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Funding and Risk Management Statement for Natural Hazards Commission Toka Tū Ake

Hon David Seymour
Associate Minister of Finance

2024 –2029

New Zealand Government

Funding and Risk Management Statement for Natural Hazards Commission Toka Tū Ake

Ministerial Foreword

I am pleased to present the inaugural Funding and Risk Management Statement issued under section 136 of the Natural Hazards Insurance Act 2023 (**NHI Act**). This statement marks a significant milestone in our commitment to ensuring the sustainable management of costs and risks associated with natural hazard claims.

As New Zealanders navigate through an era of increasing environmental challenges, it is imperative to foster public confidence in our ability to effectively manage and fund claims arising from natural hazards. This statement embodies our dedication to transparency, accountability, and prudent financial management.

The purpose of the Funding and Risk Management Statement includes ensuring transparency and confidence in managing the costs associated with claims and to communicate the financial strategy of the Crown concerning the funding of these costs of the Scheme over the next five years.

Initial assessments for this Funding and Risk Management Statement have indicated that the current levy rate is insufficient to cover the provisions of natural hazard insurance under the NHI Act (the **Scheme**), along with associated administration costs and reinsurance premiums. This evaluation considers the estimated annualised costs of infrequent but very costly events, such as a large earthquake or tsunami.

The current levy rate of 16 cents per $100 dollars of cover will remain in place for now. While acknowledging the inadequacy of the current levy rate for covering long-term costs, I consider that the current levy rate is sufficient to meet known short-term financial obligations. In the event a major natural disaster occurs, and the Natural Hazard Fund's (the Fund) assets are insufficient to cover payments forecasted for the next 12 months, the Crown is still obliged to provide loan or grant support under section 112 of the NHI Act.

Given the Crown's support for the Scheme, including under section 112 of the NHI Act, I am confident that the Natural Hazards Commission Toka Tū Ake will always have sufficient funds to meet claims as they fall due. In accordance with section 139(1)(b) of the NHI Act, I have decided to undertake a review of the financial settings and levy settings. This decision underscores the Crown's commitment to ensuring that the financial mechanisms underpinning the scheme are both adequate and appropriate.

The forthcoming review will take into account a range of risk-sharing options and will involve thorough financial projections of different funding options. It will build on our preparations for the first Funding and Risk Management Statement.

I propose that any changes to financial settings or levy settings to be implemented at least six months after Cabinet decisions. This buffer period is intended to provide notice to insurers and homeowners, including sufficient time for insurers, who collect the levy on behalf of the Natural Hazards Commission, to adapt to any change. Depending on the outcomes of the review a longer implementation period may be justified. This is a matter on which officials will engage with stakeholders.

This review may mean changes to the settings in this Funding and Risk Management Statement, and we look forward to engaging with stakeholders during this process to achieve the best possible outcomes for New Zealanders.

In conclusion, I extend my gratitude to all those who have contributed to the development of the first Funding and Risk Management Statement for the Natural Hazards Commission Toka Tū Ake.

Yours sincerely,

Hon David Seymour
Associate Minister of Finance
27 June 2024

Purpose of the Funding and Risk Management Statement

This Funding and Risk Management Statement is prepared in accordance with the provisions outlined in Natural Hazards Insurance Act 2023 (the **NHI Act**), issued under section 136. The Natural Hazards Commission Toka Tū Ake (the **Commission**) must give effect to this statement when executing the functions of the Commission under section 129(b) and (d) of the NHI Act.

The purpose of the Funding and Risk Management Statement is to foster confidence through transparency, accountability, and prudent fiscal management. Section 136(2) provides that the purpose of the Funding and Risk Management Statement is to:

(a) Support public confidence in the costs of claims being met by providing transparency about how those costs will be shared between the Fund and the Crown; and
(b) Provide transparency about how financial settings and levy settings are determined; and
(c) Communicate the Crown’s financial strategy in relation to the funding of those costs and its impact on the financial settings and levy settings; and
(d) Set out requirements relating to the investment of the Fund that the Commission is required to comply with under section 115(3)(b); and
(e) Provide guidance to the Commission in performing its functions under section 129(b) and (d).

Content of the Funding and Risk Management Statement

1. ***Financial Settings and Levy Settings:***
The Funding and Risk Management Statement outlines the current financial settings and levy settings and any proposed changes to them.

2. ***Financial Projections:***
The Funding and Risk Management Statement outlines the financial projections, including estimates of the costs of providing natural hazard cover, the amount in the Natural Hazard Fund (the **Fund**), and the financial implications of proposed changes to financial settings or levy settings.

3. ***Methodology and Assumptions:***
The Funding and Risk Management Statement outlines the methodologies, assumptions, and forecasts utilised in preparing the financial projections.

4. ***Policy Considerations:***
The Funding and Risk Management Statement outlines the policy considerations taken into account by the Minister during the preparation of the Statement.

5. ***Risk Allocation and Government Strategy:***
The Funding and Risk Management Statement outlines the current and projected allocation of risk between the Crown and the Fund, along with the Government's strategy to reduce or finance any deficiency in the Fund.

6. ***Investment Guidelines:***
The Funding and Risk Management Statement outlines the Commission’s investment guideline for the Fund, determined by the Minister, in consultation with the Commission. This replaces two Ministerial Directions that related to the investment of the Fund.

7. ***Commission's Functions:***
The Funding and Risk Management Statement includes copies of any current directions or letters of expectation given by the Minister to the Commission concerning its functions under sections 129(b) and 129(d) of the NHI Act. Section 129(b) provides for the Commission to manage the Fund, including investing the Fund, in accordance with the Act. Section 129(d) provides for the Commission to arrange reinsurance or other risk transfer products in respect of all or part of natural hazard cover.

Commencement

This Funding and Risk Management Statement will come into force on 01 July 2024, with the commencement of the NHI Act. At least once every five years, the Minister is required to produce a Funding and Risk Management Statement for the subsequent five-year period. This Funding and Risk Management Statement remains in force until replaced by a new one. The Funding and Risk Management Statement must be consistent with the requirements of the NHI Act.

Implementation and Transparency

This Funding and Risk Management Statement will be presented to the House of Representatives and made available on the Commission's website.

Conclusion

This Funding and Risk Management Statement aims to provide clarity and transparency in managing the financial aspects of natural hazard cover. It serves to foster public confidence that the cost of claims will be met. By adhering to the legislative requirements and objectives outlined in section 136 and section 138 of the NHI Act, it aims to foster public trust and facilitate effective decision-making in safeguarding against natural disasters.

This Funding and Risk Management Statement remains effective until replaced by a subsequent statement, as stipulated by the legislative framework.

The Commission's Objectives/Scheme's Purpose

New Zealand faces a range of natural hazard risks. Established in 1945, the Natural Hazards Insurance scheme (the **Scheme**)[1] exists to provide New Zealand homeowners with an accessible, sustainable way to manage financial impacts of natural hazard events by providing natural hazard cover (**NHCover**).

NHCover supports affordable access to natural hazard insurance for New Zealand homeowners (dwellings and some coverage of land). By assuming a significant portion of the risk, NHCover helps prevent a scenario where homes would be uninsured or underinsured for natural hazard damage. This proactive approach strengthens communities' ability to recover after a natural hazard event.

Homeowners with private home insurance including fire cover are entitled to NHCover for loss or damage from earthquakes, volcanic eruptions, landslips, hydrothermal activity, tsunami, and natural disaster fire. Residential dwellings are generally insured for a maximum amount of $300,000 + GST through the Scheme. Any cover beyond this cap is through private insurance.

NHCover also applies to some land damage, including for storms and floods. NHCover for land has clear limits set out in the NHI Act and is generally intended to cover the land needed to support or access a home.

The NHI Act establishes a Crown entity, Natural Hazards Commission Toka Tū Ake (the **Commission**), to administer the Scheme. Its primary objective is to reduce the impact of natural hazards on people, property, and the community. The Commission's functions are to (among other things):

- Facilitate research and education, and contribute to the sharing of information, knowledge, and expertise on natural hazard risks, impacts and resilience
- Collect the levy for the insurance provided under the NHI Act
- Manage the Fund, including by investing in the Fund in accordance with the NHI Act
- Arrange reinsurance or other risk transfer products in respect of all or part of natural hazard cover
- Administer natural hazard cover when claims arise
- Undertake additional functions specified in legislation or conferred by the Minister.

The Scheme, including the insurance it provides and the Commission's functions above, is funded primarily by the NHI levy.

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1 The Scheme has been known by other names over time, most recently as 'EQC Scheme' under the Earthquake Commission Act 1993.

1. Financial Settings and Levy Settings

The Funding and Risk Management Statement outlines the current financial settings and levy settings and any proposed changes to them.

Section 134 of the NHI Act sets out the components that are defined as financial settings and levy settings.

The Act does not require the Minister to review the financial settings or levy settings for this first Funding and Risk Management Statement. Unless specified in the NHI Act, these settings are consistent with those under the Earthquake Commission Act 1993.

Financial settings

The financial settings and their values are set out in the following table[2].

Financial settings		Reference in Act	Value
(a)	building cover excess	section 31(2)(b)	$500 (including GST) per dwelling
(b)	building cover cap (where the insurance contract specifies a replacement sum insured)	section 35(2)	Specified replacement sum insured to a maximum of $300,000 plus GST per dwelling
	building cover cap (where the fire contract specifies an amount for which the residential building is to be insured)	section 36	the greater of the amount specified and the insured floor area multiplied by $2,500 plus GST, with a maximum payable of $300,000 plus GST per dwelling
	building cover cap (where neither section 35 or section 36 apply)	section 37	$300,000 plus GST per residential dwelling
(c)	land cover excess	section 39(2)(b)(i)	$500 (including GST) per dwelling
	land cover excess (maximum payable)	section 39(2)(b)(ii)	maximum $5,000 (including GST)
(d)	cap for retaining walls	section 43(1)(b)(ii)	$50,000 plus GST per dwelling
	cap for bridges or culverts	section 43(1)(c)(ii)	$25,000 plus GST per dwelling

[2] Note that claims are paid based on the applicable settings at the time the claim occurred, so the Commission will continue to pay claims based on previous settings where relevant.

Levy settings

Levy settings	Value
The rate of the levy, or the method for determining the rate of the levy, set out in the regulations made for the purposes of section 116.	16 cents per $100 dollars of cover

The Minister has decided to undertake a review of the financial settings and levy settings in accordance with section 139(1)(b) of the NHI Act. In undertaking this review, the Minister may have regard to a range of statutory criteria, including the potential impacts of any changes on insured individuals, fire insurers, the Crown, and other affected parties, as well as the availability, affordability, and uptake of catastrophe insurance for residential buildings.

2. Financial Projections

The Funding and Risk Management Statement outlines the financial projections, including estimates of the costs of providing natural hazard cover, the amount in the Natural Hazard Fund (the **Fund**), and the financial implications of proposed changes to financial settings or levy settings.

Estimates of the costs of providing natural hazard cover

The nature of the natural hazard events covered by the Scheme means that the costs arising in any single year can vary considerably, particularly if a significant natural hazard event occurs. Analysis for this statement has dealt with this uncertainty through considering the Average Annual Loss (AAL) occurring under the cover for each natural hazard. This represents the average loss of modelled potential events, weighted by their probability of occurrence. This is intended to represent the long-term cost of all events and spread this cost across the generations of levy payers. This is particularly important for the Scheme which covers very high cost but low probability events, such as the Canterbury Earthquake Sequence. This approach is in line with industry practice.

A formal independent review of the costs of providing the Scheme was undertaken by the Commission's actuaries, in conjunction with scientific advice from GNS and NIWA on the likelihood and cost of natural hazard events. This involved consideration of:

- the costs of running the Scheme and operating the Commission
- the AAL of the natural hazard covered under the Scheme, and associated claims handling expenses (CHE)
- the net cost of risk financing – this is the cost of putting in place reinsurance and other risk transfer arrangements, less expected recoveries. This has been calculated under the Board of the Commission's recommended programme (3 cents per $100 of cover).

These estimated costs and expected levy income at the rate of 16 cents per $100 of cover are set out in Table 1 below, by year of the Funding and Risk Management Statement. These estimates are on an incurred basis, so represent the estimated final costs and recoveries for events that occur in the year, even though payments for those events and reinsurance recoveries might be paid over a number of years.

These show a shortfall against the average annual cost of providing the Scheme which, if modelled experience is borne out, will need to be met either by future levy payers or through section 112 of the NHI Act. The cost estimates indicate that the Scheme will be underfunded by approximately 34% over the five-year period. This is before allowance for any interest that may become payable on Crown support provided as a loan rather than a grant.

Table 1 - Estimated costs of providing the cover under the NHI Scheme

Year beginning	1 July 2024 ($m)	1 July 2025 ($m)	1 July 2026 ($m)	1 July 2027 ($m)	1 July 2028 ($m)	Total ($m)
NHC expenses	107	110	110	112	115	553
AAL including CHE	980	1,044	1,114	1,190	1,273	5,603
Net cost of risk financing	160	170	188	176	183	877
Total costs	1,247	1,324	1,412	1,478	1,571	7,033
Estimated levy income	865	895	925	956	988	4,629
Shortfall	(382)	(429)	(486)	(522)	(584)	(2,403)

Projection of the balance of the Fund

A financial projection of the value of the Fund is shown below. The projection allows for:

- The Commission's proposed risk financing programme, including an allowance for increases in reinsurance premiums that might occur following a major event
- The likely timing of claim payments and reinsurance recoveries after a major event – this can be up to several years
- An estimated opening balance representing the Commission's envisaged cash position as at the opening date of this Funding and Risk Management Statement
- Projected payments in respect of existing liabilities from past events, for example, the Canterbury Earthquake Sequence and the North Island weather events in early 2023; and
- Investment earnings at 6% per annum on the Fund's assets.
- The Fund to go into debt if outgoings exceed income, with interest at 4.5% per annum on any negative cash balance. This will be met by way of loans or grants via section 112 of the NHI Act. The modelling illustrates the impact on the Fund balance assuming the costs are met by interest bearing loans.

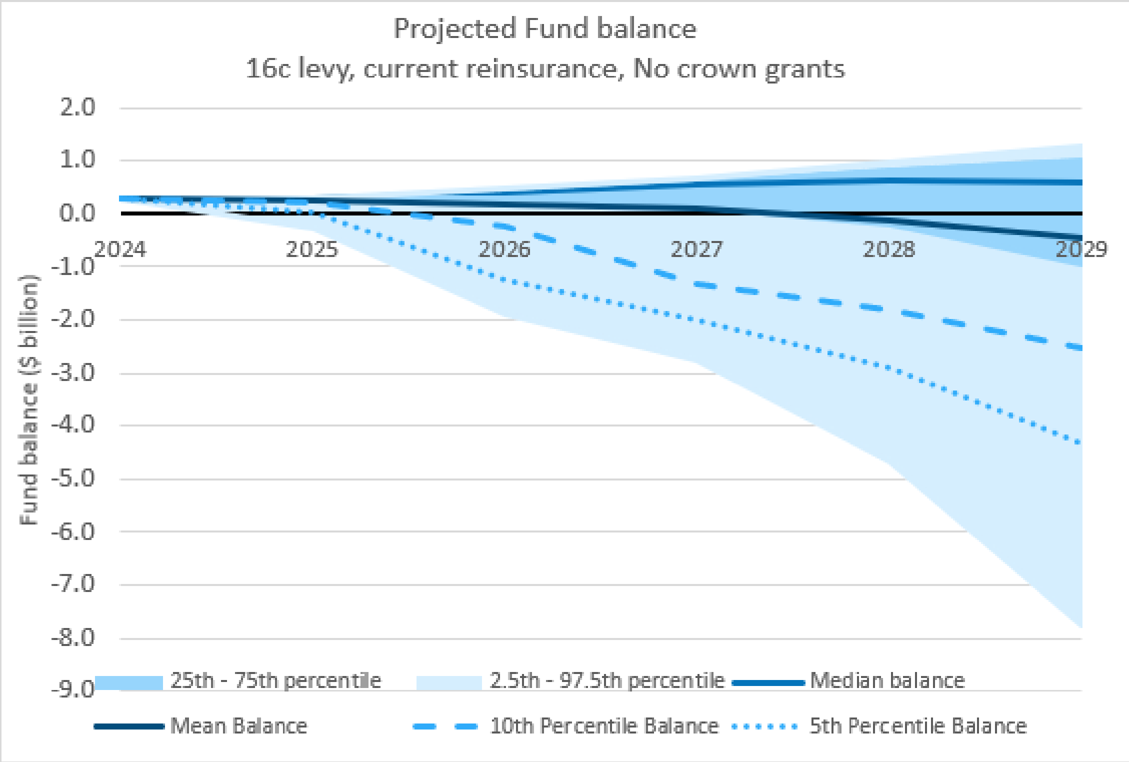
Further details of the modelling assumptions are given in Section 3 or are available from the Commission.

The financial projection is shown as a probability distribution to reflect the uncertain nature of the Commission's future liabilities. This was developed using a stochastic model of possible natural hazard event occurrences and their financial implications over 100,000 iterations. It shows:

- The mean balance – being the average of all iterations
- The median balance – being the middle iteration
- The inter-quartile range – being the middle 50% of iterations; and

- A 95% confidence interval – the range of potential outcomes excluding the 2.5% best and worst outcomes.

Figure 1 - Projected Fund balance



In understanding the cash flow projection, it should be borne in mind that as liabilities from major events arise, it will take time for claims to be settled and cash to be paid from the Fund, hence the net financial position in the Commission's financial statements is generally worse than the cash position.

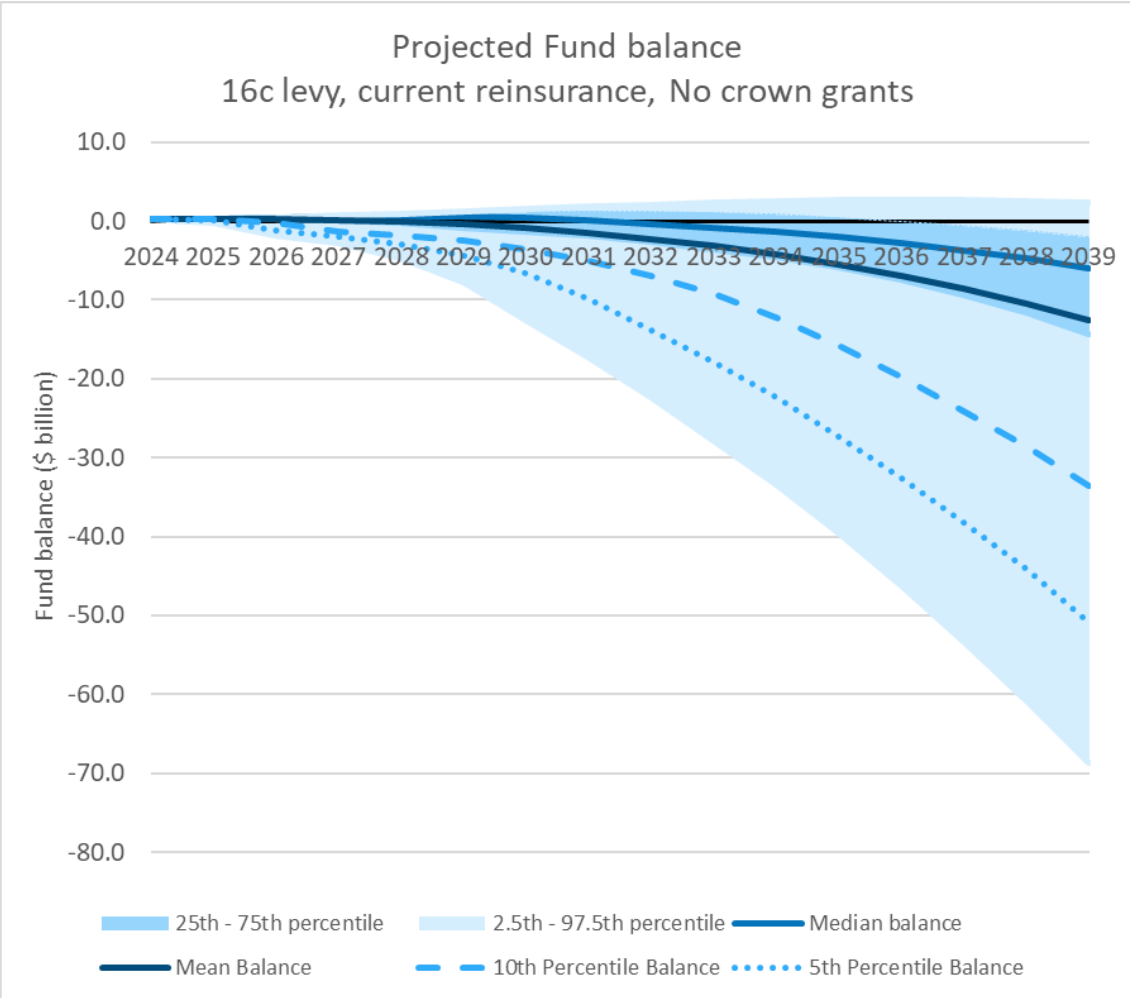
The financial implications of the current financial settings and levy settings

The analysis of the likely costs of providing the Scheme (Table 1) indicates that the Scheme is currently underfunded by approximately 34% over the first five years from the NHI Act's commencement, i.e., the current levy is inadequate for the Scheme to be self-sustaining. While this levy income may fund claims if experience is good, this shortfall will restrict the build-up of assets in the Fund to help meet claim costs when there is a more significant event in the future. A lack of accumulated funds also impacts the Scheme's ability to meet the Scheme's reinsurance deductible (excess), currently around $2 billion.

The Figure 1 indicates that this underfunding alongside the low Fund balance and ongoing claims costs from past events means there is more than a 28% probability that the Commission will need to draw on the Crown support by 2028, and 35% by 2029. The median balance of the Fund is projected to start to decrease from 2028 and the mean balance is expected to be negative as the Scheme's cash outgoings exceed levy income under assumptions of ongoing natural hazard experience. However, if there are no major natural hazard events in the five-year period, the Fund could grow to in excess of $1.2 billion to contribute to future events.

Looking at a similar graph over 15 years (Figure 2), it indicates that if the levy settings and other settings continue to be maintained at the current level, the Scheme has only a 13% probability of having funds by 2037.

Figure 2 - Projected Fund balance over 15 years at current settings



3. Methodology and Assumptions

The Funding and Risk Management Statement outlines the methodologies, assumptions, and forecasts utilised in preparing the financial projections.

Stochastic modelling of the Fund

The Commission's actuaries stochastically modelled the expected growth of the Fund over a 15-year period using a proprietary risk and capital modelling software package. The model is run across one hundred thousand possible scenarios and thereby builds up a picture of a wide range of possible outcomes and their likelihood.

This enables projection of the expected build-up of the Fund over time based on a random selection of possible future natural hazard events. It can also be used to assess the impact of different reinsurance strategies on the expected Fund size.

Key assumptions within the model

Exposure and portfolio growth

It is assumed that the Commission insures 1.9 million properties at the commencement of the projection. This assumes that 95% of eligible residential properties have NHCover through a private domestic property insurance policy. This number is assumed to grow in line with historical trends from Statistics NZ dwelling unit count.

Operating costs and other expenses

Operating costs are based on the Board of the Commission's approved forecasts, submitted as part of Treasury's 2023 Half-Year Economic and Fiscal Update exercise, which cover the first three projection years and are then assumed to increase by 2% per year. The budget figures allow for relevant inflationary effects such as Consumer Price Index and wage growth.

Claims handling expense (CHE) ratios are estimated separately for Business-As-Usual (BAU) losses and for claims resulting from a catastrophe event, based on past experience. Claims handling costs will increase in line with claims costs which are assumed to increase with inflation.

Other expenses include fixed fees remitted to insurers as part of claims handling expenses, including operational administrative costs. These fees have been adjusted for inflation based on the Labour Cost Index as at 30 June 2023.

Reinsurance

The reinsurance programme structure used in each of the model projections is assumed to remain the same throughout the projection period. Reinsurance premium rates are assumed to increase after a major event. The expected reinsurance premium increases each year based on expected losses.

An allowance is made for brokerage fees payable under the Commission's brokerage contract, and the expenses related to the Commission's current catastrophe bond.

Losses and payment patterns

Losses are split into attritional losses – small events that occur frequently during a year - and catastrophe losses, which require specialised modelling for each natural hazard.

Attritional losses are based on an analysis of historical trends and estimated to be $25.19 per property per year, increasing by the assumed rate of building inflation each year for the projection period.

Catastrophe losses for tsunami, volcano and earthquake are randomly generated in each projection year.

- Earthquake losses are estimated using the Commission's PRUE loss modelling tool and include the 2022 National Seismic Hazard Model.
- Volcano and tsunami Average Annual Losses and Event Loss Tables were provided by GNS, the New Zealand government entity with specialist knowledge in these natural hazards which are not currently modelled by the Commission.
- Earthquake and Volcano losses are assumed to increase over time in line with exposure and inflation. Tsunami losses are assumed to increase in line with exposure only.

Payment patterns are incorporated into the modelling reflecting that it takes time for claim settlements to be made following a natural hazard event. The patterns are based on observed experience for past events.

Other assumptions

- The assumed investment return on any cash and investments Fund balance is 6%.
- Inflation was accounted for using Statistic NZ indices and projected inflation, including a separate allowance for building cost inflation. Building cost inflation is assumed to be 5.7% per annum for the period 2024-2029.

Further detail on key assumptions

Further detail on the derivation of key assumptions is available from the Commission upon request.

4. Policy Considerations

The Funding and Risk Management Statement outlines the policy considerations taken into account by the Minister during the preparation of the Statement.

Under Section 13 of Schedule 1 of the NHI Act, a review of the financial settings and levy settings is not required for the initial Funding and Risk Management Statement. Instead, the initial Funding and Risk Management Statement is based on existing financial settings and levy settings continued under the NHI Act.

Accordingly, the key policy considerations taken into account during the preparation of this Funding and Risk Management Statement relate to:

- the Government's strategy to reduce or finance any deficiency in the Fund, set out in section 5; and
- the investment mandate for the Fund, set out in section 6.

Government strategy
The policy considerations taken into account for the Government strategy for addressing any deficiencies in the Fund, specified in section 5 of this Funding and Risk Management Statement, are outlined in that section.

Investment Guidelines
The requirements relating to the investment of the Fund, set out in section 6 of this Funding and Risk Management Statement, include allowance for diversification of the Fund that has the potential to lead to higher returns than the current Ministerial Directions related to the investment of the Fund allow. This has taken into account the policy objective of preserving the real capital value of the Fund, thereby safeguarding its ability to meet future obligations without unduly burdening levy payers.

5. Risk Allocation and Government Strategy

The Funding and Risk Management Statement outlines the current and projected allocation of risk between the Crown and the Fund. It also describes the Government's strategy to reduce or finance any deficiency in the Fund.

Current and projected allocation of risk between the Crown and the Fund

The Natural Hazard Insurance scheme insures New Zealanders against natural hazard events which range from a few hundred dollars in losses to many billions of dollars. Whilst the collection of a levy from insured homeowners contributes to the cost of providing cover under the scheme, the Crown retains the ultimate risk if the accumulated levies and investment earnings in the Fund, alongside any applicable reinsurance recoveries, are insufficient to meet the costs of claims as they arise.

The risk to the Crown is dependent on:

- the level of the Fund (including past liabilities which need to be funded)
- the level of levy income, and
- the risk transfer programme implemented by the Commission.

In the short term, the Crown can alter the risk it accepts by changing the rate of the levy. Growing the balance of the Fund is a longer-term lever, which is dependent on levy income, investment earnings, the risk transfer programme, and the occurrence of natural hazard events.

At the commencement of this Funding and Risk Management Statement, the level of risk borne by the Crown is relatively high. The levy settings have not been reviewed since the new National Seismic Hazard Model (released October 2022) greatly increased the estimated risk of the Scheme. The Fund balance is low and significant risk arises from the shortfall between the Fund balance and the amount at which the Commission’s reinsurance programme comes into effect.

The current level of risk transfer, estimated to cost approximately 3 cents for each $100 of cover insured, has been allowed for in the projections within this Funding and Risk Management Statement. The reinsurance programme currently attaches at around $2 billion, representing the Board’s view of an efficient trade-off between cost and protection.

Estimating the risk to the Crown

The risk to the Crown arises on a cashflow basis, while the estimation of the cost of providing the Scheme is carried out on an expected average annual cost basis (akin to an accrual basis).

Funding the Scheme on an average annual cost basis underpins the principles of scheme sustainability and inter-generational equity.

Measuring the risk to the Crown over a defined period on a cash-flow basis may underestimate the impact of choices – for example, funding and reinsurance purchases – that may continue to be felt for many years afterwards. It should therefore be considered as part of a range of metrics about the scheme.

The Commission's actuaries have estimated an expected draw on the Crown support of $1,014 million over the five-year period of the Funding and Risk Management Statement. This has been determined across 100,000 modelled scenarios, many with no Crown funding needed, and some with very high needs. 35% of scenarios result in a need for funding assistance at some point. This can be thought of as a 35% probability of drawing on the Crown support in the next five years at the current settings. The modelled probabilities of various levels of funding assistance are shown in Table 2 below.

Table 2 – Probability of scheme requiring funding assistance over five-year period by funding range

Draw on Crown support over five years	**Probability**	**Average amount ($ million)**
No draw	65%	0
Less than or equal to $0.5bn	7%	235
$0.5bn – $1bn	4%	732
$1bn – $2bn	12%	1,479
$2bn – $5bn	9%	3,064
Greater than $5bn	4%	12,661

The share of risk borne by the Crown over the five-year period has been considered relative to the cash available via the Fund to support claim payments over the coming five years (see Table 3). The share of risk is impacted by the choice of risk transfer purchase, and this is reflected in the analysis.

Table 3 - Determination of Crown share of risk

		$ million
Starting Fund balance		292
Less	Estimated liabilities from previous events at the start of the Funding and Risk Management Statement expected to be paid during Funding and Risk Management Statement period	-471
Less	Expenses of running the scheme	-553
Less	Risk transfer costs	-2,454
Plus	Estimated levy income during Funding and Risk Management Statement period	4,629
Plus	Estimated investment income received	112
Plus	Estimated reinsurance recoveries received	751
Equals	Funds contributed by Fund	2,306
Estimated draw on Crown support		1,014
Total envisaged funding		3,320
Proportion of total funding borne by Crown		31%

The risk borne by the Crown can be considered as its share of non-expense related post reinsurance costs, being $1,014m from $3,320m in total, or 31% if support is provided via grant. Providing support via a loan reduces the risk to the Crown.

Government strategy to reduce or finance any deficiency in the Fund

Initial assessments for this Funding and Risk Management Statement have indicated that the current levy rate is insufficient to cover the expected long-term costs of the Scheme, including associated administration costs and reinsurance premiums. Under section 112 of the NHI Act, Crown support (by way of loan or grant) applies in the case of the assets of the Fund being insufficient to pay the amounts forecast to be due and payable out of the Fund under section 111 of the NHI Act in any upcoming 12-month period.

In terms of financing mechanisms, under section 112 the Government is required to provide liquidity by way of loans or grants, bridging any funding shortfalls within the Fund. The Government's approach will be characterised by prudence and responsibility, when deciding whether to fund any insufficiency in the Fund by way of loans or grants, without imposing undue burdens on levy payers.

As part of the financial settings and levy settings review, the Minister will consider the merits of offering loans rather than grants by utilising Crown financing, enabling the Scheme to cover claims through future levies. This approach aims to manage uncertainties about Crown support as per section 112 of the NHI Act. The review will consider a range of scenarios to test the implications on the Scheme of different financing mechanisms and capacities and how these may align with the Crown's risk appetite. Providing a loan facility that reflects the Crown's borrowing costs will result in levy payers meeting the claims costs of an event from future levies if those costs exceed the accumulated value of the Fund. The Minister will retain the ability to provide additional support as grants.

Policy considerations taken into account in forming the Government strategy

The Government's strategy to address any deficiencies in the Fund is underpinned by a set of policy considerations aimed at ensuring the long-term resilience and effectiveness of the Scheme. These policy considerations outline that the Scheme should strive to be self-sustaining, avoid excessive levy volatility, ensure its management of volatility is efficient in the long-term, and sufficient liquidity is available to pay claims from natural hazard events when they fall due.

Recognising the broader fiscal imperatives facing the Government, the decisions made should acknowledge the need to balance the funding and financing objectives of the Scheme with broader fiscal objectives, such as reducing New Zealand's net debt to a sustainable level relative to GDP. Therefore, the Government may, from time to time, overlay an additional risk appetite related to the condition of the Crown balance sheet in its decision making on the scheme.

Overall, this Government strategy represents a concerted effort to ensure the financial resilience and sustainability of the Fund while minimising adverse impacts on levy payers and the broader economy. By considering these policy considerations, the Government aims to balance between fiscal prudence, risk allocation, and to provide effective support in the aftermath of natural disasters.

6. Investment Guidelines

The Funding and Risk Management Statement outlines the Commission's investment guideline for the Fund, determined by the Minister, with consultation with the Commission.

Purpose

The purpose of the Fund is to provide for payment of claim settlement costs and the other amounts as set out under section 111 of the NHI Act.

Investment objectives of the Fund

1) The Commission is responsible for investing the Fund, under section 115 of the NHI Act.

2) Subject to subsections (2) and (3) of the section 115 under the NHI Act, the Commission must invest the Fund on a prudent, commercial basis that is consistent with —

   a. Best-practice portfolio management; and

   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.

Risk appetite

The Commission must invest the fund having regard to the amounts required to be paid out of the Fund under section 111 of the NHI Act.

Other requirements

- The Commission must have regard to the requirements on section 112 of the NHI Act for the Minister to make one or more payments into the Fund.
- The Fund should be invested in liquid, publicly traded assets.[3]
- Derivatives can be used to hedge risk but not to take leverage.
- The Fund is prohibited from using leverage.
- The Fund should be well diversified.
- When forecasts indicate a probable payment under section 112 of the NHI Act within a 12-month period, there is an expectation for minimising investment risk since the timing of impending liabilities can be predicted.

[3] Includes cash and term deposits.

Statement of Investment Policies & Objectives

- The Commission must prepare, and adhere to, a Statement of Investment Policies & Objectives for the Fund that must cover (but is not limited to):
  - Long-term performance objectives and expected tracking error;
  - Asset classes which the Fund can invest in and the selection criteria for investments within those classes;
  - Benchmarks against which the performance of the Fund as a whole, and classes of investments, will be assessed;
  - Investment Beliefs;
  - Rebalancing Policy;
  - Responsible Investments Policy;
  - The return expectation is consistent with the level of risk taken in the fund;
  - The use of options, futures and other derivative financial instruments;
  - The management of credit concentration, liquidity, operational, currency, interest rate, market and other financial risks;
  - Voting Policy;
  - The method of, and basis for, valuation of investments that are not regularly traded at a public exchange; and
  - Prohibited or restricted investments or any investment constraints or limits.
- The Commission must consult with the Minister of Finance ("the Minister") if it intends to modify the Statement of Investment Policies & Objectives to any substantive degree.
- The Commission must review the Statement of Investment Policies & Objectives for the Fund at least annually.

Implementation

In developing the *Investment Guidelines* for this statement, the Minister has revoked two Ministerial Directions which have governed the investment and management of the Fund under the previous Act. Over the course of 2024/25 the Commission will be developing a new Statement of Investment Policies & Objectives that are consistent with the FRMS.

Until the new Statement of Investment Policies & Objectives for the Fund is finalised and agreed, the Commission will manage the Fund in accordance with its existing Statement of Investment Policies Standards & Procedures.

7. Commission's Functions:

The Funding and Risk Management Statement includes copies of any current directions or letters of expectation given by the Minister to the Commission concerning its functions under section 129(b) and 129(d) of the NHI Act. Section 129(b) provides for the Commission to manage the Fund, including investing the Fund, in accordance with the Act. Section 129(d) provides for the Commission to arrange reinsurance or other risk transfer products in respect of all or part of natural hazard cover.

Ministerial Directions

The table below provides the Ministerial Directions currently applied to the Commission. Note that this is a full list of Ministerial Directions, not only those concerning the Commission's functions under section 129(b) and (d).

Table 4

Topic of Direction	Description	Date of Direction	Link
Damage apportioned to unclaimed events	A Direction allowing the Commission to make payment in relation to building damage apportioned to events that formed part of the Canterbury earthquake sequence, even where the insured person did not notify the Commission of damage for each event in the sequence.	19 December 2012	Direction to the Earthquake Commission Pursuant to Section 112 of the Crown Entities Act 2004 - 2013-go8055 - New Zealand Gazette
Amendment to previous direction	A Direction amending the Direction effective 19 December 2012 such that no excess applies in respect of the unclaimed event.	19 December 2013	Amendment to Direction to the Earthquake Commission - 2013-go7997 - New Zealand Gazette
Land damage apportioned to unclaimed events	A Direction allowing the Commission to pay out on land damage apportioned to events that formed part of the Canterbury earthquake sequence, even where the insured person did not notify the Commission of damage for each even in the sequence.	20 October 2015	Direction to the Earthquake Commission Pursuant to Section 112 of the Crown Entities Act 2004 - 2015-au6388 - New Zealand Gazette
Administering the On-sold programme	A Direction to administer the support package established by the Crown for qualifying owners of On-Sold properties.	07 October 2019	Direction to the Earthquake Commission - 2019-go4839 - New Zealand Gazette

Topic of Direction	Description	Date of Direction	Link
Acting as agent for Southern Response Earthquake Services Limited (SRES)	A direction to the Commission that the Commission may act as agent for SRES for the purposes of administering open insurance claims against SRES in respect of damage arising from the Canterbury earthquakes, being claims that exceed, or may exceed, the cap. In performing the additional function under this Direction, the Commission must act in accordance with the terms and conditions of the agency agreement dated 21 October 2019 between the Commission and SRES (as varied by agreement between the parties from time-to-time following consultation with the Minister).	21 October 2019	Direction to Extend Function of EQC Earthquake Commission to Act as Agent for Southern Response - 2019-go5031 - New Zealand Gazette
Replacing certain storm water and sewerage services and structures under the Canterbury earthquake sequence	A Direction to pay the amount of the damage to or replace or reinstate (at the Commission's option), any storm water and sewerage services and structures appurtenant to them that suffered damage as the direct result of one or more of the 2010-2011 Canterbury earthquake sequence.	01 December 2021	Direction to the Earthquake Commission Pursuant to Section 112 of the Crown Entities Act 2004, as Permitted by Section 5(1)(f)(ii) of the Earthquake Commission Act 1993 - 2021-go5373 - New Zealand Gazette

Letters of Expectations

Ministers send a letter of expectations to Crown Entities, usually on an annual basis, outlining expectations for the year ahead. Note that this is not a legislative requirement but should be considered by the Board when developing other legislative accountability documents, such as the Statement of Performance Expectations.

The letters of expectations are published on the Treasury website.

Definitions

In this Funding and Risk Management Statements, terms not defined below have the meaning given to them in the NHI Act.

Attritional losses
Attritional losses, often referred to as business-as-usual (BAU) losses, are every day, non-catastrophic insurance claims that result from routine occurrences within a business's normal operations, distinct from major events.

Average Annual Loss (AAL)
Average Annual Loss represents the expected financial loss over a one-year period due to a specific risk or set of risks.

Cap

- in the case of a residential building claim, the statutory amount set out in section 35 - 37 of the NHI Act; and
- in the case of a residential land claim, the statutory amount set out in section 39 of the NHI Act.

Catastrophe bond or 'cat bond'
A financial instrument used to transfer the risk of catastrophic events from the insurer to investors. Catastrophe bonds are a way for the insurance and reinsurance industry to access additional capital to cover large-scale and infrequent risks.

Claims handling expenses (CHE)
The costs associated with processing and settling claims, outside of the settlement for the damage.

The Commission
Means Toka Tū Ake – Natural Hazards Commission continued by section 125 of the NHI Act. The Commission is a Crown entity for the purposes of section 7 of the Crown Entities Act 2004.

Cost of risk financing
Expenses incurred by an organisation to transfer or manage its financial exposure to various risks. This cost encompasses the fees, premiums, or expenses associated with mechanisms such as insurance, reinsurance, risk retention, or other financial strategies used to mitigate the potential negative impact of uncertain events. The net cost of risk financing refers to these costs, less expected recoveries from the risk transfer programme.

EQC Act
Earthquake Commission Act 1993.

Excess
The initial portion of the loss that the policyholder must bear.

Incurred but not reported (IBNR)
Any claim or claim amount that, at a particular point in time, pertains to a loss event that has already occurred, but the insurer has not yet been notified and/or the claim has not entered the claims system.

Liability
A present obligation of the entity, arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits.

Natural Hazard Fund (Fund)
A financial reserve managed by the Commission and funded through levies and investment returns, and payments made by the Minister (which are required by section 112 if the assets of the Fund are not sufficient to pay the amounts forecast to be due and payable out of the Fund under section 111 in any upcoming 12-month period). The purpose is to ensure that insurance claims can be paid out in the event of a natural disaster. It follows on from the Natural Disaster Fund under the EQC Act.

National Seismic Hazard Model (NSHM)
A model which estimates likelihood and intensity of earthquake shaking across the whole of New Zealand over the next 100 years. This is the main hazard input for loss modelling. The NSHM team is led by GNS Science.

NHCover
The natural disaster insurance for residential buildings and associated residential land under the EQC Act. It follows on from EQCover under the EQC Act.

NHI Act
Natural Hazards Insurance Act 2023.

PRUE
The Commission's loss modelling tool, based on the RiskScape® risk modelling software developed by GNS and NIWA.

Scheme
The provision of natural hazard insurance to insured New Zealand homeowners under the NHI Act, implemented in accordance with the financial and levy settings and other relevant requirements of the Act and associated regulations or instruments.