and adopt a clear set of investment beliefs to ensure investment values are communicated, aligned and understood across an organisation.

Accordingly, EQC has developed this Statement of Investment Beliefs.

This is a philosophical statement that:

- guides EQC in its development of its investment organisation, investment policies and actions of the investment operations.
- guides management and administration of the assets of the Fund in a consistent manner that reflects the:
 - views of the Board
 - Statement of Intent, and
 - Ministerial Direction under which EQC operates.

The fundamental principles of this Statement of Investment Beliefs are described below.

Strategic asset allocation

The strategic asset allocation is the key investment decision.

The strategic asset allocation decision:

- lies at the core of the Fund's risk and return, and
- therefore provides the greatest impact to the Fund's future returns, as the majority of returns from a given asset class are typically driven by the underlying market exposure (beta).

Note: EQC has limited scope to alter strategic asset allocation, as Ministerial approval is required to amend policy to any substantive extent.

Higher returns = higher risk

Higher levels of return are typically associated with higher levels of risk.

Diversification lowers risk

Diversification, particularly in low or negatively correlated asset classes, should lower overall portfolio risk.

Increasing the number of asset classes, or Investment Managers within those classes has the ability to lower risk across the portfolio for the same level of return.

Likewise when considering asset classes, the breadth of decision making within that class needs to be considered. For example, increasing the number of independent or uncorrelated decisions in most cases will lower risk.

A broader Investment Manager selection will be considered in the context of increased manager cost and resourcing constraints, with costs offsetting the potential for reduced risk.

Continued on next page

Statement of Investment Beliefs, Continued

Appoint skilful Investment Managers

Markets are typically highly competitive but imperfectly efficient, and market inefficiencies allow skilful Investment Managers to add value. Active investment management is generally a 'zero sum game' in fact slightly negative once fees are taken into account. However, EQC recognises that Investment Managers with genuine skill can add value.

Finding these Investment Managers can be challenging as:

- past performance is not necessarily a good indicator of future performance, and
- separating skill from luck or timing can be difficult.

EQC will only appoint active Investment Managers where EQC is confident that they have the skills to enable them to add value.

Portfolio risk

The majority of portfolio risk should be attributed to market risk rather than specific Investment Manager risk.

In making Investment Manager allocations EQC must take this into account.

Market timing and tactical asset allocation

Market timing and tactical asset allocation are not reliable ways of investing, as in the short term, returns are often random in nature and therefore do not allow reliable investment decisions to be made.

However, significant deviations away from the norm should be taken into consideration, particularly when allocating funds to new investments.

Forms of global tactical asset allocation may be able to add value due to the breadth of decisions and the focus on major deviations from the norm.

Liquidity of assets

The uncertain nature of the liabilities creates a need for a portion of the Fund to invest in highly liquid assets, but given the likely time to draw all funds following a major event, it does not totally prohibit the Fund from holding some less liquid investments.

Illiquid securities and markets can offer enhanced returns but in addition to the liquidity issues are often more resource intensive and less diversified.

Net of costs

Investment returns should be considered net of costs. Costs can erode real returns and remove the apparent risk premium in an investment.

Costs can be direct or indirect and may include:

- implementation delays
 - transaction costs
 - fees
 - commissions
 - market impact costs, and
 - taxation (where it is deducted at source and is non-recoverable).
-

Internal governance

An internal governance structure that promotes decisiveness, efficiency and accountability will help in the achievement of fund objectives.

Continued on next page

Statement of Investment Beliefs, Continued

External Resources

EQC operates with a small investment team and therefore will need to utilise external advisors, custodians and investment managers as required.

One external investment advisor may not be able to meet all requirements and it may be beneficial to have peer reviews for major pieces of work. Use of external resources will also be used to build internal knowledge.

Environment, social and governance issues

Long term financial performance can be affected by environmental, social and governance issues, therefore EQC encourages investment managers to incorporate these factors into their EQC portfolio management, in particular giving consideration to avoiding prejudice to New Zealand's reputation in the world community.

Chapter 2 – EQC's General Investment Policies

Overview

Introduction

The Board will invest the Fund subject to Ministerial Direction.

The asset allocation, operational ranges, and investment management structures established by the Board are to achieve and maintain an appropriate level of diversification across securities, sectors, asset classes, countries and investment management styles.

Portfolio volatility is to be minimised for the expected level of return, recognising the constraints imposed under the investment objectives.

This topic describes EQC's general investment policies. The specific policy for responsible investment is described in detail in Chapter 3 (see page 24).

Review

All aspects of the investment process and functions are to be reviewed on a regular basis. Investment Managers will be:

- monitored continuously for compliance with mandates and guidelines
- assessed at least quarterly on their performance, and
- subject to a formal comprehensive review no less frequently than every three years.

Trades in NZ Government Securities

To comply with the Ministerial Direction, all trades in New Zealand Government Securities must be transacted only through the NZ Debt Management Office.

Responsible Investment

In investing the Fund the Board will have consideration for avoiding prejudice to New Zealand's reputation as a responsible member of the world community by instructing managers of the portfolio to be vigilant against the effects on companies' long-term performance prospects that could arise from any practices which alienate civilised society including socially irresponsible behaviour. The complete Responsible Investment Policy which can be extracted as a stand alone document is follows as Chapter 3.

Contents

This chapter contains the following topics.

Topic	See Page
Eligible Asset Classes and Investments	9
Approved Bank Accounts	11
Asset Allocation, Operational Ranges and Rebalancing	12
Measuring Investment Performance	13
Investment Management Structures and Mandates	14
Currency exposure and hedging	16
Use of Other Derivative Financial Instruments	17
Credit Risks Management	18
Market Risks Management	19
Voting Rights	21
Reporting Requirements	22
Investment Redemptions and Liquidity	23

Eligible Asset Classes and Investments

Introduction

The Fund shall be invested in the following asset classes:

- Global Equities
- NZ Fixed Interest, and
- NZ Cash.

Eligible investments within these asset classes shall only include those listed in this topic.

Global Equities

The following Global Equity securities are eligible:

- Equity securities
- Rights
- Warrants
- Restricted (as to resale) securities
- Securities subject to SEC rule 144A
- American Depository Receipts and
- Global Depository Receipts

all in respect of entities' securities listed/traded on primary and widely recognised stock exchanges

- initial public offerings of entities' securities to be listed/traded on primary and widely recognised stock exchanges, and
- Cash.

Due to the rapidly changing nature of securities markets, individual securities may be held by individual approval where they meet the intentions of the EQC policy – they are publicly traded, reasonably liquid and transparent.

Should new securities become widespread they will be considered for inclusion into the above list of eligible Global Equity securities.

NZ Fixed Interest

NZ fixed interest investments shall consist of securities issued or guaranteed by the NZ Government or the Reserve Bank.

Investment in index-linked securities and other non-standard debt instruments will require approval from the Investment Committee on a case by case basis. In any case the maximum invested in Inflation Indexed Bonds shall be 12% of the Fund.

NZ Cash

NZ cash investments shall consist of securities that have a maturity or redemption date of twelve months or less.

These securities must be:

- issued or guaranteed by the NZ Government or the Reserve Bank, or
- issued in NZ by approved banks.

Deposits, including Registered Certificates of Deposit (RCDs) and accounts at approved banks may be utilised.

Continued on next page

Eligible Asset Classes and Investments, Continued

Foreign Cash

Foreign Cash is a subset of Global Equities asset class.

All residual foreign cash is held with approved banks that meet the requirements determined by the Board from time to time (currently a short term credit rating of A-1 or higher from Standard & Poor's (S&P) or being held with EQC's custodian).

Approved Bank Accounts

Introduction Section 158 of the Crown Entities Act 2004 permits all Crown Entities to operate certain types of bank accounts.

This includes an account with a bank that is registered under the Reserve Bank of New Zealand Act 1989, and has a short term credit rating of one of the following:

If rated by...	then a credit rating of...
Standard & Poor's (S&P) only	A-1 or higher.
Moody's only	Prime-1 or higher.
both S&P and Moody's	<ul style="list-style-type: none"> • A-1 or higher from S&P, and • Prime-1 or higher from Moody's.

Authorisation to hold and operate accounts

In addition, EQC is authorised to hold and operate accounts:

- with any bank outside New Zealand, or
- denominated in any foreign currency with a registered bank or building society in New Zealand.

in line with its policies relating to the management of the Fund.

Act reference: Authorisation to hold and operate accounts is given under Ministerial authorisation dated 27 July 2005, given under sections 158(2)(a)(i) and 158(2)(b)(i) of the Crown Entities Act 2004.

Delegation to others

EQC is authorised to delegate any of its functions or powers to (among others) an investment manager or managers or custodian or custodians.

Where EQC has appointed a custodian or custodians in relation to the Fund, and delegated to that custodian the power to operate bank accounts in relation to the Fund, the authorisations relating to operation of bank accounts referred to in the immediately preceding section will be applicable to the operation of bank accounts in relation to the Fund by that custodian.

Act reference: Delegation of functions or powers is given under Ministerial approval dated 18 July 2005, given under section 73(1)(d) of the Crown Entities Act 2004.

Asset Allocation, Operational Ranges and Rebalancing

Asset allocation and operational ranges

The Board has adopted the following asset allocation and operational ranges for those eligible asset classes.

Asset Class	Policy allocation (% of portfolio)	Range (% of portfolio)
Global Equities	30%	27-33%
NZ Fixed Interest	63%	55-73%
NZ Cash	7%	0-12%

Rebalancing

The Board has adopted a systematic passive asset allocation rebalancing process.

Rebalancing will be undertaken when eligible asset class weights move outside their acceptable ranges, based on monthly valuations.

Asset classes will be rebalanced to **halfway** between the:

- policy allocation, and
 - the extreme of the range beyond which the weight had moved.
-

Measuring Investment Performance

Introduction The overall investment performance of the Fund shall be measured and compared with the objective 'Improve the real value of the Fund' (see page 4 for detail).

Benchmarks For individual asset classes, the benchmarks against which performance will be measured are as follows:

Asset Class	Benchmark
Global Equities	MSCI World Index with net dividends re-invested measured in NZ dollars. Active managers are assigned quantified individual out-performance targets relative to this benchmark.
NZ Inflation Indexed Bonds	NZX NZ Inflation Indexed Index.
NZ Government Stock	NZX NZ Government Stock Index.
NZ Cash	NZX 90-day Bank Bill Gross Return Index.

Investment Management Structures and Mandates

Introduction

EQC has ultimate responsibility for the management of all Fund assets.

EQC utilises the services of:

- an external investment advisor to assist in determining investment strategy as well as the selection of investment managers within an asset class.
 - individual investment managers, and
 - external custodians to provide custody for all directly held assets. This maintains independence from investment managers to meet best practice portfolio management.
-

Management of NZ fixed interest and cash

The Investment Committee and EQC Management are appointed to manage NZ Fixed Interest and Cash within authorised investment limits agreed by the Board from time to time.

EQC internally manages the cashflows, and resulting transactions between asset classes.

Additionally, EQC passively manages the domestic portfolio, including:

- NZ Government Stock
 - Inflation indexed bonds
 - Treasury bills, and
 - NZ registered bank registered certificates of deposit (RCDs).
-

Management of Global Equities

Global Equities are managed by investment managers specifically selected for their abilities to select equities in certain styles in order to maintain diversity among managers.

All of the investment manager mandates are selected based on a comprehensive proposal and due diligence process.

Currently the passive equity holding is managed by one manager as an investment in a Common Trust Fund (CTF).

The following further explains the Investment Manager allocations.

Passive Equity Management

It has been determined that:

- Of the allocation to global equities, 40% shall be invested with core passive equity manager(s) with an allowable range when fully invested of 30%-50%.

Active equity management

It has been determined that:

- A multi-manager style neutral structure be adopted, comprising value, growth and market-orientated styles
- The remaining 60% with an allowable range of 50%-70% allocated to global equities be allocated between the active managers in proportions agreed from time to time by the Investment Committee and subject to benchmark-relative out-performance and tracking error targets (if appropriate) agreed from time to time by the Investment Committee.

Investment Management Structures and Mandates, Continued

The Passive-Active management split is expected to change in the future in favour of an exclusively Active management allocation.

Investment management mandates and guidelines

Investment management mandates and guidelines shall be prescribed in a manner:

- to best achieve the investment objectives of EQC, and
- to be consistent with this EQC SIPSP document.

In particular, these mandates shall include:

- eligible investments
 - performance measurements
 - constraints and exposure limits (including country and issues exposures)
 - use of derivatives, and
 - reporting requirements.
-

Currency exposure and hedging

Policy

Currency exposure is to be managed in a manner to best achieve the investment objectives.

Under the current asset allocation, currency exposures will only arise through investments in Global Equities. With respect to investments in such equities, the current policy is to remain **unhedged**.

EQC must consult the Minister if it forms the intention to hedge its pre-disaster currency exposures and may not proceed with the implementation of a hedging strategy without first obtaining the consent of the Minister.

Use of Other Derivative Financial Instruments

Introduction The policy on the use of other derivative financial instruments, including options and futures, is outlined in this topic.

Global Equities Exchange traded futures contracts may be held on global equities for transition management purposes for either pooled or direct accounts.

Exchange traded futures and options on global equities may be held in directly invested accounts.

All futures and options must be fully collateralised and the account must not be leveraged at any time. In particular:

- all futures contracts must be fully collateralised with cash, and
- the writing of a put option must be backed by sufficient cash to meet the exercise of that option.

Over-the-counter currency forward rate agreements and options may also be held in directly managed accounts. These are subject to:

- each counterparty being rated AA or higher by S&P for counterparty risk, and
 - a current ISDA agreement being in place between the manager and each counterparty.
-

Fixed Interest and Cash The Board will not use derivative securities in its fixed interest or cash portfolios.

Credit Risks Management

Introduction Credit risks associated with investments shall be managed within the constraints described in this topic.

Note: Credit risk management constraints are not applicable for global equities, unless investment managers are holding foreign cash.

NZ Fixed Interest All NZ Fixed Interest securities must be issued or guaranteed by the NZ Government or Reserve Bank.

NZ Cash **Approved bank ratings**
All NZ Cash securities must be issued or guaranteed by the NZ Government or Reserve Bank or issued in NZ by an approved bank with a short-term credit rating of one of the following:

If rated by...	then a credit rating of...
Standard & Poor's (S&P) only	A-1 or higher.
Moody's only	Prime-1 or higher.
both S&P and Moody's	<ul style="list-style-type: none"> • A-1 or higher from S&P, and • Prime-1 or higher from Moody's.

Exposure limited on individual banks

The manager shall ensure that no more than **25%** of the total market value of the NZ cash portfolio is invested in the securities of any one bank, subject to the overall limits that follow.

The manager may invest the NZ cash portfolio in the securities of any bank subject to the following limits:

Up to 25% of the total market value of the NZ cash portfolio in any bank rated by...	then a credit rating of...
S&P only	A-1+ or higher.
Moody's only	Prime-1 or higher.
both S&P and Moody's	<ul style="list-style-type: none"> • A-1+ or higher from S&P, and • Prime-1 or higher from Moody's.

Up to 15% of the total market value of the NZ cash portfolio in any bank rated by...	then a credit rating of...
S&P only	A-1 or higher.
Moody's only	Prime-1 or higher.
both S&P and Moody's	<ul style="list-style-type: none"> • A-1 or higher from S&P, and • Prime-1 or higher from Moody's.

Negative outlook ratings

No investments (or further investment) in any bank with S&P or Moody's negative outlook rating.

Foreign cash Credit risk associated with any residual cash holdings in the global equity asset class is managed through investment guidelines, with holdings required to be with approved banks that meet the requirements determined by the Board from time to time (currently a S&P rating of A-1 or higher, or being held with EQC's Custodian).
Such holdings are constrained to a maximum of **10%** of any manager's mandate.

Market Risks Management

Introduction Market risks associated with investment of the Fund shall be managed as follows.

NZ Fixed Interest The manager shall not vary the duration of the NZ Government Stock portfolio by more than ± 0.25 year from the duration of the benchmark. In addition to complying with the duration constraint, the manager shall ensure that a reasonable diversification of weighted duration exposures is maintained in the portfolio at all times.

NZ Cash The manager shall ensure that the duration of the NZ Cash portfolio shall not exceed 90 days.

Global Equities – passive Managers of passive accounts will be required to maintain a tracking error against the benchmark index of not more than 0.5% per annum.

Global Equities – active The active global equities portfolio must:

- adhere to aggregate country exposure ranges
- adhere to management structure rules

Investment Managers of active accounts for Global Equities need to:

- maintain portfolio sector weights within specified limits
- remain fully invested
- maintain mandate weights within specified limits, and
- maintain exposure to illiquid securities within specified limits

These are described below and on the next page.

Country exposure The aggregate exposure to each country (including the effective exposure generated from futures and options contracts) must fall within the following ranges:

Weight of country in benchmark index	Lower limit for portfolio weight	Upper limit for portfolio weight
10% or above	Benchmark weight less 20% (subject to minimum of zero)	Benchmark weight plus 20%
Between 5% and 10%	0%	Benchmark weight plus 15%
Below 5%	0%	Benchmark weight plus 10%
Not represented in benchmark	0%	Aggregated maximum of 10%

Note: % means percentage points.

Continued on next page

Market Risks Management, Continued

Active management structure

Any active management structure adopted shall be constructed so as to ensure that:

- no more than 5% of the total market value of the aggregate of active portfolios is invested in the securities of any one company, and
 - the aggregate of active portfolios holds no more than 5% of the market capitalisation of any one company or related companies.
-

Portfolio sector weights

Active managers' portfolio sector weights will typically be limited to a widest acceptable range of +/-20% of benchmark sector weights.

Alternative ranges may be negotiated with individual managers depending on their management style.

Fully invested at all times

Active managers will be expected to remain fully invested at all times, with maximum permitted cash holdings of 10%.

Exception: At mandate inception, EQC recognises that it may take some time to be fully invested.

Total mandate exposure

Active managers' total mandate exposure to the following shall be limited to a maximum of 5% of the total market value of the portfolio for:

- initial public offerings
 - rights
 - warrants, and
 - restricted (as to resale) securities (prior to their listings).
-

Illiquid limits

Limits on holdings of illiquid securities will be negotiated with each active manager depending on their management style.

Voting Rights

Pooled accounts

The Board will retain the right to exercise any vote attached to units held in a pooled account.

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

Directly held accounts

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

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

Reporting Requirements

Introduction Reporting on the investment performance of the Fund and of individual asset classes shall be as follows.

Reporting by EQC Management EQC Management shall provide:

- monthly reports to the Board, and
- quarterly reports to the Investment Committee and the Board.

Monthly reports

These are monthly reports on portfolio performance and characteristics, including an explanation of the factors affecting the portfolio.

Quarterly reports

These are comprehensive quarterly reports that incorporate:

- performance summary and explanation
 - market summary and outlook
 - factors affecting the portfolio
 - deviations from policy or benchmark positions, and
 - future portfolio strategy.
-

Statement of Compliance Managers responsible for individual portfolios including fixed interest, cash and equities, shall provide a statement of compliance with investment guidelines and mandates on a monthly basis.

Reporting by Custodian For any actively managed portfolio compliance will also be monitored by an independent global custodian.

Investment Redemptions and Liquidity

Natural disaster liquidity In the event of a natural disaster requiring liquidation and/or redemption of investments, decisions on sell-down of investments and currency risk management shall be made in consultation with the Minister of Finance.

In respect of investment redemptions of New Zealand government securities, the Commission will maintain its present policy arrangements with the Treasury in respect of redeeming the Commission's holdings of Treasury bills and New Zealand government bonds, including inflation indexed bonds.

Other liquidity Liquidity for day to day working capital is to be maintained separate from the Fund in on call or cheque accounts with approved banks.

All other liquidity is to be maintained in the fund as Approved Bank deposits or NZ Government Treasury Bills, taking account of reinsurance and other financial resource arrangements.

Chapter 3 – EQC's Responsible Investment Policy

Overview

Obligations and responsibilities

The Earthquake Commission (the Commission) is a crown entity acting under the Earthquake Commission Act 1993. Under this Act the Commission has responsibility for the Natural Disaster Fund (the Fund). The investments of the Fund are governed by the Earthquake Commission Act 1993, the Crown Entities Act 2004 and Ministerial Direction.

The Commission must invest the Fund on a prudent, commercial basis, and in doing so, must manage and administer the Fund in a manner consistent with:

- a. best practice portfolio management;
- b. maximising return without undue risk to the Fund as a whole; and
- c. avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

No one of these obligations has precedent over the others.

EQC considers responsible investment to be part of evolving best practice. The policy in this chapter outlines the principles of responsible investment that EQC will follow in order to administer the Fund using 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, by integrating environmental, social, and governance considerations into the investment process.

In implementing this policy EQC is aware that maximising returns without undue risk implies diversifying across a range of assets. The strategic asset allocation is set by a Ministerial direction. EQC has appointed Investment Managers who are responsible for the day to day buying and selling of stock.

Review

This policy will be reviewed at regular intervals.

Approval

The EQC Responsible Investment Policy outlined in this chapter was approved by the EQC Board of Commissioners on 6 December 2007.

What this policy applies to

This policy applies to all the Fund's assets under management. However, EQC's operational processes and procedures may vary across the assets depending on:

- the nature of the investment (for example, segregated or pooled funds)
- investors' rights
- whether it is practical to implement, and
- the cost of implementation.

Contents

This chapter contains the following topics.

Topic	See Page
If a Company is in Breach	25
Responsible Investment Principles	26
Implementation of Responsible Investment Principles	27
Appendix 1 – UN Principles for Responsible Investment	30
Appendix 2 – Excluded Investments	31

If a Company is in Breach

Introduction

If companies invested in by the Fund are found to have corporate practices that breach EQC's responsible investment policy, EQC will consider:

- engaging with the company either directly or in conjunction with other investors, or
 - taking other shareholder action.
-

Dialogue with company

EQC believes that it can, in most instances, have a greater impact on company practices through dialogue with company management in conjunction with others, than through immediate divestment.

EQC's actions are guided by the Principles described on page 26 of this policy.

Shareholder influence

In developing this policy, EQC is conscious of the boundaries of responsibility, and the degrees of influence, that exist between shareholders and companies.

While it is not the role of shareholders to interfere with the direct management of companies, they can seek to influence outcomes by:

- raising concerns with company boards or management, or
 - excluding investments from their portfolio for reasons of responsibility and ethics.
-

Divest investment

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

Responsible Investment Principles

Introduction

EQC considers that responsible investment decision making that takes account of social, environmental and governance considerations is part of evolving best practice.

Responsible investment actions can include:

- engagement
- voting
- exclusion of certain investments, and/or
- divestment.

Consideration of issues

EQC, at its discretion, and provided that it is consistent with its obligation to invest the Fund on a prudent, commercial basis may consider other issues arising from the Fund's investments. In doing so, EQC may take into account factors including:

- whether the issue is contrary to New Zealand law and New Zealand's international agreements, or
- is inconsistent with Crown actions.

Internationally agreed standards

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

About the UN PRI

EQC acknowledges the UN PRI as a component of emerging best practice in responsible investment. There is a growing view among investment professionals that environmental, social and corporate governance (ESG) can affect the performance of investment portfolios. The UN PRI provides a framework for investors to give appropriate consideration to ESG issues. These principles will be used to guide the investment decisions of EQC.

The UN PRI operates its own secretariat that helps international institutional investors collaborate when engaging with companies. The initiative encourages improvements in the inclusion of social, environmental and governance issues into investment analysis. The UN PRI provides tools to enable EQC to benchmark its performance in the area of responsible investment.

Reference: For details of the UN PRI, go to 'Appendix 1 – UN Principles for Responsible Investment' on page 30.

International codes and standards

EQC recognises international agreements signed by New Zealand, the UN Global Compact, and other international codes or standards.

EQC may take these into account, where relevant, in its investment activities.

The UN Global Compact asks companies to embrace, support, and enact, within their sphere of influence, a set of core values in the areas of:

- human rights
 - labour standards
 - the environment, and
 - anti-corruption.
-

Implementation of Responsible Investment Principles

Introduction

This topic describes implementation of responsible investment principles, grouped under the following headings.

Heading	See Page
Shareholder activities	27
Monitoring	27
Analysis	27
Engagement	28
Investment Managers	28
Corporate governance and voting	29
Sovereign securities	29
Exclusion and divestment	29
Transparency and reporting	29

Shareholder activities

EQC, or its investment managers (where delegated), may undertake shareholder activities consistent with best practice responsible investment.

These include, but are not limited to:

- improving EQC's expertise in, and effectiveness of, its shareholder activities
 - developing and maintaining, in conjunction with other agencies, a system for monitoring portfolio holdings against relevant standards
 - implementing an engagement programme, in conjunction with other agencies, to encourage improvements in responsible corporate behaviour
 - encouraging disclosure by companies, of material social and environmental information to better understand the impact of these issues on long-term shareholder value, and
 - exercising votes (including by proxy) at company meetings.
-

Monitoring

Following development and implementation of processes, EQC will monitor portfolio holdings against relevant standards to ensure compliance with this policy.

If EQC receives valid reports of breaches of responsible investment standards by companies in the Fund, EQC may:

- consider these issues on a case by case basis, and
 - undertake any of the actions outlined in this policy.
-

Analysis

EQC and its Investment Managers may undertake further analysis on key issues, or breaches of responsible investment standards, in order to assess the most appropriate shareholder response.

Analysis of investments will use the principles outlined in the Responsible Investment Principles Responsible Investment Principles topic, on page 26 of this chapter.

EQC's analysis of responsible investment issues may include the:

- nature of involvement by the company and the Fund
- materiality of the issue or breach of responsible investment standards
- regulatory environment, including international conventions and NZ law
- impact on long-term financial performance
- effectiveness of shareholder actions, and
- impact on the Fund's portfolio.

Continued on next page

Implementation of Responsible Investment Principles

Continued

EQC is aware that firms operate in different legal, cultural, and geographical contexts. Achieving certain standards (such as compliance with the UN Global Compact) may therefore be work in progress.

EQC will endeavour to understand individual circumstances if breaches of standards occur.

Engagement

EQC or its Investment Managers may engage with companies in which the Fund invests. This engagement may occur unilaterally or with other investors.

In most cases engagement will involve:

- encouraging companies to address significant breaches of standards, and/or
- improving their policies and practices.

EQC may also take a more general approach to engagement in order to raise awareness of relevant standards amongst business and investors.

Investment Managers

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

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

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

In addition, consistent with the UN PRI, EQC will encourage its investment managers to:

- integrate ESG factors into evolving research and analysis, and
- undertake and report on ESG-related engagement.

The investment managers will report to EQC on their application of the responsible investment requirements, on a six monthly basis.

Investment managers will be formally instructed of any exclusion or divestment decisions by EQC.

Implementation of Responsible Investment Principles

Continued

Corporate governance and voting

EQC believes that good corporate governance should maintain a balance between the:

- rights of shareholders on one hand, and
- needs of the corporate board and management to direct and manage the company's affairs on the other.

Responsible governance should:

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

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

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

Sovereign securities

Note: EQC does not invest in this type of asset. The following information is here in case we invest in sovereign securities in the future.

For investments in securities issued by sovereign states, EQC will be guided by UN standards and other similar international organisations.

These standards include the:

- Universal Declaration of Human Rights, and
- UN sanctions.

EQC will also seek expert assessment of the sovereigns' records on:

- human rights
- labour standards
- environmental standards
- trans-national crime
- evidence of reprehensible conduct, or
- other breaches of responsible investment standards.

Where a breach of responsible investment standards on sovereign securities is identified, EQC may elect to divest from the sovereign securities of that country.

Exclusion and divestment

EQC may decide to exclude investment in or divest from certain securities.

Reference: See 'Appendix 2 – Excluded Investments' on page 31 for a list of currently excluded investments.

Transparency and reporting

EQC recognises that the New Zealand public has a legitimate interest in the Fund. EQC will publish its responsible investment policy and communicate on its responsible investment activities in the annual report.

Appendix 1 – UN Principles for Responsible Investment

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, and asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following six principles of the UN PRI:

1. We will incorporate ESG issues into investment analysis and decision-making processes.
 2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
 3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
 4. We will promote acceptance and implementation of the Principles within the investment industry.
 5. We will work together to enhance our effectiveness in implementing the Principles.
 6. We will each report on our activities and progress towards implementing the Principles.
-

Appendix 2 – Excluded Investments

Current excluded investments

In line with the obligations and responsibilities of the Responsible Investment Policy, EQC and its Investment Managers will not invest the Fund in the following:

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

Discretionary changes

EQC is not limited to the exclusion of these investments and may exclude other investments or divest from securities at its discretion.

Appendix 3 – Minister’s Direction

Direction to the Earthquake Commission pursuant to Section 12 of the Earthquake Commission Act 1993.

- i. This direction comes into effect on 1 November 2001 and as of that date the direction dated 2 June 1998 is hereby revoked.
- ii. The Earthquake Commission (the Commission) shall invest the Natural Disaster Fund (the Fund) in:
 - a. NZ Government securities comprising Treasury bills and/or Government stock and/or Inflation-Indexed Bonds tradeable only through the NZ Debt Management Office;
 - b. global equities; and
 - c. New Zealand bank bills.
- iii. The Commission shall invest the Fund with the objectives of:
 - a. achieving an average rate of return of at least 1% per annum over the Crown's cost of borrowing over a rolling ten year period (where the Crown's cost of borrowing is measured by the change in the CSFB New Zealand Government Stock Gross Index);
 - b. subjecting the Fund to no more than 1 chance in 4 that over any 10 year period the annual rate of return will be less than the Crown's cost of borrowing; and
 - c. ensuring that there is no more than 1 chance in 30 of the Fund incurring an investment of less than negative 2% in any one financial year.
- iv. The Commission must invest the Fund on a prudent, commercial basis, and in doing so, must manage and administer the Fund in a manner consistent with:
 - a. best practice portfolio management;
 - b. maximising return without undue risk to the Fund as a whole; and
 - c. avoiding prejudice to New Zealand's reputation as a responsible member of the world community.
- v. The Commission must prepare, and adhere to, a statement of investment policies, standards, and procedures for the Fund that is consistent with paragraph iv of this direction.
- vi. The Commission must review those investment policies, standards, and procedures for the Fund at least annually.
- vii. A statement of investment policies, standards, and procedures must cover (but is not limited to):
 - a. the classes of investments in which the Fund is to be invested and the selection criteria for investments within those classes;
 - b. the determination of benchmarks or standards against which the performance of the Fund as a whole, and classes of investments, will be assessed;
 - c. standards for reporting the investment performance of the Fund;
 - d. ethical investment for avoiding prejudice to New Zealand's reputation as a responsible member of the world community;
 - e. the balance between risk and return in the overall Fund portfolio;
 - f. the fund management structure;
 - g. the use of options, futures, and other derivative financial instruments;
 - h. the management of credit, liquidity, operational, currency, market, and other financial risks;
 - i. the retention, exercise, or delegation of voting rights acquired

- through investments;
 - j. the method of, and basis for, valuation of investments that are not regularly traded at a public exchange; and
 - k. prohibited or restricted investments or any investment constraints or limits.
- viii. The Commission must consult with the Minister of Finance (the Minister) if it intends to modify the statement of investment policies, standards, and procedures to any substantive degree.
- ix. The Commission must consult with the Minister if it intends to modify the portfolio composition from the following:
- a. NZ Government securities;
 - b. up to a maximum of 35% of the market value of the Fund in global equities; and
 - c. up to a maximum of \$250 million of New Zealand bank bills.
- x. The Commission must consult the Minister if it forms the intention to cover its pre-disaster currency exposures and may not proceed with the implementation of a hedging strategy without the consent of the Minister being first had and obtained.
- xi. In the event of a major natural disaster likely to involve claims on the Commission in excess of \$250 million the Commission must consult with the Minister before liquidating any part of the investment portfolio of the Fund apart from the holdings of New Zealand bank bills.
- xii. 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.



Hon Dr Michael Cullen
Minister of Finance

30 October 2001
