

EARTHQUAKE COMMISSION STATEMENT OF INVESTMENT POLICIES, STANDARDS AND PROCEDURES

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Table of Contents

Introduction	3
Preamble	3
Governance	3
Earthquake Commission Act 1993	3
Ministerial Direction obligations.....	3
Purpose	3
Audience	3
Definition of Key Terms	4
Chapter 1 – Investment Objectives, Philosophy and Principles	5
Introduction	5
Ministerial Direction Objective	5
Statement of Investment Beliefs	5
Roles & Responsibilities	6
Chapter 2 – EQC’s General Investment Policies	7
Overview	7
Eligible Asset Classes and Investments	7
Approved Bank Accounts	8
Asset Allocation and Operational Ranges	8
Measuring Investment Performance	8
Investment Management Structures and Mandates.....	9
Credit Risks Management	9
Operational Risk Management	10
Market Risks Management	10
Voting Rights	10
Investment Redemptions and Liquidity	10

Introduction

Overview

Preamble

As a consequence of the Canterbury Earthquake sequence (CES) which began in September 2010, EQC is currently settling claims using funds made available under the s16 Crown Guarantee. This means that many of the obligations outlined in this policy only apply in the event that the fund is replenished. That is, this policy does not apply to funds currently held in EQC's transactional account.

This Statement of Investment Policies, Standards and Procedures (SIPSP) is prepared taking account of this background and should be reviewed again by June 2020 to consider its ongoing applicability in the circumstances at that time. The SIPSP does not address how the fund may be rebuilt post the settlement of claims from the CES.

Governance

The Earthquake Commission (EQC) is a Crown Entity which continued in existence under the Earthquake Commission Act 1993 (the Act). Under the Act, EQC must administer the Natural Disaster Fund (the Fund).

The investment of the Fund is 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 the 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 Minister 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 current and possible future financial position.

Ministerial Direction obligations

EQC must invest the Fund on a prudent, commercial basis, and in doing so, must 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.

Purpose

The purpose of this SIPSP is to state clearly the obligations and how EQC will meet the requirements of the Governance bodies listed above (see Governance), to ensure that EQC invests the Fund conservatively and maintains its liquidity to meet claims in the aftermath of the CES.

Audience

The intended audience for this SIPSP includes:

- EQC Board
- EQC Chief Executive and staff
- The Auditor-General, who has appointed EY to carry out the audit of EQC, and
- The Treasury.

Definitions of Key Terms

Terms

The following key terms are used in this document.

Term	Definition
Approved Banks	Banks which: <ol style="list-style-type: none"> I. Are registered under the Reserve Bank of New Zealand Act 1989; II. Have a short term credit rating of A-1, Prime-1 or higher; and III. If rated by both the Moody's and Standard & Poor's credit rating agencies, ratings from both which equal or exceed the foregoing ratings.
EQC	Earthquake Commission as defined by the Earthquake Commission Act 1993.
Minister	Minister Responsible for the Earthquake Commission or the Minister of Finance as the context requires.
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 Responsible for the Earthquake Commission on 27 July 2015.
NZ Cash	Investments in short term investments (less than one year) including: <ul style="list-style-type: none"> • Treasury Bills, and • Bank 'Bills' (Revolving Certificate of Deposits, Bank Bills, Term Deposits), and • Cash on-call. <p>NZ Cash as defined in this document excludes funds held in the current account for working capital requirements.</p>
NZ Fixed Interest	Investments in NZ Government Securities as issued by the New Zealand Government tradeable only through the New Zealand Debt Management Office.
NZ Government Securities	New Zealand Government Securities comprising Treasury bills and/or Government Stock and/or Inflation-Indexed Bonds tradeable only through the New Zealand Debt Management Office.
NZ Government Stock	Investments in NZ Government-issued Stocks and Bonds, but excluding NZ Government-issued Inflation Indexed Bonds.
Derivative	A financial instrument whose value is derived from the value of an underlying security. Examples of derivatives include: <ul style="list-style-type: none"> • Options • Future Contracts • SWAPs
Relevant EQC manager	The EQC staff member who has responsibility as part of their role for the fund operations.

Chapter 1 – Investment Principles

Overview

Introduction

Investment policies listed in this section are subject to Ministerial Direction.

EQC has developed the Statement of Investment Principles (described in this chapter) to ensure investment values that relate to these policies are:

- communicated
- aligned, and
- understood across EQC.

Ministerial Direction Objective

EQC's investment objective is given in paragraph 8 of the Ministerial Direction dated 27 July 2015:

The Commission shall invest the Fund with the objective of achieving an average rate of return of at least the rate of change in the ANZ 90-day Bank Bill Index (or any successor to that index) for each financial year less 25 basis points per annum.

Statement of Investment Principles

Policies and Standards

EQC believes it is essential to have a clear set of investment principles in regards to investment risk and return in order to provide a basis for its investment actions.

Strategic asset allocation

The strategic asset allocation is the key investment decision and

- 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: During the period of drawing down the Fund to meet Canterbury earthquake claims, the key investment decision is focused around ensuring the safety and availability of the Fund to meet the claims payments. EQC has limited scope to alter strategic asset allocation, as Ministerial approval is required to amend policy to any substantive extent. The Commission must also consult with the Minister if it intends to modify the statement of investment policies, standards, and procedures to any substantive degree.

Risk Appetite

EQC adopts a low risk investment appetite, as it aims to ensure sufficient liquidity exists in the fund to meet all payments in the upcoming twelve month period.

Diversification

Diversification within the investment portfolio will reduce concentration risk.

Higher returns = higher risk

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

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:

- 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 the fund objective and purpose.

**Environment,
social and
governance issues**

Long term financial performance can be affected by environmental, social and governance issues. EQC encourages investments that take account of these issues, in particular by avoiding prejudice to New Zealand’s reputation in the global community.

Roles & Responsibilities

Board

The Board of Commissioners is responsible for:

- reviewing and approving the SIPSP,
- reviewing investment performance and directing that corrective action be taken, where appropriate, and
- ratifying the appointment of new investment managers or custodians.

**Administrator
(Chief Financial
Officer)**

The Administrator is responsible for:

- communicating and negotiating with external investment services providers,
- providing consolidated investment performance reporting,
- carrying out any investment-related transactions required, and
- other tasks related to the day-to-day management of the Fund.

**Investment
Approvers (as
stimulated in the
Delegations
Framework)**

Investment Approvers are responsible for:

- ensuring that transactions undertaken are in the best interest of the Fund,
- that the transaction is appropriate and supported by the correct documentation, and
- is within their financial approval level.

Chapter 2 –General Investment Policies

Overview

Introduction EQC will invest the Fund according to the investment policies outlined in the Ministerial Direction dated 27 July 2015. This excludes funds held in EQC’s transactional account.

This section describes EQC's general investment policies.

Eligible Asset Classes and Investments

Introduction The Fund shall be invested in the following asset classes:

- NZ Fixed Interest, and
- NZ Cash.

Eligible investments within these classes shall include only those listed in this topic. Any changes Require the Minister’s approval.

NZ Fixed Interest NZ fixed interest investments shall consist of Treasury bills, Government nominal bonds and Government inflation indexed bonds (“New Zealand Government Securities” issued or guaranteed by the NZ Government tradeable only through the New Zealand Debt Management Office.

Investment in Inflation Indexed Bonds will require approval from the Board on a case by case basis. In any case the maximum invested in Inflation Indexed Bonds shall be 15% 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 tradeable only through the New Zealand Debt Management Office, or
- issued in NZ by Approved banks.

Deposits, including Term Deposits (TDs) and accounts at approved banks may be utilised.

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.

Delegation to others EQC is authorised to delegate any of its investment functions or powers to one or more investment managers 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 and Operational Ranges

Asset allocation Maximum investment limits exist for each asset class to address liquidity and concentration risks.

Asset Class	Maximum Hold
NZ Fixed Interest	\$1,000m or 75% of portfolio
NZ Cash	\$1,000m

Other than these allocations EQC may balance the fund between asset classes as appropriate (e.g. as the fund diminishes it is likely that it may be held in the cash asset class).

Measuring Investment Performance

Benchmark The overall investment performance of the Fund shall be measured and compared to the S&P/NZX 90-day Bank Bill Index, less 25 basis points per annum as stipulated in the 27 July 2015 Ministerial Direction.

Individual asset classes will also be measured against this benchmark.

Reporting by EQC Management EQC Management shall provide monthly reports to the Board on portfolio performance and characteristics. These reports are provided by EQC's custodians, and reviewed by EQC Management. The reports as a minimum should include:

- Detail of how the fund is allocated between asset classes,
- Performance of the fund vs. benchmark,
- Return on each asset class held in the financial year

This reporting will take place when an investment strategy is being actively managed. When the natural disaster fund is low and being held primarily in transactional bank accounts, this reporting shall not take place.

Investment Management Structures and Mandates

Introduction EQC has ultimate responsibility for the management of all Fund assets. As EQC no longer has a dedicated investment team, Finance team members liaise with EQC's investment custodian, with direction and agreement from the Chief Financial Officer.

Peer reviews from alternative providers may be used for major pieces of work. Use of external resources will also be used to build internal knowledge.

Management of NZ fixed interest and cash EQC's Management is appointed to manage NZ Fixed Interest and Cash within authorised investment limits agreed by the Board and documented in the Delegations Framework.

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

Use of Financial Instruments

Currency exposure and hedging EQC no longer has any global Investments; however, it is still receiving tax rebates on global equities held previously. EQC does not hedge these positions and would need to seek Ministerial Approval if it wished to do so.

Derivatives EQC will not use derivatives in its fixed interest or cash portfolios.

Credit Risk Management

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

NZ Fixed Interest All NZ Fixed Interest securities must be issued or guaranteed by the NZ Government tradable only through the New Zealand Debt Management Office.

NZ Cash **Approved bank ratings**
All NZ Cash must be issued or guaranteed by the NZ Government 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. EQC 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.

Operational Risk Management

Introduction	Operational risk is the risk of financial loss due to mismanagement, error, fraud or unauthorized transactions.
Segregation of duties	All investment approvals involve segregation of duties, with two approved authorizers required to review and approve transactions before they are processed. Roles authorized to approve transactions are specified in the Delegations Framework.
External custodian	An independent custodian is engaged by EQC to record transactions, monitor compliance to the SIPSP and mandates plus report on performance.

Market Risks Management

Introduction	Market risks associated with investment of the Fund shall be managed as follows.
NZ Fixed Interest	The duration of the NZ Government Stock portfolio will become shorter than the duration of the benchmark over time, as Treasury issues longer-dated stock. This is in light of EQC being required to sell down the Government Stock portfolio in the course of meeting earthquake claims. The relevant EQC manager will engage with Treasury in regards to the maturity dates of the bonds it wishes to redeem.
NZ Cash	The relevant EQC manager shall ensure that the average duration of the NZ Cash portfolio shall not exceed 90 days.

Voting Rights

Voting Rights	As the fund no longer invests in equities, the exercising of voting rights is no longer relevant.
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Investment Redemptions and Liquidity

Natural disaster liquidity	<p>In the event of a major natural disaster likely to involve claims on EQC 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.</p> <p>In respect of investment redemptions of New Zealand government securities, EQC will maintain its present policy arrangements with the Treasury in respect of redeeming EQC's holdings of Treasury bills and New Zealand government bonds.</p> <p>In respect of the CES EQC will ensure that adequate liquidity is available to meet the projected profile of claims settlement.</p>
Other liquidity	<p>Liquidity for day to day working capital is to be maintained in on call or cheque accounts with Approved banks.</p> <p>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.</p> <p>Should the net assets of the Fund decrease to less than \$200 million, EQC must notify the Minister of this fact as soon as practicable after the occurrence of this event.</p>