2021 Interim Financial Report

Providing our customers with financial security for retirement

challenger.com.au
Challenger Limited ACN 106 842 371

Contents

Key dates

23 March 2021
Interim dividend payment date

10 August 2021
Full year financial results

22 September 2021
Final dividend payment date

28 October 2021
2021 Annual General Meeting

Full listing of key dates available at

› **challenger.com.au/shareholder/shareholder-information/key-dates**

Dates may be subject to change. Any change in dates will be advised to the Australian Securities Exchange.

About this Interim Financial Report

The 2021 Interim Financial Report can be downloaded from Challenger's online Shareholder Centre at:

› **challenger.com.au/shareholder**

Operating and financial review

1 About Challenger

Challenger Limited (Challenger, CGF, the Group or the Company) is an investment manager founded in 1985. Challenger is the largest annuity provider and one of the largest[1] active fund managers in Australia.

Challenger is listed on the Australian Securities Exchange (ASX) and has offices in Australia, London and Tokyo. Challenger is regulated by the Australian Prudential Regulation Authority (APRA), the Australian banking, superannuation and insurance regulator.

Challenger's activities are also subject to supervision by other regulatory agencies both in Australia and in other markets in which it operates.

Challenger's assets under management were $96.1 billion, up 11.3% on the prior corresponding period (PCP). Normalised net profit before tax was $196.2 million, down $82.4 million or 29.6% on the PCP. See sections 2 and 8 for a description of Challenger's operating segments and its normalised cash operating earnings framework.

Normalised net profit after tax was down $54.6 million or 28.5% to $136.8 million. Statutory net profit after tax for the period, which includes investment experience (i.e. the valuation movements on assets and liabilities supporting the Life business) and non-recurring significant items, was $222.8 million, up $2.4 million on the PCP. Investment experience profit after tax was $87.1 million compared to $38.4 million in the PCP. Challenger had total equity of $3.5 billion as at 31 December 2020 and employed 709 people on a full-time equivalent (FTE) basis.

2 Operating segments and principal activities

For internal reporting and risk management purposes, Challenger's principal activities are currently divided into two operating segments: Life and Funds Management. The Life operating segment is serviced by the Distribution, Product and Marketing team, which is responsible for ensuring the appropriate marketing and distribution of Life's products. Both operating segments and the Distribution, Product and Marketing team are supported by centralised operations which are responsible for appropriate processes and systems, in addition to providing the necessary resources to meet regulatory, compliance, financial reporting, legal, tax and risk management requirements.

Life – the Life segment mainly comprises Challenger Life Company Limited (CLC), Australia's leading provider of annuities and guaranteed retirement income products.

As Australia's largest[2] annuity provider, Life provides reliable guaranteed incomes to Australian retirees.

Life's annuity products appeal to retirees because they provide security and certainty of guaranteed[3] income while protecting against risks from market downturns and inflation. Lifetime annuities protect retirees from the risk of outliving their savings by paying guaranteed income for life.

The retirement incomes Life pays are backed by a high-quality investment portfolio, predominantly in fixed income and commercial property investments. These long-term investments generate regular and predictable investment income which is used to fund retirement income paid to Life's customers.

Life's products are distributed via third-party financial advisers, both independent and part of the major advice hubs. Life's products are included on all major advice hubs' Approved Product Lists (APLs) and are available on other leading administration platforms. Challenger is also focused on building institutional partnerships and being the partner of choice for superannuation fund advisers, wealth managers and investment platforms in providing retirement income solutions.

Life is the market leader in Australian retirement incomes, with an 80%[2] annuity market share and has won the Association of Financial Advisers 'Annuity Provider of the Year' for 12 consecutive years.

Life also has an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary), a leading provider of both US dollar and Australian dollar-denominated annuities in Japan.

Funds Management – the Funds Management segment focuses predominantly on the retirement savings phase of Australia's superannuation system by providing products seeking to deliver superior investment returns. Funds Management is also expanding into selective international markets.

As one of Australia's largest[1] active fund managers, Funds Management invests across a broad range of asset classes, including fixed income, commercial property and Australian and global equities. The Funds Management segment comprises two business divisions: Fidante Partners and CIP Asset Management (CIPAM).

Fidante Partners encompasses a number of investments in boutique investment managers that each operate under their own brands. Fidante Partners provides administration and distribution services to the boutique investment managers and shares in the profits of these businesses through equity ownership. Fidante Partners also has a presence in Europe with interests in alternative asset managers.

[1] Consolidated FUM for Australian Fund Managers – Rainmaker Roundup, September 2020.
[2] Plan for Life – September 2020 – based on annuities under administration at 30 September 2020.
[3] The word 'guaranteed' means payments are guaranteed by Challenger Life Company Limited from the assets of its relevant statutory fund.

2 Operating segments and principal activities (continued)

CIPAM develops and manages assets for CLC and third-party institutional investors. The investments managed by CIPAM are predominantly in fixed income and commercial property.

The Funds Management business is growing strongly, with funds under management (FUM) increasing by more than 66% over the last five years to $91.2 billion.

Principal activities – there have been no significant changes in the nature of these principal activities or the state of affairs of the Company during the period.

On 23 December 2020, Challenger entered into an agreement to acquire MyLifeMyFinance Limited (MyLife MyFinance), a small Australian bank offering its customers a range of simple savings and lending products. Completion of the acquisition is expected in late March 2021, subject to regulatory approval, and will provide Challenger with an APRA Authorised Deposit-taking Institution (ADI) licence.

3 Challenger's vision and strategy

Challenger's vision is to provide its customers with financial security for retirement. Challenger has four strategic pillars to ensure that it achieves its vision over the long-term. The four strategic pillars are:

- increase the use of secure retirement income streams;
- lead the retirement incomes market and be the partner of choice;
- provide customers with excellent funds management solutions; and
- maintain leading operational and people practices.

4 Risk management

The management of risk is fundamental to Challenger's business and to building shareholder value. At Challenger, risk is everyone's business. The Board's Risk Appetite Statement outlines the level of risk that is acceptable in striving to achieve Challenger's strategic goals and financial objectives. This is combined with an effective risk management framework which monitors, mitigates and manages the risks to which Challenger is exposed.

The Board recognises the broad range of risks that Challenger faces as a participant in the financial services industry. These include funding and liquidity risk, investment and pricing risk, counterparty risk, business and reputational risk, operational risk, licence and regulatory risk, cyber and information security risk, climate change risk and conduct risk. Increasingly, the risk of climate change is being considered within the investment process. Challenger invests in assets with long-term cash flows to match the annuity payments required to be made within its portfolio. This means that Challenger must consider the risk of climate change within its risk management framework and work to ensure that this risk is mitigated where possible. Challenger is not currently materially exposed to climate risk.

An integral part of risk management for Challenger is the maintenance of a strong risk culture among its employees. Challenger's expectations of its employees are encapsulated in the 'Challenger I ACT' values of:

- Act with integrity;
- Aim high;
- Collaborate; and
- Think customer.

All employees are assessed against the Challenger I ACT values as part of their annual performance reviews, and this outcome contributes to their overall performance ratings and remuneration outcomes.

5 Challenger's 1H21 strategic progress

1H21 strategic progress

Progress in 1H21 against strategic priorities is set out below:

Increase the use of secure retirement income streams

Industry lifetime annuity sales currently represent less than 2% of the annual transfer from the retirement savings (accumulation) phase to the retirement spending (retirement) phase. Challenger is focused on growing the allocation of Australian retirement savings to secure and stable incomes.

1H21 progress:

Strategy to diversify sales delivering – Life sales up 10% to $3.4bn

Challenger has focused on diversifying its sales channels in order to build resilient sales across a range of retail and institutional clients.

In 1H21, sales increased across all key Life product categories, including domestic term annuities (up 2%), domestic lifetime annuities (up 64%), institutional Challenger Index Plus (up 5%) and Japanese annuity sales (up 15%).

Life sales are benefiting from Challenger's strategy to diversify its distribution, including:

- Forming an annuity relationship with MS Primary in Japan and expanding the relationship to include the reinsurance of US dollar-denominated annuities;
- Increasing focus on institutional sales; and
- Working with a wider range of independent financial advice networks following structural change in the domestic financial advice market.

Stabilisation of structural change to Australian financial advice market

Life has traditionally relied upon third party financial advisers, both independent and part of the major advice hubs, to distribute its products. The Australian wealth management and financial adviser markets have been significantly disrupted following the public hearings and completion of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) in 2019.

These industry changes have impacted Challenger's annuity sales, particularly term annuity sales, which were traditionally well supported by advisers aligned to the wealth management operations of the major banks.

With adviser movement from the major banks to Independent Financial Adviser (IFA) networks stabilising over the last 12 months, the scope for further impact on Challenger's domestic term sales by the major banks has reduced. The contribution to Challenger term annuity sales by the major banks has stabilised and accounted for approximately 13% of 1H21 domestic fixed term annuity sales, which was broadly consistent with the contribution in FY20.

Challenger has recently acquired an Authorised Deposit-taking Institution which provides the opportunity to enter Australia's term deposit market and extend Challenger's customer and product reach. The acquisition provides access to direct customers and new channels and is a strategic response to structural changes in the Australian financial advice market.

Sales disruption from COVID-19 pandemic

Since March 2020, the COVID-19 pandemic has impacted the ability of financial advisers to meet new clients, and their focus has been on servicing their existing client base, rather than on boarding new clients. New clients on-boarded at the point of retirement represent an opportunity to recommend annuities, particularly lifetime and aged care focused annuities.

The COVID-19 pandemic has also delayed retirees entering aged care. Despite this, CarePlus sales were 9% higher than in 1H20.

Life sales mix and focus on long-term products

Challenger's annuity sales mix continues to evolve toward long-term products. Long-term annuities embed more value for shareholders as they lengthen the tenor of the annuity book, improve the maturity profile and typically enhance shareholder return on equity.

In 1H21, long-term annuity sales, which include Australian lifetime annuities and fixed term annuities distributed through MS Primary in Japan, was a record at 41% of total annuity sales, up from 35% in 1H20. The tenor of new business sales was 9 years. Longer tenor product sales have the impact of reducing future annuity maturity rates and supporting future net book growth.

The annuity book continues to shift toward long-term annuities, with the long-term annuity book now representing 57% of the total annuity book, up from 32% five years ago.

5 Challenger's 1H21 strategic progress (continued)

1H21 strategic progress (continued)

Increase the use of secure retirement income streams (continued)

Extending customer reach and entering Australia's term deposit market

In December 2020, Challenger announced the acquisition of MyLife MyFinance, an Australian-based customer savings and loans bank, for $35 million[1].

The acquisition is highly strategic and provides Challenger the opportunity to significantly expand its secure retirement income offering, including entering Australia's approximately $1 trillion[2] term deposit market.

Adding an Authorised Deposit-taking Institution (ADI) capability to sit alongside the existing Life and Funds Management operations will broaden both Challenger's product and distribution reach and help fulfil its vision to provide customers with financial security for retirement.

The acquisition also provides Challenger the opportunity to attract and engage with customers at an earlier age as they approach and enter the retirement phase, increasing Challenger's brand recognition in early age demographics.

ADIs have had great success in attracting government guaranteed retail deposits. Challenger sees significant opportunity to leverage its leading retirement income position and capability to provide guaranteed returns for customers.

Challenger will initially focus on expanding MyLife MyFinance's term deposit offering by replicating the investment strategy used to support Challenger's term annuity business. The term deposit products are familiar to Australian savers and are government guaranteed[3], enabling Challenger to play an increased role supporting customer retirement incomes and broaden access to direct customers.

The acquisition will provide Challenger with access to a wider range of customers through multiple distribution channels, including new intermediated channels such as the broker term deposit market and direct customer engagement. Challenger will also distribute term deposit products via its existing network of independent financial advisers currently recommending Challenger products, while also attracting direct customers.

Under Challenger ownership, it will be able to provide term deposit customers compelling value across a range of different tenors with the opportunity to innovate within the term deposit market. It is expected Challenger's term deposit offering will provide Australian savers with a very familiar product offering which will assist new customer acquisition across all of Challenger's businesses.

Challenger has a strong track record in the term annuity market and the acquisition will provide a platform to leverage Challenger's existing investment capability, including its competitive advantage in private lending markets to drive additional growth via an ADI capability.

Term deposit business conducted via an ADI is economically similar to Challenger's term annuity business but will be accounted for and operated under accounting and capital standards applicable to ADIs.

For customers, term deposits are considered simple deposit products under financial advice requirements, which do not require advisers to undertake a full comprehensive Statement of Advice in order to recommend them to their clients.

The acquisition is subject to approval by both the Australian Prudential Regulation Authority (APRA) and the Federal Treasurer[4], and is expected to settle in late March 2021 once approval has been obtained.

The acquisition price and capital requirements, including regulatory capital to support growth, will be funded by a $100 million distribution from Challenger Life Company Limited (CLC) during the March 2021 quarter.

The acquisition is expected to reduce Challenger's FY21 normalised net profit before tax by approximately $3 million, with the ADI expected to break even during the 2022 financial year, subject to sufficient additional term deposit business being written.

[1] Acquisition price subject to completion adjustments and based on a net asset value of $18 million.
[2] APRA Monthly Authorised Deposit-taking Institution Monthly Statistics.
[3] Financial Claims Scheme (FCS) which provides protection to depositors of up to $250,000 per account-holder per ADI.
[4] Completion is subject to regulatory approvals, including approval under the Financial Sector (Shareholdings) Act.

5 Challenger's 1H21 strategic progress (continued)

1H21 strategic progress (continued)

Lead the retirement incomes market and be the partner of choice

Challenger's strategy includes being the partner of choice for superannuation fund advisers, wealth managers and investment platforms in providing retirement income solutions. Challenger is the market leader in annuities with 80%[1] market share.

1H21 progress:

Building institutional partnerships

Challenger is focused on providing institutional investors with targeted solutions that help address their strategic and fiduciary objectives. Challenger does this by offering innovative strategies that cater to the needs of superannuation funds, insurance companies and multi-managers. Challenger's institutional offering includes:

- Retirement solutions, encompassing longevity protection, sequencing risk and decumulation solutions;
- Income solutions to provide guaranteed returns in the form of an agreed margin above fixed income indices;
- Defined benefit solutions in the form of buy-ins, buy-outs and successor fund transfers; and
- Beta Solutions offering customers a set alpha above an agreed index with zero management fees and flexibility to choose from a range of investment terms and liquidity profiles.

Challenger Life's institutional business continues to grow strongly and increased by 25% in 1H21.

Sales are benefiting from an expansion in the institutional product offering, new institutional clients and relationships and a focus on solutions-led strategies for profit-for-member superannuation and insurance companies.

In 1H21, the institutional sales team attracted a range of new clients, including insurance and superannuation funds seeking to maximise capital guaranteed investment returns in the low interest rate environment.

In 1H21 Challenger was also successful in winning institutional lifetime annuity business, including from an institutional client representing reinsurance of its closed lifetime annuity portfolio. This success reflects recent efforts to target Australia's large closed defined benefit pension and closed lifetime annuity markets.

Reflecting the renewed focus on institutional sales opportunities, Challenger's website has been enhanced to include institutional specific client information in order to provide an overview of Challenger's retirement, income and beta solutions for institutional clients.

Superannuation fund clients are also increasing their focus on providing retirement income solutions for their members and engaging on how Challenger's capabilities can support them in building more comprehensive retirement solutions for their members. The focus on more comprehensive solutions, including using guaranteed income products, represents a significant growth opportunity for Challenger.

Advice transformation project

Challenger believes in the value of financial advice, particularly in the retirement phase. The Advice Transformation project is a multi-year, organisation-wide program to drive sales performance and deliver sustainable growth in the retail advice channel.

The program consists of a mix of short and medium-term initiatives across service, distribution, marketing and technology.

This program aligns to the signposts in the Retirement Income Review around increased use of stable and reliable income in retirement.

The Advice Transformation program will make it easier for advisers to do business with Challenger, improve data, reporting and the online experience to attract new advisers to the product offering and ultimately increase annuity sales.

Enhanced customer digital engagement through Challenger Investor Online

Challenger is committed to providing a high-quality service and experience for its customers.

In 1H21, Challenger's online customer portal, Investor Online, which provides customers access to their account details and product information, was enhanced in order to provide an improved customer experience with increased security.

[1] Plan for Life – September 2020 – based on annuities under administration at 30 September 2020

5 Challenger's 1H21 strategic progress (continued)

1H21 strategic progress (continued)

Lead the retirement incomes market and be the partner of choice (continued)

Enhanced customer digital engagement through Challenger Investor Online (continued)

The enhancements also drive efficiencies by transitioning customers from paper processes to digital engagement. The enhancements provide a range of new features, including online self-service and the ability for customers to reinvest maturing term annuities.

Leading adviser ratings

Despite structural changes in the Australian financial advice market and new competitors entering the retirement income market, Challenger has remained the dominant retirement income brand.

Among Australian financial advisers, Challenger continues to be the most recognised retirement income provider with 90%[1] of financial advisers rating Challenger as a leader in retirement income. Challenger's retirement income leadership position, which supports new distribution and product relationships, is 35 percentage points above its nearest competitor.

Provide customers with excellent funds management solutions

Challenger is focused on providing excellent funds management solutions in order to help customers build retirement savings.

1H21 progress:

Distributor of the year

In 1H21 Funds Management attracted strong net inflows of $6.4 billion, which included Fidante Partners' net inflows of $5.8 billion. Fidante Partners is the fastest growing active investment manager[2] in Australia and is benefiting from a diverse range of boutique managers covering key asset classes and high-quality retail and institutional sales teams.

Fidante Partners' distribution capability continues to be externally recognised and in 1H21 won Distributor of the Year at the annual Zenith Fund Awards. Zenith recognised Fidante Partners' sales teams and broad distribution footprint, with 40 retail funds available across all major investment and administration platforms.

Top ranking wholesale trust for inflows

The Ardea Real Outcome Fund achieved the highest inflows of any wholesale investment trust in the entire Australian market for the second consecutive year[3] and is one of the fastest growing Active ETFs in Australia[4].

The Ardea Real Outcome Fund also received its first highest conviction rating in retail with Lonsec upgrading it to Highly Recommended.

Adding new boutiques and investment strategies

Fidante Partners continues to expand its product offering by adding new boutiques, forming new partnerships and developing new investment strategies for existing managers. Fidante Partners has an active program of seeking and screening potential new boutique managers and expects to announce the addition of new boutique managers over time.

In November 2020, Ares Australia Management, launched the Ares Diversified Credit Fund (ADCF). This follows the launch of the first product in May 2020, the Ares Global Credit Income Fund. The ADCF offers investors direct access to global private credit markets not readily accessible by Australian wholesale investors. It seeks to provide investors superior risk-adjusted returns across various market cycles by investing in a diversified portfolio of liquid and illiquid asset classes. The Fund seeks to capitalise on market inefficiencies and relative value opportunities throughout the entire global credit spectrum.

Fidante Partners' European business has partnered with Proterra Investment Partners, a leading private equity fund manager focused on the food and agribusiness sectors, providing European investors with access to Asia's food sector. Proterra Asia's Food Strategy invests across the entire food value chain in Asia, with a particular focus on the fast-growing and high return-oriented branded food sector.

Funds Management has also entered into a distribution partnership agreement with global investment manager Nomura Asset Management, which will see them work together to support their respective ambitions in both Australia and Japan. Nomura Asset Management has in excess of US$500 billion under management.

[1] Marketing Pulse Adviser Study, December 2020.
[2] Measured as net inflows over the past 12 months compared to FUM 12 months ago for listed Australian fund managers.
[3] Plan for Life Wholesale Trust Data, September 2020.
[4] ASX Investment Products monthly update July-December 2020, inflows/outflows.

5 Challenger's 1H21 strategic progress (continued)

1H21 strategic progress (continued)

Provide customers with excellent funds management solutions (continued)

Adding new boutiques and investment strategies (continued)

In October 2020, CIP Asset Management (CIPAM) launched a retail version of the CIP Asset Management Credit Income Fund, which is a floating rate, multi-sector credit strategy investing in public and private debt markets while managing for monthly rather than daily liquidity. The Fund aims to provide high net worth investors with capital stability and income on a regular basis accompanied by lower levels of volatility than traditional fixed income strategies.

CIPAM also launched its third income-oriented fund in December 2020 with external seeding. The CIPAM Private Lending Opportunities Fund is a higher returning fund open to institutional investors, focusing on floating rate investments in mezzanine private lending opportunities, primarily within Australia and New Zealand.

Maintaining superior investment performance

Funds Management has a long track record of achieving superior investment performance, which has helped attract strong net flows over many years.

Long-term investment performance for Fidante Partners Australian boutiques remains strong with 88% of FUM outperforming benchmark over five years[1]. Since fund inception, 81% of Fidante Partners' funds have achieved either first or second quartile investment performance[2].

Award-winning investment strategies

Fidante Partners' investment managers continue to be externally recognised. During 1H21, the following funds won investment manager awards:

- Greencape Capital – Zenith Fund Awards Australian Equities - Large Cap (2020);
- Alphinity's Sustainable Share Fund – Money magazine Best of the Best Awards - Best Australian Share ESG Fund (2021); and
- Ardea Investment Management – Zenith Fund Awards - Global and Diversified Fixed Interest (2020).

Highly rated retail investment products

Fidante Partners' investment managers and funds are highly rated by external asset consultants:

- 36% of ratings are the top rating (e.g. 'Highly Recommended' or 'Gold') compared to an average of approximately 12% across the Australian funds management industry; and
- 82% of ratings are a 'buy' rating compared to an average of approximately 68% across the Australian funds management industry.

The quality and performance of Fidante Partners' investment managers and funds continue to receive strong independent validation. During 1H21, Zenith rated 22 out of the 23 ratings awarded to Fidante Partners' funds as either Recommended or Highly Recommended.

Maintain leading operational and people practices

Challenger believes maintaining a highly engaged, diverse and agile workforce committed to sustainable business practices with a strong risk and compliance culture is essential for providing customers and shareholders with superior outcomes.

1H21progress:

Health and wellbeing of our people during the COVID-19 pandemic

Looking after the health of employees during the COVID-19 pandemic is a key business priority. Almost all of Challenger's employees have worked from home for some period of time from mid-March 2020 and have adapted well, with business continuity maintained throughout the period.

Internal employee surveys show high employee engagement, with the majority feeling positive towards Challenger, notwithstanding the difficult working environment. An employee survey in December 2020 showed 96% of staff felt Challenger cared about their wellbeing, and 98% were confident in the Leadership Team's ability to navigate through the disruption. Importantly it showed 97% of employees felt positive about their ability to adjust to work-from-home arrangements, and 93% felt well connected to their teams during this time.

[1] As at 31 December 2020. Percentage of Fidante Partners Australian boutiques meeting or exceeding performance benchmark.
[2] Mercer as at December 2020.

5 Challenger's 1H21 strategic progress (continued)

1H21 strategic progress (continued)

Maintain leading operational and people practices (continued)

Launched a mental health and wellbeing strategy

Challenger is committed to maintaining a positive and inclusive workplace culture where everyone feels safe and encouraged to talk about mental health and reach out for support when needed. In these unprecedented times, providing a supportive and caring environment has never been more important. Guiding Challenger's approach are three core areas of focus:

- Improving understanding of mental health and combating stigma;
- Promoting positive health and wellbeing; and
- Increasing awareness and support for impacted employees.

Published Challenger's first climate change statement

Challenger recognises that climate change is one of the biggest challenges facing society now and for future generations. It is a shared global challenge that requires input from governments, businesses and individuals.

A climate change statement has been developed to convey Challenger's overall position on climate change and how it considers climate-related risks and opportunities across the Life and Funds Management businesses. It supports environment, social and corporate governance (ESG) positioning already disclosed in the Challenger Life Company Limited and CIP Asset Management property and fixed income responsible investment statements and in Challenger's 2020 Sustainability Report. Publishing this statement provides improved disclosure for stakeholders in line with current industry practice.

Became a signatory to the Investors Against Slavery and Trafficking initiative

Investors Against Slavery and Trafficking (IAST) is an investor-led initiative engaging with companies to pursue real action to combat modern slavery, human trafficking and labour exploitation. Challenger understands the importance of industry collaboration and supports the IAST Asia-Pacific initiative. Challenger has joined other signatories to add focus to this important issue. As a signatory to this initiative, Challenger is included on a letter sent to all ASX100 companies setting out investor expectations.

Fidante UK joined Pensions for Purpose

Fidante UK joined the Pensions for Purpose initiative in the United Kingdom (UK). This is a collaborative initiative of impact managers, pension funds, social enterprises and others involved or interested in impact investment. Its aim is to promote understanding of impact investing in companies, organisations and funds that have the commercial purpose of solving social or environmental problems.

Fidante UK joined this initiative to demonstrate their commitment to ESG and interest in impact investing. Fidante UK, together with Fidante Partners UK based boutique managers, plan to launch a thought leadership series on ESG investing across various asset classes and showcase this on the Pensions for Purpose platform.

6 Market overview and outlook

Australia's superannuation system commenced in 1992 and is now the fourth largest pension system globally and the fastest growing, with assets increasing by 11% per annum over the past 20 years[1].

Features that have contributed to Australia having the fastest growing global pension system, include Government-mandated contributions, tax incentives to encourage additional retirement savings, and an efficient and competitive institutional superannuation fund model.

Growth in the superannuation system is also supported by changing demographics and the Government's focus on enhancing the retirement phase of superannuation.

The superannuation system is forecast to grow from $2.9 trillion today[2] to almost $7 trillion[3]. over the next 15 years.

Challenger's Life and Funds Management businesses are both expected to benefit over the long term from growth in Australia's superannuation system.

Life outlook

Life focuses on the retirement spending phase of superannuation by providing products that convert retirement savings into safe and secure income. Challenger Life is Australia's leading provider of annuities[4], driven by demographic changes and a maturing of Australia's superannuation system.

The number of Australians over the age of 65, which is Life's target market, is expected to increase by over 50% over the next 20 years[5]. Reflecting these demographic changes, and growth in the superannuation system, the annual transfer from the retirement savings phase of superannuation to the retirement spending phase was estimated to be approximately $70 billion[6] in 2020.

Annuities represent only a small part of the retirement phase, with lifetime annuities representing less than 2% of the annual transfer to the retirement phase.

The purpose of the superannuation system is to provide income in retirement to substitute or supplement the Government-funded age pension. With the transition from Government-funded age pensions to private pensions, retirees are demanding safe, secure retirement income products that convert savings into income and provide financial security.

The Australian Government is progressing a range of retirement income regulatory reforms designed to enhance the retirement phase and better align it with the overall objective of the superannuation system: to provide income in retirement to substitute or supplement the Government-funded age pension. These reforms provide a significant opportunity to increase the proportion of retirement savings invested in products that deliver stable, regular and reliable income in retirement.

As Australia's leading provider of annuities, Challenger Life is expected to continue to benefit from the long-term growth in Australia's superannuation system and regulatory reforms designed to enhance the retirement phase.

Challenger has been recognised as a retirement income product innovator and has won the Association of Financial Advisers 'Annuity Provider of the Year' for the last 12 years, is the dominant retirement income brand in Australia and is recognised by 90%[7] of financial advisers as a leader in retirement incomes.

The profit-for-member sector of the superannuation system is growing strongly and currently represents approximately 40%[8] of total superannuation assets. As members transition to retirement, focus by profit-for-member funds to provide comprehensive retirement income solutions to their members is increasing. The profit-for-member sector provides a significant growth opportunity for Challenger.

Challenger Life is diversifying its product offering and extending its customer reach. In December 2020, Challenger announced the acquisition of MyLife MyFinance, an Australian-based customer savings and loans bank, for $35 million[9]. The acquisition is highly strategic and provides Challenger the opportunity to significantly expand its secure retirement income offering by entering Australia's approximately $1 trillion[10] term deposit market. The acquisition will provide Challenger with access to a wider range of customers through multiple distribution channels, including direct and via intermediated channels.

In Japan, Life commenced an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary) to provide Australian-dollar annuities in November 2016. MS Primary is a leading provider of annuity products in Japan and is part of MS&AD Insurance Group Holdings Inc. (MS&AD).

In 2019, the reinsurance agreement with MS Primary was expanded to include both Australian-dollar and US-dollar denominated annuity products.

Under the expanded reinsurance arrangement, which commenced on 1 July 2019, MS Primary will provide Challenger an annual amount of reinsurance, across both Australian and US-dollar annuities, of at least ¥50 billion (equivalent to approximately A$670 million[11]) per year for a minimum of five years[12]. This is subject to review in the event of a material adverse change for either MS Primary or Challenger Life.

At 31 December 2020, MS&AD held approximately 15% of Challenger Limited issued share capital and a representative from MS&AD and an Alternate Director have been appointed Non-Executive Directors of Challenger Limited.

Funds Management outlook

Funds Management focuses on building savings for retirement by providing investment strategies that seek to deliver superior investment returns.

[1] Willis Towers Watson Global Pension Study 2020.
[2] APRA, as at September 2020.
[3] Rice Warner Superannuation Market Projections Report 2020.
[4] Plan for Life – September 2020 – based on annuities under administration at 30 September 2020.
[5] 2020 – 2040 comparison based on Australian Bureau of Statistics, Population Projections Series B, cat no 3222.0.
[6] Based on Taxation Statistics 2017-18 from Australian Taxation Office.
[7] Market Pulse Adviser Study December 2020.
[8] APRA Quarterly Superannuation Performance Statistics, September 2020.
[9] Acquisition price subject to completion adjustments and based on a net asset value of $18 million.
[10] APRA Authorised Deposit-taking Institution Monthly Statistics.
[11] Based on the exchange rate as at 1 July 2020.
[12] Challenger Life entered into a new agreement with MS Primary to commence reinsuring the US dollar version of the 20-year term product from July 2019. Challenger will provide a guaranteed interest rate and assume the investment risk in relation to those policies issued by MS Primary and reinsured by Challenger.

6 Market overview and outlook (continued)

Funds Management has operations in Australia, Europe and Japan and is Australia's fourth largest active fund manager[1].

Growth in funds under management can be attributed to the strength of Challenger's retail and institutional distribution teams, a market-leading business model focused on investor alignment and strong long-term investment performance.

Funds Management comprises Fidante Partners and CIP Asset Management.

The Fidante Partners' business model involves taking minority equity interests in separately branded boutique fund management firms, with Challenger providing distribution, administration and business support, leaving investment managers to focus on managing investment portfolios.

Fidante Partners' business model has allowed it to attract and build successful active equity, active fixed income and alternative investment managers.

Fidante Partners is focused on expanding its product offering, which includes partnering with new boutique managers, expanding the product offering of existing boutique managers and accessing new distribution channels.

CIP Asset Management is transitioning from an internally focused to an externally focused asset manager, and Challenger is committed to growing the business and building on CIP Asset Management's breadth of investment expertise.

CIP Asset Management principally originates and manages fixed income and commercial real estate, along with providing investment solutions for leading global and Australian institutions, including Challenger Life.

Funds Management has operations in both Japan and Europe and is developing its distribution and product opportunities in both regions.

Funds Management is well positioned to benefit from growth in both Australia's superannuation system and, more broadly, global pension markets.

COVID-19 pandemic

The COVID-19 pandemic has presented significant challenges to global economies and investment markets.

Looking after the health of our people during this time has been a key business priority for Challenger, which transitioned almost all its employees to working from home arrangements from mid-March 2020. As COVID-19 restrictions ease across Australia, Challenger is complying with national and state public health orders.

Challenger has also been supporting its customers and business partners through the pandemic, which has included supporting advisers, superannuation fund clients and commercial property tenants.

Investment market conditions have been significantly disrupted by the COVID-19 pandemic, initially resulting in a market-sell off and increased market volatility. Following the pandemic related market sell-off in March 2020, Challenger Life actively managed its investment portfolio and repositioned it to more defensive settings.

As a result of the repositioning, Life was holding over $3 billion of cash and liquid investments at 1 July 2020, which are being progressively deployed into higher yielding investments over the course of 2021.Once fully deployed, these investments are expected to enhance both Life's earnings and Return on Equity (RoE).

With Challenger's increased franchise size, including growth in both the retail annuity and institutional guaranteed retirement incomes business, Challenger expects to maintain appropriate investment portfolio settings.

Risks

The above outlook for the Life and Funds Management businesses is subject to the following key business risks:

- investment market volatility;
- ongoing impact of COVID-19 pandemic on the global economy and the ability of individuals, businesses, and governments to operate;
- general uncertainty around the global economy and its impact on markets in which Challenger operates and invests;
- regulatory and political changes impacting financial services participants;
- demand for and competition with Challenger products, including annuities and managed funds; and
- operational risk.

7 Key performance indicators (KPIs)

7.1 Profitability and growth

KPIs for the period ended 31 December 2020 (with the six months to 31 December 2019 being the prior comparative period (PCP), unless otherwise stated) include:

	31 Dec 2020	31 Dec 2019	Change %
Profitability			
Statutory profit attributable to equity holders ($m)	222.8	220.4	1.1
Normalised NPBT ($m)	196.2	278.6	(29.6)
Normalised NPAT ($m)	136.8	191.4	(28.5)
Statutory EPS (cents)	33.2	36.3	(8.5)
Normalised EPS (cents)	20.4	31.5	(35.2)
Interim dividend (cents)	9.5	17.5	(45.7)
Interim dividend franking	100%	100%	-
Normalised cost: income ratio	39.0%	33.5%	5.5
Statutory RoE after tax	13.0%	12.0%	1.0
Normalised RoE pre-tax	11.5%	15.2%	(3.7)
Normalised RoE after tax	8.0%	10.4%	(2.4)
Sales, Flows, AUM			
Total Life annuity sales ($m)	2,191.0	1,956.9	12.0
Other Life sales ($m)	1,246.5	1,182.2	5.4
Total Life sales ($m)	3,437.5	3,139.1	9.5
Total Life net flows ($m)	708.7	923.6	(23.3)
Total Life book growth	4.7%	6.2%	(1.5)
Total FM net flows ($bn)	6.4	1.9	large
Total AUM ($bn)	96.1	86.4	11.3

[1] Consolidated FUM for Australian Fund Managers – Rainmaker Roundup, September 2020.

7 Key performance indicators (KPIs) (continued)

7.1 Profitability and growth (continued)

During March 2020, COVID-19 was declared a global pandemic. COVID-19, and the resulting impact on economic activity, had a significant impact on world debt and equity markets.

The deterioration of market conditions in March 2020 resulted in Challenger recognising significant investment experience losses at that time and subsequently lowering exposure to certain asset classes to reduce capital intensity and increase Life's excess regulatory capital position.

Domestic Life annuity sales activity has also continued to be challenged as a result of government-imposed COVID-19 lockdowns across the country.

Challenger's $222.8 million statutory profit attributable to equity holders for the period was slightly higher than the prior comparative period (PCP), primarily as a result of higher investment experience profit offsetting the decline in normalised earnings.

Normalised net profit after tax decreased by 28.5% compared to PCP, reflecting lower Life cash operating earnings offset by lower expenses, higher Funds Management net fee income and a lower effective tax rate.

Investment experience profit after tax was $87.1 million compared to $38.4 million in the PCP.

An interim dividend of 9.5 cents was announced, franked at 100% (31 December 2019: 17.5 cents, 100% franked).

Challenger's normalised cost to income ratio of 39.0% is higher than the ratio in the prior period (33.5%), primarily as a result of the decline in net income in the period.

Statutory Return on Equity (RoE) after tax of 13.0% has increased compared to the prior period (31 December 2019: 12.0%) as a result of higher after-tax statutory profit and lower average shareholder equity. Normalised RoE after tax decreased from 10.4% in the prior period to 8.0%, primarily reflecting lower normalised net profit after tax.

7.2 Capital management

Challenger's capital position is managed at both the Group and the prudentially-regulated CLC level, with the objective of maintaining the financial stability of the Group and CLC while ensuring that shareholders earn an appropriate risk-adjusted return.

Refer to Note 9 Contributed equity for further information on the CLC Internal Capital Adequacy Assessment Process.

On 22 June 2020, Challenger announced an underwritten institutional placement of equity in the amount of $270 million together with a non-underwritten share purchase plan (SPP) for retail shareholders. The institutional placement of $270 million was completed on 23 June 2020, while the SPP was completed on 24 July 2020, raising $35 million.

The decision to raise capital was taken to strengthen CLC's capital position and to provide the flexibility to further enhance Life's investment returns once the excess cash and liquid investments were redeployed.

The $270 million proceeds of the institutional placement were injected directly into CLC on 26 June 2020 and the majority of the SPP proceeds ($30 million) were also subsequently injected into CLC on 31 July 2020.

On 25 November 2020, Challenger completed its third capital notes issue, Challenger Capital Notes 3, raising $385 million through the issue of 3.85 million notes for $100 each. On the same date, Challenger confirmed the repurchase and redemption of approximately 2.975 million Challenger Capital Notes with a face value of $100 each. The net proceeds of these transactions provided incremental Additional Tier 1 regulatory capital for CLC.

The following table highlights the key capital metrics for CLC and the Group:

Capital	31 Dec 2020	31 Dec 2019	Change
Net assets attributable to equity holders ($m)	3,512.8	3,715.8	(203.0)
CLC excess capital over PCA ($m)	1,516.4	1,406.3	110.1
Group cash ($m)	136.6[1]	141.2	(4.6)
CLC excess capital over PCA + Group cash ($m)	1,653.0	1,547.5	105.5
CLC PCA ratio (times)	1.63	1.54	0.09
CLC CET1 ratio (times)	1.09	1.07	0.02

1. Includes $50 million of the Group corporate debt facility drawn.

7 Key performance indicators (KPIs) (continued)

7.2 Capital management (continued)

CLC regulatory capital base

CLC holds capital in order to ensure that, under a range of adverse scenarios, it can continue to meet its regulatory and contractual obligations to its customers. CLC is regulated by APRA and is required to hold a minimum level of regulatory capital. CLC has ongoing and open engagement with APRA.

CLC maintains a level of capital representing the Prescribed Capital Amount (PCA) plus a target surplus. The target surplus is a level of excess capital that CLC seeks to carry over and above APRA's minimum requirement in order to provide a buffer against adverse market conditions, having regard for CLC's credit rating.

CLC uses internal capital models to determine its target surplus, which are risk-based and responsive to changes in CLC's asset allocation and market conditions. While CLC does not target a specific PCA ratio, under current circumstances CLC's internal capital models result in a PCA ratio in the range of 1.3 to 1.6 times. This range may change over time and is dependent on a number of factors. CLC's PCA ratio was slightly above the top end of this range at 31 December 2020, being 1.63 times.

In addition to CLC's excess regulatory capital, Challenger maintains cash at a Group level which can be used to meet regulatory capital requirements. Challenger further maintains a Group corporate debt facility of $400 million in order to provide additional financial flexibility. The facility was drawn in full in March 2020 in response to the investment market volatility caused by COVID-19 and $350 million was subsequently repaid in June 2020 leaving $50 million drawn at the end of the period. These drawn proceeds remain at the Group level and provide financial flexibility.

Dividends and dividend reinvestment plan

Dividends	31 Dec 2020	31 Dec 2019	Change
Interim dividend (cents)	9.5	17.5	(45.7%)
Interim dividend franking	100%	100%	-
Normalised dividend payout ratio	46.6%	55.5%	(8.9)

The Board targets a dividend payout ratio of 45% to 50% of normalised earnings per share. The normalised dividend payout ratio for the period ended 31 December 2020 was in line with this range at 46.6% (31 December 2019: 55.5%).

The Company also seeks to frank its dividend to the maximum extent possible and expects future dividends over the medium term to be fully franked. However, the actual dividend payout ratio and franking will depend on prevailing market conditions and capital allocation priorities at the time.

The Dividend Reinvestment Plan (DRP) will be available for the 2021 interim dividend and the Board has determined that new shares will be issued to fulfil DRP requirements in respect of the interim dividend. The new shares will not be issued at a discount to the prevailing Challenger share price.

No shares were bought back during the period.

7.3 Credit ratings

Challenger Limited and CLC are rated by Standard & Poor's (S&P). In November 2020, S&P reaffirmed both Challenger Limited and CLC's credit ratings.

Ratings were confirmed as:

- CLC: 'A' with a stable outlook; and
- Challenger Limited: 'BBB+' with a stable outlook.

8 Normalised profit and investment experience

Normalised framework (Non IFRS)

CLC and its consolidated entities are required by AASB 1038 *Life Insurance Contracts* to value all assets and liabilities at fair value where permitted by other accounting standards.

This gives rise to fluctuating valuation movements on assets and liabilities being recognised in the profit and loss in CLC and on consolidation in Challenger Limited. CLC is generally a long-term holder of assets, due to holding assets to match the term of life contract liabilities. As a result, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements.

Investment experience represents the difference between actual investment gains/losses (both realised and unrealised) and expected gains/losses based on CLC's medium to long-term expected returns together with the new business strain[1] that results from writing new annuities. Investment experience also includes any impact from changes in economic and other actuarial assumptions.

A reconciliation between statutory revenue and the management view of revenue and net income is included in the financial report as part of Note 3 Segment information. This note also includes a reconciliation of statutory profit after tax and normalised net profit after tax (the management view of post-tax profit). The application of the normalised profit framework has been reviewed by Challenger's independent auditor to ensure that the reported results are consistently applied in accordance with the methodology described in Note 3 Segment information in the financial report.

[1] New business strain is a non-cash accounting adjustment recognised when annuity rates on new business are higher than the discount rate used to fair value annuities. The new business strain unwinds over the annuity contract.

8 Normalised profit and investment experience (continued)

Management analysis – normalised results

	31 Dec 2020 $m	31 Dec 2019 $m	Change $m	Change %
Net income[1]	325.3	422.7	(97.4)	(23.1)
Comprising:				
– Life normalised COE	244.0	344.8	(100.8)	(29.2)
– FM net income	81.3	77.7	3.6	4.6
– Corporate and other income	-	0.2	(0.2)	(large)
Operating expenses[1]	(126.8)	(141.6)	(14.8)	(10.5)
Normalised EBIT	**198.5**	**281.1**	**(82.6)**	**(29.4)**
Comprising:				
– Life normalised EBIT	192.8	285.8	(93.0)	(32.6)
– FM normalised EBIT	35.3	27.9	7.4	26.5
– Corporate and other normalised EBIT	(29.6)	(32.6)	3.0	9.3
Interest and borrowing costs	(2.3)	(2.5)	(0.2)	(8.0)
Normalised NPBT	**196.2**	**278.6**	**(82.4)**	**(29.6)**
Tax on normalised profit	(59.4)	(87.2)	(27.8)	(31.8)
Normalised NPAT	**136.8**	**191.4**	**(54.6)**	**(28.5)**
Investment experience after tax	87.1	38.4	48.7	large
Significant items after tax	(1.1)	(9.4)	8.3	(large)
Statutory net profit after tax attributable to equity holders	**222.8**	**220.4**	**2.4**	**1.1**

[1] 'Net income' and 'Operating expenses' are internal classifications and are defined in Note 3 Segment information in the financial report. These differ from the statutory revenue and expenses classifications, as certain costs (including distribution expenses, property expenses, management fees, special purpose vehicle expenses and finance costs) are netted off against gross revenues. These classifications have been made in the Directors' report and in Note 3 Segment information to reflect how management measures business performance. While the allocation of amounts to the above items and investment experience differ to the statutory view, both approaches result in the same total net profit after tax attributable to equity holders.

Life normalised cash operating earnings (COE) and earnings before interest and tax (EBIT) decreased as a result of reduced Life average investment assets, lower investment yield generated on the portfolio and a lower contribution from normalised capital growth, due to both a composition change in Life investment assets as well as a reduction in normalised capital growth factors when compared to the PCP. Life's average assets under management (AUM) decreased by $0.5 billion or 2.5% as a result of the net book growth in annuities and external unit holders' liabilities offset by valuation movements on investment assets.

Funds Management net income increased (up $3.6 million) due to increased equity accounted profits and distribution fee revenue. Funds Management average FUM increased by 7.5% as a result of mark-to-market gains on investments and strong net inflows over the period.

Operating expenses decreased by $14.8 million (10.5%) for the period ended 31 December 2020. Challenger's employee numbers decreased by 8 (or 1.2%) to 709 (on a full-time equivalent basis) when compared to the PCP.

Normalised tax for the period was $59.4 million, reflecting a normalised effective tax rate for the period of 30.3% (31.3% at 31 December 2019).

The normalised effective tax rate was lower for the period due to the relative composition of domestic and offshore earnings and respective tax rate differentials and the non-deductible interest on Challenger Capital Note instruments.

Significant items were negative $1.1 million (after tax) in the period and represent costs associated with the acquisition of MyLife MyFinance.

Management analysis – investment experience

	31 Dec 2020 $m	31 Dec 2019 $m
Actual capital growth[1]		
– Cash and fixed income	212.4	32.6
– Equity and infrastructure	42.4	-
– Property (net of debt)	(9.7)	23.4
– Alternatives	0.2	-
– Infrastructure	-	35.8
– Equity and other investments	-	19.4
Total actual capital growth	**245.3**	**111.2**
Normalised capital growth[2]		
– Cash and fixed income	(25.1)	(22.6)
– Equity and infrastructure	8.2	-
– Property (net of debt)	33.2	33.6
– Alternatives	-	-
– Infrastructure	-	17.6
– Equity and other investments	-	42.0
Total normalised capital growth	**16.3**	**70.6**
Investment experience		
– Cash and fixed income	237.5	55.2
– Equity and infrastructure	34.2	-
– Property (net of debt)	(42.9)	(10.2)
– Alternatives	0.2	-
– Infrastructure	-	18.2
– Equity and other investments	-	(22.6)
– Policy liability experience[3]	(108.4)	14.3
Asset and policy liability experience	120.6	54.9
New business strain[4]	3.9	1.0
Investment experience before tax	124.5	55.9
Tax expense	(37.4)	(17.5)
Investment experience after tax	**87.1**	**38.4**

[1] Actual capital growth represents net realised and unrealised capital gains or losses and includes the attribution of interest rate, inflation and foreign exchange derivatives that are used to hedge exposures.

[2] Normalised capital growth is determined by multiplying the normalised capital growth rate for each asset class by the average investment assets for the period. The normalised capital growth rates represent Challenger's expectations for each asset class over the investment cycle. The annual normalised growth rate is +4.0% for equity and infrastructure, +2.0% for property, 0.0% for alternatives, and -0.35% for cash and fixed income in order to allow for credit defaults. The rates have been set with reference to medium to long-term market growth rates and are reviewed to ensure consistency with prevailing market experience.The asset classes' composition changed from 1 July 2020. The annual normalised growth rates for the PCP were as follows, and reflect the composition of the portfolio at that time: +3.5% for equity and other investments, +4.0% for infrastructure, +2.0% for property, and -0.35% for cash and fixed income.

[3] Policy liability experience represents the impact of changes in macroeconomic variables including bond yields, inflation factors, expense assumptions and other factors applied in the valuation of life contract liabilities.

[4] New business strain is a non-cash accounting adjustment recognised when annuity rates on new business are higher than the discount rate, being a risk-free rate plus an illiquidity premium, used to fair value annuities together with certain maintenance expenses. The new business strain unwinds over the annuity contract.

8 Normalised profit and investment experience (continued)

Management analysis – investment experience (continued)

Investment experience after tax relates to changes in the fair value of Life's assets and liabilities. Investment experience is a mechanism employed to remove the volatility arising from asset and liability valuation movements and new business strain from Life business earnings so as to more accurately reflect the underlying performance of the Life business.

Pre-tax investment experience for the period comprised an asset and policyholder liability experience gain of $120.6 million and a gain of $3.9 million from Life's new business strain. These gains are largely unrealised and were primarily due to the improvement of fixed income and equity markets during the period.

9 Life segment results

The Life segment includes CLC, Australia's leading provider of annuities and guaranteed retirement income products. CLC has won the Association of Financial Advisers/Plan for Life Annuity Provider of the Year for the past 12 years.

CLC is regulated by APRA and its financial strength is rated by Standard & Poor's, with an 'A' credit rating and stable outlook. CLC is strongly capitalised, with significant excess capital above APRA's minimum regulatory requirements.

Life normalised results	31 Dec 2020 $m	31 Dec 2019 $m	Change $m	Change %
Normalised COE	244.0	344.8	(100.8)	(29.2)
– Cash earnings	227.7	274.2	(46.5)	(17.0)
– Normalised capital growth	16.3	70.6	(54.3)	(76.9)
Operating expenses	(51.2)	(59.0)	(7.8)	(13.2)
Normalised EBIT	**192.8**	**285.8**	**(93.0)**	**(32.6)**

Life normalised EBIT decreased by $93.0 million (down 32.6%) due to lower normalised COE (down $100.8 million or 29.2%), which was partially offset by operating expenses decreasing $7.8 million (or 13.2%). The lower normalised COE was the result of reduced investment assets, with Life average investment assets decreasing by $0.5 million or 2.5%, as well as lower asset yields and contribution from normalised capital growth. The lower yields were mainly attributable to earnings on the Cash and fixed income portfolio, impacted by higher levels of cash and liquids held in the portfolio, and lower distributions in the Equity and infrastructure and Alternative portfolios. CLC held $3.0 billion of cash and liquids at the start of the period given the COVID-19 related market volatility, and the majority of this is gradually being deployed into higher yielding assets, mainly investment-grade fixed income assets, over the course of FY21. The cash and liquids balance has reduced to $2.0 billion at 31 December 2020. The lower contribution from normalised capital growth of $54.3 million is due to both a decline and composition change in Life investment assets as well as a net reduction in the normalised capital growth factor for Alternatives.

Life generated a normalised Return On Equity (pre-tax) of 12.1%, down by 4.7 percentage points from the PCP as a result of lower normalised EBIT and decreased average net assets.

Total Life sales increased from the prior period (up 9.5%), with increased Lifetime sales (up 64.3%), increased fixed term sales (up 5.6%) and other Life sales (up 5.4%).

Lifetime sales increased by 64.3% due to new institutional relationships and growing momentum across the retail advised channel.

CLC participates in the Japanese foreign currency annuity market via a reinsurance agreement with MS Primary, a Japanese life insurance company and subsidiary of MS&AD Insurance Group Holdings, Inc. The reinsurance agreement with MS Primary provides CLC with an annual amount of reinsurance across both Australian and US dollar annuities of at least ¥50 billion (approximately A$670 million based on the exchange rate at 1 July 2020)[1] each year for a minimum of five years commencing from 1 July 2019. The MS Primary reinsured sales comprised 24.8% of Life's total annuity sales in the period, which is a slight increase on the PCP (24.1%).

Life sales	31 Dec 2020 $m	31 Dec 2019 $m	Change $m	Change %
Fixed-term annuities	1,844.4	1,746.0	98.4	5.6
Lifetime annuities	346.6	210.9	135.7	64.3
Total Life annuity sales	2,191.0	1,956.9	234.1	12.0
Other Life sales	1,246.5	1,182.2	64.3	5.4
Total Life sales	**3,437.5**	**3,139.1**	**298.4**	**9.5**
Annuity net flows	**157.6**	**93.6**	64.0	68.4
Other Life net flows	**551.1**	**830.0**	(278.9)	(33.6)
Total Life net flows	**708.7**	**923.6**	**(214.9)**	**(23.3)**

Annuity net flows (new annuity sales less capital repayments) increased by 68.4% to $157.6 million, driven by higher annuity sales. Based on the opening Life annuity book for the 2021 financial year ($12,581.2 million), annuity net book growth for the period was 1.3%, up from 0.7% in the prior period.

Other Life sales represents Challenger's Index Plus products and increased as a result of new client sales during the period.

Other Life net flows for the period were $551.1 million, decreasing by $278.9 million compared to $830.0 million in the prior period. Total Life net flows were $708.7 million, representing total Life net book growth of 4.7% (31 December 2019: $923.6 million or 6.2% book growth).

[1] This is subject to review in the event of a material adverse change for either MS Primary or Challenger.

10 Funds Management segment results

Challenger's Funds Management segment is one of Australia's largest[1] active investment managers.

Fidante Partners' multi-boutique platform comprises a number of separately branded funds management businesses. The model seeks to align the interests of investors, boutique investment managers and Fidante Partners.

The Funds Management model is delivering superior investment performance, with approximately 81% of funds achieving first or second quartile performance since inception[2].

CIP Asset Management (CIPAM) develops and manages assets for CLC and third-party institutional investors.

FM normalised results	31 Dec 2020 $m	31 Dec 2019 $m	Change $m	Change %
Net income	81.3	77.7	3.6	4.6
– Fidante Partners	49.7	45.5	4.2	9.2
– CIPAM	31.6	32.2	(0.6)	(1.9)
Operating expenses	(46.0)	(49.8)	(3.8)	(7.6)
Normalised EBIT	**35.3**	**27.9**	**7.4**	**26.5**

Funds Management normalised EBIT increased by 26.5% for the period, with increased net income and lower operating expenses during the period.

Fidante Partners' net income includes distribution fees, transaction fees, administration fees and a share in the equity accounted profits for the boutique fund managers (inclusive of performance fees) in which it has an equity interest.

Fidante Partners' net income increased for the period primarily as a result of higher FUM income (up $3.1 million) and higher performance fees (up $1.1 million).

CIPAM's net income decreased due to lower transaction fees (down $0.6 million).

Funds Management's normalised RoE (pre-tax) for the period was 27.8%, up by 4.0 percentage points from the PCP.

FM FUM and flows	31 Dec 2020 $bn	31 Dec 2019 $bn	Change $bn	Change %
Total FUM	91.2	82.8	8.4	10.1
– Fidante Partners	71.8	62.7	9.1	14.6
– CIPAM	19.4	20.1	(0.7)	(3.5)
Net flows	6.4	1.9	4.5	large
– Fidante Partners	5.8	1.9	3.9	large
– CIPAM	0.6	(0.1)	0.7	large

Funds Management FUM increased by $8.4 billion (10.1%) compared to the PCP.

During the period, Fidante Partners net inflows were positive $5.8 billion compared to a net inflow of $1.9 billion in the PCP. The net flows were supported by strong flows across a number of fixed income and equity boutiques.

11 Corporate and other segment results

The Corporate and other segment comprises central functions such as the Group executive, finance, treasury, legal, tax, human resources, risk management and strategy.

The financial results also include interest received on Group cash balances and any interest and borrowing costs associated with Group debt facilities.

Corporate and other normalised results	31 Dec 2020 $m	31 Dec 2019 $m	Change $m	Change %
Net income	-	0.2	(0.2)	large
Operating expenses	(29.6)	(32.8)	(3.2)	(9.8)
Normalised EBIT	**(29.6)**	(32.6)	**3.0**	**9.3**
Interest and borrowing costs	(2.3)	(2.5)	(0.2)	(8.0)
Normalised loss before tax	**(31.9)**	(35.1)	**3.2**	**9.1**

Normalised EBIT for the Corporate and other segment was higher (up $3.0 million) as a result of lower operating expenses.

12 Outlook for the 2021 financial year

Challenger continues to be well positioned with a diverse Life and Funds Management product range, positive retirement market demographics and highly efficient operations.

For 2021, Challenger is targeting normalised net profit before tax of between $390 million and $440 million. This profit guidance range reflects the prudent and gradual deployment of Life's excess cash and liquids balance into higher yielding assets and appropriate portfolio settings given the current macro environment. Following the interim result, Challenger expects to be within the guidance range.

Challenger continues to target a normalised RoE of RBA cash rate plus 14% (pre-tax) over the medium term. However, this target is not expected to be achieved in 2021, mainly due to the speed of Life's excess cash and liquids deployment. The Board expects to maintain the same target dividend payout ratio of 45 – 50% of normalised profit for 2021 (subject to prevailing market conditions and capital allocation priorities at the time). An interim dividend of 9.5 cents was announced, franked at 100%.

[1] Consolidated FUM for Australian Fund Managers – Rainmaker Roundup, September 2020.
[2] Mercer as at December 2020.

Directors' report

1 Directors

The names and details of the Directors of Challenger Limited holding office during the six months to 31 December 2020 and as at the date of this report are listed below. Directors were in office for this entire period unless otherwise stated.

Directors	
Peter Polson	Independent Chair
Richard Howes	Managing Director and Chief Executive Officer
John M Green	Independent Non-Executive Director
Steven Gregg	Independent Non-Executive Director
Masahiko Kobayashi[1]	Non-Independent Non-Executive Director
Heather Smith (appointed 20 January 2021)	Independent Non-Executive Director
JoAnne Stephenson	Independent Non-Executive Director
Duncan West	Independent Non-Executive Director
Melanie Willis	Independent Non-Executive Director

[1] Hiroyuki Iioka is an alternate director to Masahiko Kobayashi.

The information appearing on pages 1 to 15 forms part of the Directors' report for the six months to 31 December 2020 and is to be read in conjunction with the following information.

2 Significant events after the balance date

At the date of this financial report, no matter or circumstance has arisen that has, or may significantly affect the Group's operations, the results of those operations or the Group's state of affairs in future financial years which has not already been reflected in this report.

3 Rounding

The amounts contained in this report and the financial report have been rounded to the nearest $100,000 unless otherwise stated, under the option available to the Group under Australian Securities and Investments Commission (ASIC) Corporations Instrument 2016/191.

4 Authorisation

Signed in accordance with a resolution of the Directors of Challenger Limited:

P Polson
Independent Chair

8 February 2021

R Howes
Managing Director & Chief Executive Officer

8 February 2021

5 Auditor's independence declaration

The Directors received the following declaration from the auditor of Challenger Limited:

Building a better working world

Ernst & Young
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Sydney NSW 2000 Australia
GPO Box 2646 Sydney NSW 2001

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Auditor's independence declaration to the Directors of Challenger Limited

As lead auditor for the review of the half-year financial report of Challenger Limited for the half-year ended 31 December 2020, I declare to the best of my knowledge and belief, there have been:

a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review*;* and

b) no contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect of Challenger Limited and the entities it controlled during the financial period.

Ernst & Young

T Johnson
Partner

Sydney
8 February 2021

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Financial statements

Notes to the financial statements

Signed reports

Additional information

This financial report covers Challenger Limited (the Company) and its controlled entities (the Group or Challenger).

Statement of comprehensive income

For the six months ended 31 December	Note	2020 $m	2019 $m
Revenue	1	1,289.5	1,222.2
Expenses	2	(848.9)	(803.5)
Finance costs		(144.3)	(109.6)
Share of profits of associates		16.1	12.8
Profit before income tax		**312.4**	**321.9**
Income tax expense	4	(89.6)	(99.7)
Profit for the period after income tax		**222.8**	**222.2**
Profit attributable to shareholders of Challenger Limited		222.8	220.4
Profit attributable to non-controlling interests		-	1.8
Profit for the period after income tax		**222.8**	**222.2**
Other comprehensive income			
Items that may be reclassified to profit and loss, net of tax			
Translation of foreign entities		(41.9)	(4.6)
Hedge of net investment in foreign entities		39.6	2.7
Cash flow hedges – SPV[1]		(0.6)	(0.1)
Other comprehensive income for the period		(2.9)	(2.0)
Total comprehensive income for the period after tax		**219.9**	**220.2**
Comprehensive income attributable to shareholders of Challenger Limited		219.9	218.4
Comprehensive income attributable to non-controlling interests		-	1.8
Total comprehensive income for the period after tax		**219.9**	**220.2**
Earnings per share attributable to ordinary shareholders of Challenger Limited		**Cents**	**Cents**
Basic	12	33.2	36.3
Diluted	12	27.3	31.5

[1] SPV = Special Purpose Vehicles.

The statement of comprehensive income should be read in conjunction with the accompanying notes.

Statement of financial position

As at	Note	31 Dec 2020 $m	30 Jun 2020 $m	31 Dec 2019 $m
Assets				
Cash and cash equivalents		717.8	603.9	760.2
Cash and cash equivalents – SPV		56.1	58.0	65.0
Receivables		412.6	594.1	306.5
Derivative assets		1,042.4	1,112.5	819.9
Financial assets – fair value through profit and loss	5	21,094.9	20,834.0	20,813.9
Development property held for sale	6	6.7	-	-
Investment and development property	6	3,656.7	3,685.9	3,703.6
Mortgage assets – SPV		637.9	706.6	776.2
Finance leases		30.2	31.7	30.3
Property, plant and equipment		25.1	25.9	27.5
Investment in associates		63.3	63.0	56.1
Other assets		61.4	65.8	60.3
Deferred tax assets		3.8	49.8	5.6
Goodwill		579.9	579.9	580.3
Right-of-use lease assets		37.9	32.4	34.4
Other intangible assets		17.6	18.1	21.7
Total assets of shareholders of Challenger Limited and non-controlling interests		**28,444.3**	**28,461.6**	**28,061.5**
Liabilities				
Payables		985.6	1,640.9	1,022.5
Current tax liability		10.9	1.0	28.5
Derivative liabilities		682.3	725.4	468.1
Interest bearing financial liabilities	10	6,899.3	7,278.2	6,301.4
Interest bearing financial liabilities – SPV		415.4	460.7	677.2
External unit holders' liabilities		3,031.5	2,415.8	2,705.6
Provisions		31.8	35.5	17.0
Lease liabilities		72.4	67.6	70.2
Deferred tax liabilities		32.6	5.7	181.9
Life contract liabilities	7	12,769.7	12,581.2	12,845.3
Total liabilities of shareholders of Challenger Limited and non-controlling interests		**24,931.5**	**25,212.0**	**24,317.7**
Net assets of shareholders of Challenger Limited and non-controlling interests		**3,512.8**	**3,249.6**	**3,743.8**
Equity				
Contributed equity	9	2,422.6	2,377.6	2,110.8
Reserves		(55.5)	(50.9)	(61.0)
Retained earnings		1,145.7	922.9	1,666.0
Total equity of shareholders of Challenger Limited		**3,512.8**	**3,249.6**	**3,715.8**
Non-controlling interests		-	-	28.0
Total equity of shareholders of Challenger Limited and non-controlling interests		**3,512.8**	**3,249.6**	**3,743.8**

The statement of financial position should be read in conjunction with the accompanying notes.

Statement of changes in equity

		Attributable to shareholders of Challenger Limited								
For the period ended 31 December 2019	Note	Contributed equity $m	Share-based payment reserve $m	Cash flow hedge reserve – SPV $m	Foreign currency translation reserve $m	Adjusted controlling interest reserve $m	Retained earnings $m	Total shareholder equity $m	Non-controlling interests $m	Total equity $m
Balance at 1 July 2019		2,093.7	(57.7)	0.1	(2.6)	7.8	1,559.0	3,600.3	22.5	3,622.8
Transition of new leasing standard net of tax		-	-	-	-	-	(3.7)	(3.7)	-	(3.7)
Restated balance at 1 July 2019		**2,093.7**	**(57.7)**	**0.1**	**(2.6)**	**7.8**	**1,555.3**	**3,596.6**	**22.5**	**3,619.1**
Profit for the period		**-**	**-**	**-**	**-**	**-**	**220.4**	**220.4**	**1.8**	**222.2**
Other comprehensive income for the period		-	-	(0.1)	(1.9)	-	-	(2.0)	-	(2.0)
Total comprehensive income for the period		**-**	**-**	**(0.1)**	**(1.9)**	**-**	**220.4**	**218.4**	**1.8**	**220.2**
Other equity movements										
Ordinary shares issued	9	2.6	-	-	-	-	-	2.6	-	2.6
Treasury shares purchased	9	(8.8)	-	-	-	-	-	(8.8)	-	(8.8)
Treasury shares vested	9	14.5	-	-	-	-	-	14.5	-	14.5
Settled forward purchases of Treasury shares	9	8.8	-	-	-	-	-	8.8	-	8.8
Share-based payment expense net of tax less releases		-	(7.2)	-	-	-	-	(7.2)	-	(7.2)
Dividends paid	11	-	-	-	-	-	(109.7)	(109.7)	-	(109.7)
Other movements		-	-	-	-	0.6	-	0.6	3.7	4.3
Balance at 31 December 2019		**2,110.8**	**(64.9)**	**-**	**(4.5)**	**8.4**	**1,666.0**	**3,715.8**	**28.0**	**3,743.8**
For the period ended 31 December 2020										
Balance at 1 July 2020		2,377.6	(56.2)	0.1	(0.5)	5.7	922.9	3,249.6	-	3,249.6
Profit for the period		-	-	-	-	-	222.8	222.8	-	222.8
Other comprehensive income for the period		-	-	(0.6)	(2.3)	-	-	(2.9)	-	(2.9)
Total comprehensive income for the period		**-**	**-**	**(0.5)**	**(2.8)**	**-**	**222.8**	**219.9**	**-**	**219.9**
Other equity movements										
Ordinary shares issued	9	34.8	-	-	-	-	-	34.8	-	34.8
Treasury shares purchased	9	-	-	-	-	-	-	-	-	-
Treasury shares vested	9	10.2	-	-	-	-	-	10.2	-	10.2
Share-based payment expense net of tax less releases		-	(1.7)	-	-	-	-	(1.7)	-	(1.7)
Dividends paid	11	-	-	-	-	-	-	-	-	-
Other movements		-	-	-	-	-	-	-	-	-
Balance at 31 December 2020		**2,422.6**	**(57.9)**	**(0.5)**	**(2.8)**	**5.7**	**1,145.7**	**3,512.8**	**-**	**3,512.8**

The statement of changes in equity should be read in conjunction with the accompanying notes.

Statement of cash flows

For the six months ended 31 December	Note	2020 $m	2019 $m
Operating activities			
Receipts from customers		308.7	316.5
Annuity and premium receipts	7	2,206.3	1,968.6
Annuity and claim payments	7	(2,192.3)	(2,054.4)
Receipts from external unit holders		1,246.6	1,182.2
Payments to external unit holders		(744.5)	(486.7)
Payments to vendors and employees		(297.7)	(316.2)
Dividends received		33.6	45.7
Interest received		325.6	396.0
Interest paid		(26.8)	(61.8)
Income tax paid		(9.0)	(48.9)
Net cash inflows from operating activities	8	**850.5**	**941.0**
Investing activities			
Payments on net purchases of investments		(436.4)	(766.3)
Payments for purchase of controlled entities		-	(10.2)
Net mortgage loan repayments		52.2	77.6
Payments for net purchases of property, plant and equipment		(3.5)	(6.0)
Net cash outflows from investing activities		**(387.7)**	**(704.9)**
Financing activities			
Proceeds from issue of ordinary shares	9	35.0	2.6
Costs associated with issue of ordinary shares		(0.2)	-
Net repayments from borrowings – interest bearing financial liabilities	10	(465.4)	(89.3)
Payments for lease liabilities		(3.4)	(2.6)
Receipts/(payments) for Treasury shares		2.4	(3.8)
Net dividends paid	11	-	(109.7)
Proceeds from the issue of Challenger Capital Notes 3		385.0	-
Costs associated with the issue of Challenger Capital Notes 3		(6.7)	-
Repayment of Challenger Capital Notes 1		(297.5)	-
Net cash outflows from financing activities		**(350.8)**	**(202.8)**
Net increase in cash and cash equivalents		**112.0**	**33.3**
Cash and cash equivalents at the beginning of the period		661.9	791.9
Cash and cash equivalents at the end of the period		**773.9**	**825.2**

The statement of cash flows should be read in conjunction with the accompanying notes.

Basis of preparation and overarching significant accounting policies

Challenger Limited (the Company or the parent entity) is a company limited by shares, incorporated and domiciled in Australia, whose shares are publicly traded on the Australian Securities Exchange (ASX).

The interim financial report for Challenger Limited and its controlled entities (the Group or Challenger) for the six months ended 31 December 2020 was authorised for issue in accordance with a resolution of the Directors of the Company on 8 February 2021.

(i) Basis of preparation and statement of compliance

This is a general purpose interim financial report for the six months ended 31 December 2020 that has been prepared in accordance, and complies, with the requirements of the *Corporations Act 2001* and AASB 134 *Interim Financial Reporting*. Challenger Limited is a for-profit entity for the purposes of preparing financial statements.

The interim financial report does not include all the notes normally included in an annual financial report. It is recommended that this interim financial report be read in conjunction with the financial report for the year ended 30 June 2020 and any public announcements made by the Group in accordance with the continuous disclosure obligations of the ASX Listing Rules.

Unless otherwise stated, amounts in this financial report are presented in Australian dollars and have been prepared on a historical cost basis. The assets and liabilities disclosed in the statement of financial position are grouped by nature and listed in an order that reflects their relative liquidity.

(ii) Significant accounting judgements, estimates and assumptions

The carrying values of amounts recognised on the statement of financial position are often based on estimates and assumptions of future events. The key estimates and assumptions that have a significant risk of causing a material adjustment to the recognised amounts within the next annual reporting period are disclosed individually within each of the relevant notes to the financial statements. The continued impact of COVID-19 has been considered in relation to the disclosures made in these financial statements.

Coronavirus (COVID-19) impact

Background

COVID-19, which is a respiratory illness caused by a new virus, was declared a worldwide pandemic by the World Health Organization in March 2020. COVID-19, as well as measures to slow the spread of the virus, have since had a significant impact on global economies and equity and debt markets. The Group has considered the impact of COVID-19 and associated market volatility in preparing its financial statements.

The impact of COVID-19 has resulted in the application of further judgement in the areas in which significant judgement already occurs. Given the dynamic and evolving nature of COVID-19 and limited recent experience of the economic and financial impacts of such a pandemic, changes to the estimates and outcomes that have been applied in the measurement of the Group's assets and liabilities may arise in the future.

Processes applied

As a consequence of COVID-19 and in preparing this interim financial report, management:

- re-evaluated whether there were any additional areas of judgement or estimation uncertainty;
- reviewed external market communications to identify other COVID-19-related impacts;
- reviewed public forecasts and experience from previous downturns and conducted several internal processes to ensure consistency in the application of the expected impact of COVID-19 across all asset classes;
- assessed the carrying values of its assets and liabilities and determined any impact that may occur as a result of market inputs and variables impacted by COVID-19;
- ran multiple stress-testing scenarios, which are an integral component of the Group's risk management framework and a key input to the capital adequacy assessment process, to assess the potential impacts of the COVID-19 pandemic on its portfolio to assist in the organisation's prudent risk management; and
- considered the impact of COVID-19 on the Group's financial statement disclosures.

(iii) New and revised accounting standards and policies

The accounting policies and methods of computation are the same as those adopted in the annual report for the prior comparative period.

There have been no new or revised accounting standards or interpretations that are effective from the period beginning on or after 1 July 2020 which materially impact the interim financial results. Where applicable, comparative figures have been updated to reflect any changes in the current period.

Accounting standards and interpretations issued but not yet effective

AASB 17 *Insurance Contracts*

AASB 17 *Insurance Contracts* replaces AASB 4 *Insurance Contracts*, AASB 1038 *Life Insurance Contracts* and AASB 1023 *General Insurance Contracts,* and is effective for Challenger from 1 July 2023. The Group is not expected to early adopt the standard. AASB 17 *Insurance Contracts* establishes globally consistent principles for the recognition, measurement, presentation and disclosure of life insurance contracts issued. Life investment contracts are currently measured under the financial instruments standard and will continue to be recognised under this standard.

Basis of preparation and overarching significant accounting policies (continued)

(iii) New and revised accounting standards and policies (continued)

AASB 17 *Insurance Contracts* (continued)

AASB 17 introduces changes to the profit emergence profiles of life insurance contracts but does not affect the underlying economics or cash flows of the contracts. The impacts on capital requirements and income tax are unknown, pending regulatory responses from APRA and the Australian Taxation Office (ATO) respectively.

The main changes anticipated for the Group under AASB 17 are set out below:

- Insurance contract portfolios will be disaggregated to more granular levels and will be required to be evaluated by risk type, issue year and profitability.
- Although conceptually similar, the Contractual Service Margin (CSM) recognises profit on a different basis to the current Margin on Services (MoS) approach, and therefore the profit signature is likely to change for portfolios with positive profit margins.
- A new risk adjustment for non-financial risk will be introduced which reflects the compensation that the Group requires for bearing the uncertainty in relation to the amount and timing of cash flows. The confidence level used to determine the risk adjustment will need to be disclosed.
- Additional disclosures will be more extensive, requiring increased granularity and more analysis of movements.

The Group has conducted a business impact assessment identifying the following focus areas:

- Measurement model – the Group will adopt the General Model approach, also referred to as the Building Block Approach (BBA). In principle, the General Model approach is similar to the current MoS methodology as prescribed under AASB 1038.The General Model approach is a more detailed methodology that will require enhanced data capture and storing for additional modelling and processes.
- Contracts affected – the Group expects that all contracts classified as insurance contracts under AASB 1038 will meet the definition of insurance contracts under AASB 17.
- Separating components – the Group has assessed the requirement to unbundle features and components under AASB 17 and expects that no change will be required given no contracts are currently unbundled under AASB 1038.
- Under AASB 17, assumptions are to be reviewed on an annual basis at a minimum with some items requiring more frequent review.
- Level of aggregation – AASB 17 requires insurance contracts that are subject to similar risks and managed together, be allocated to a portfolio. AASB 17 requires that each portfolio be divided into a minimum of:
  1. a group that is onerous (loss-making) at initial recognition;
  2. a group that at initial recognition has no significant possibility of becoming onerous subsequently; and
  3. a group of any remaining contracts in the portfolio.

The Group has conducted a high-level review of historical data to ascertain the feasibility of meeting the level of aggregation required by AASB 17. In addition, the Group will be formalising a policy for defining portfolios and contract groups. Due to the nature of insurance products that Challenger offers its customers, the Group expects that most of the portfolios will be designated as onerous. If a portfolio is designated as onerous, a CSM calculation will not be required. Alternatively, the tracking of the loss component will be required under AASB 17:

- Risk adjustment – the Group expects the risk adjustment methodology to align with the cost of capital approach.
- Disclosure - AASB 17 introduces a new way of viewing life insurance revenue and expenses and accompanying financial disclosures. Under AASB 17, insurance contract revenue will be allocated to each period in a proportion to the reduction in liability over the remaining coverage period. The Group has assessed the capability of the Group's general ledger system and confirms that no issues are anticipated for configuring the system to meet the new financial reporting and disclosure requirements under AASB 17.
- Insurance contracts will need to be restated at 1 July 2023 (being the date of initial application). The first full year financial statements presented under AASB 17 will be for the year ended 30 June 2024 with comparatives required for 30 June 2023. The first half year financial statements will be for the period ended 31 December 2023, with comparatives required for 31 December 2022. The Group notes that the full retrospective approach maybe impracticable in some cases, especially for older cohorts where assumptions cannot be determined without hindsight.

While the standard is expected to impact the Group's comprehensive income, it is not yet practicable to determine the quantum.

Existing standards and interpretations not yet effective

Other amendments to existing standards or interpretations that are not yet effective are not expected to result in a material impact to the Group's financial statements.

Note 1 Revenue

	31 Dec 2020 $m	31 Dec 2019 $m
Investment revenue		
Fixed income securities and cash[1]	667.6	372.8
Investment property and property securities	130.4	163.0
Equity and infrastructure investments	54.6	85.9
Realised and unrealised (losses)/gains on hedges and foreign exchange translation	(77.6)	32.9
Fee revenue	111.7	110.0
Other revenue		
Life insurance contract premiums and related revenue[2]	402.8	457.6
Total revenue	**1,289.5**	**1,222.2**

[1] Includes fair value and realised movements in subordinated debt and includes interest revenue of $337.9 million (31 December 2019: $404.7 million); $322.6 million (31 December 2019: $381.6 million) was calculated using the effective interest rate method.

[2] Changes in life insurance and investment contract liabilities arising from new business, annuity payments, discount rates, inflation rates and other assumptions are recognised as revenue, with other movements being included in Note 2 Expenses.

Note 2 Expenses

	31 Dec 2020 $m	31 Dec 2019 $m
Life insurance contract claims and expenses[1]	577.3	518.5
Investment property-related expenses[2]	46.5	46.1
Fee expense	67.1	62.4
Distribution expenses	25.5	22.8
Employee benefits expenses	86.5	92.4
Other expenses[3]	46.0	61.3
Total expenses	**848.9**	**803.5**

[1] Cost of life contract liabilities recognised as an expense consists of the interest expense on the liability and any loss on the initial recognition of new business less the release of liability in respect of expenses incurred in the current period. The interest expense on the liability represents the unwind of the discount on the opening liability over the period, whereas the impacts of changes in the discount rate applied for the current valuation are included in the change in life contract liabilities disclosed in Note 1 Revenue.

[2] Investment property-related expenses relate to rental income-generating investment properties.

[3] Includes depreciation of right-of-use lease asset $2.7 million (31 December 2019: $2.3 million). Comparative period includes impairments of $8.9 million.

Note 3 Segment information

The reporting segments[1] of the Group have been identified as follows:

	Life		Funds Management		Total reporting segments		Corporate and other[2]		Total	
For the six months ended 31 December	**2020 $m**	**2019 $m**	**2020 $m**	**2019 $m**	**2020 $m**	**2019 $m**	**2020 $m**	**2019 $m**	**2020 $m**	**2019 $m**
Net income	244.0	344.8	81.3	77.7	325.3	422.5	-	0.2	325.3	422.7
Operating expenses	(51.2)	(59.0)	(46.0)	(49.8)	(97.2)	(108.8)	(29.6)	(32.8)	(126.8)	(141.6)
Normalised EBIT	**192.8**	**285.8**	**35.3**	**27.9**	**228.1**	**313.7**	**(29.6)**	**(32.6)**	**198.5**	**281.1**
Interest and borrowing costs	-	-	-	-	-	-	(2.3)	(2.5)	(2.3)	(2.5)
Normalised net profit/(loss) before tax	**192.8**	**285.8**	**35.3**	**27.9**	**228.1**	**313.7**	**(31.9)**	**(35.1)**	**196.2**	**278.6**
Tax on normalised profit									(59.4)	(87.2)
Normalised net profit after tax									**136.8**	**191.4**
Investment experience after tax									87.1	38.4
Significant items after tax									(1.1)	(9.4)
Profit attributable to the shareholders of Challenger Ltd									**222.8**	**220.4**
Other statutory segment information										
Revenue from external customers[3]	849.7	721.0	101.9	96.5	951.6	817.5	-	-	951.6	817.5
Interest revenue	337.9	403.5	-	-	337.9	403.5	-	1.2	337.9	404.7
Interest expense	(128.0)	(89.3)	(0.6)	-	(128.6)	(89.3)	(15.7)	(20.3)	(144.3)	(109.6)
Intersegment revenue	(22.3)	(23.3)	22.3	23.3	-	-	-	-	-	-
Depreciation and amortisation	(3.7)	(2.8)	(2.8)	(2.0)	(6.5)	(4.8)	(0.9)	(0.7)	(7.4)	(5.5)
As at 31 December										
Segment assets	20,530.0	20,585.3	278.2	263.3	20,808.2	20,848.6	7,636.1	7,184.9	28,444.3	28,033.5
Segment liabilities	(17,365.2)	(17,111.4)	(24.0)	(26.7)	(17,389.2)	(17,138.1)	(7,542.3)	(7,179.6)	(24,931.5)	(24,317.7)
Net assets attributable to shareholders	**3,164.8**	**3,473.9**	**254.2**	**236.6**	**3,419.0**	**3,710.5**	**93.8**	**5.3**	**3,512.8**	**3,715.8**

[1] Refer below for definitions of the terms used in the management view of segments.
[2] Corporate and other includes corporate companies, corporate SPV, non-controlling interests and Group eliminations.
[3] Funds management revenue from external customers is predominantly management fees.

Definitions

Operating segments

The following segments are identified on the basis of internal reporting to Key Management Personnel, including the Chief Executive Officer (the chief operating decision maker) of the Group, and comprise component parts of the Group that are regularly reviewed by senior management in order to allocate resources and assess performance.

Life

The Life segment principally includes the annuity and life insurance business carried out by CLC and Accurium Pty Limited (provision of self-managed superannuation fund actuarial certificates). CLC offers fixed rate retirement and superannuation products that are designed for Australian investors who are seeking a low-risk, fixed term or lifetime investment and reliable income. CLC also offers fixed term and lifetime investments to investors in Japan through its reinsurance arrangement with MS Primary. CLC invests in assets providing long-term income streams for customers.

Funds Management

Funds Management earns fees from its Fidante Partners and CIP Asset Management (CIPAM) operations, providing an end-to-end funds management business. Funds Management has equity investments in a number of Fidante Partners boutique fund managers and, through the CIPAM business, offers a range of managed investments across fixed income and property.

Note 3 Segment information (continued)

Definitions (continued)

Corporate and other

The corporate segment, which is not considered an operating segment of the Group, is used to reconcile the total segment results back to the consolidated results and consists of other income and costs that fall outside the day-to-day operations of the reportable segments. These include the costs of the Group CEO and CFO, shared services across the Group, long-term incentive costs, Directors' fees, corporate borrowings and associated borrowing costs and shareholder registry services.

To reconcile to Group results, the Corporate and other segment also includes eliminations and non-core activities of the Group.

Transactions between segments

All transactions and transfers between segments are generally determined on an arm's length basis and are included within the relevant categories of income and expense. These transactions eliminate on consolidation.

Normalised vs. statutory results

Net income and operating expenses differ from revenue and expenses as disclosed in the statement of comprehensive income as certain direct costs (including distribution expenses, property expenses and management fees) included in expenses are netted off against revenues in deriving the aforementioned management view of net income. Net income consists of the following sub-categories of management views of revenue:

- normalised cash operating earnings (Life segment);
- net income (Funds Management segment); and
- other income (Corporate and other segment).

In addition, the revenues, expenses and finance costs from Special Purpose Vehicles (SPVs) are separately disclosed in the statutory view but are netted off in net income in the management view of the Life segment.

Revenue also includes investment gains and losses which are excluded from the management view as they form part of investment experience (refer below).

Normalised cash operating earnings

This is calculated as cash earnings plus normalised capital growth (refer below). Cash earnings represent the sum of investment yield (being the management view of revenue from investment assets such as net rental income, dividends and interest), interest expense, distribution expenses and fees.

Normalised EBIT

Normalised earnings before interest and tax (EBIT) comprises net income less operating expenses, as defined above. It excludes investment experience, corporate interest and borrowing costs, tax and any significant items (refer below).

Interest and borrowing costs differ from finance costs as disclosed in the statement of comprehensive income for similar reasons to revenue and expenses, with the major difference arising from the netting of SPV finance costs against SPV revenue in net income in the management view of the Life segment.

Tax on normalised profit

This represents the consolidated statutory tax expense or benefit for the period, less tax attributable to non-controlling interests, investment experience and significant items.

Investment experience after tax

The Group is required by accounting standards to value applicable assets and liabilities supporting the life insurance business at fair value. This can give rise to fluctuating valuation movements being recognised in the statement of comprehensive income, particularly during periods of market volatility. As the Group is generally a long-term holder of assets, due to assets being held to match the term of life contract liabilities, the Group takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term volatility. Investment experience is a mechanism employed to isolate the volatility arising from asset and liability valuation within the results so as to more accurately reflect the underlying performance of the Group.

Investment experience is calculated as the difference between the actual investment gains/losses (both realised and unrealised) and the normalised capital growth (refer below) plus life contract valuation changes and new business strain. Investment experience after tax is investment experience net of tax at the prevailing income tax rate.

Normalised capital growth

This is determined by multiplying the normalised capital growth rate for each asset class by the average investment assets for the period. The normalised growth rates represent the Group's medium to long-term capital growth expectations for each asset class over the investment cycle.

The annual normalised growth rates are +4.0% for equity and infrastructure, +2.0% for property, 0.0% for alternatives and -0.35% for cash and fixed income. The asset classes and normalised growth rates changed from 1 July 2020. The rates have been set with reference to the composition of the asset classes and medium to long-term market growth rates, and are reviewed to ensure consistency with prevailing market conditions. The rates for the prior period were as follows, and reflect the composition of the portfolio at that time: +3.5% for equity and other investments, +4.0% for infrastructure, +2.0% for property, and -0.35% for cash and fixed income.

Life contract valuation experience

Life contract valuation experience represents the impact of changes in macroeconomic variables, including bond yields and inflation factors, illiquidity premium, expense assumptions and other factors applied in the valuation of life contract liabilities. It also includes the attribution of the corresponding interest rate, foreign exchange and inflation derivatives used for hedging.

Note 3 Segment information (continued)

New business strain

New business strain is a non-cash valuation adjustment recognised when annuity rates on new business are higher than the risk-free rate used to fair value life contracts. Maintenance expense allowances over the expected future term of the new business are also included in the life contract valuation. New business strain reported in the period represents the valuation loss on new sales generated in the current period net of the reversal of new business strain of prior period sales.

Significant items after tax

The Group presents additional non-IFRS financial information to the market to provide meaningful insights into the financial condition of the business. Due consideration has been given to ensure that disclosure of Challenger's normalised profit framework is explained, reconciled and calculated consistently period on period. Within this framework, Challenger defines significant items as non-recurring or abnormal income or expense items.

Major customers

No individual customer amounted to greater than 10% of the Group's segment revenue as defined above.

Geographical areas

The Group operates predominantly in Australia, thus no geographical split is provided to the chief operating decision-maker. Reinsurance of annuities issued by MS Primary accounted for $543.4 million of the Group's life insurance premium income in the period to 31 December 2020 out of total life insurance premium income of $888.6 million (December 2019: $470.6 million out of a total of $681.1 million) and comprised 15.6% of total policy liabilities outstanding as at 31 December 2020 (30 June 2020: 13.7%). While the underlying annuitant resides in Japan, the reinsurance service provided by CLC is considered to be Australian business and is therefore not recognised as a geographically separate segment.

	31 Dec 2020 $m	31 Dec 2019 $m
Reconciliation of management to statutory view of after-tax profit		
Operating segments normalised net profit before tax	228.1	313.7
Corporate and other normalised net loss before tax	(31.9)	(35.1)
Normalised net profit before tax (management view of pre-tax profit)	**196.2**	**278.6**
Tax on normalised profit	(59.4)	(87.2)
Normalised net profit after tax	**136.8**	**191.4**
Investment experience after tax	87.1	38.4
Significant items after tax	(1.1)	(9.4)
Profit attributable to the shareholders of Challenger Limited	**222.8**	**220.4**
Profit attributable to non-controlling interests excluded from management view	-	1.8
Statutory view of profit after tax	**222.8**	**222.2**
Reconciliation of management view of revenue to statutory revenue		
Operating segments	325.3	422.5
Corporate and other	-	0.2
Net income (management view of revenue)	**325.3**	**422.7**
Expenses and finance costs offset against revenue		
SPV expenses and finance costs offset against SPV income	1.8	6.7
Distribution expenses offset against related income	25.5	22.8
Change in life contract liabilities and reinsurance contracts recognised in expenses	577.3	518.5
Property related expenses offset against property income	46.5	46.1
Interest and loan amortisation costs	125.5	82.5
Management fee expenses	67.1	62.4
Adjustment for non-controlling interests and other items	(4.0)	4.6
Difference between management view of investment experience and statutory recognition		
Actual capital growth	245.3	111.2
Normalised capital growth	(16.3)	(70.6)
Life contract valuation experience	(108.4)	14.3
New business strain	3.9	1.0
Statutory revenue (refer Note 1 Revenue)	**1,289.5**	**1,222.2**

Note 4 Income tax

Reconciliation of income tax expense	31 Dec 2020 $m	31 Dec 2019 $m
Profit before income tax	312.4	321.9
Prima facie income tax based on the Australian company tax rate of 30%	(93.7)	(96.6)
Tax effect of amounts not assessable/deductible in calculating taxable income:		
– Challenger Capital Notes distributions	(3.8)	(4.3)
– non-assessable and non-deductible items	7.6	4.3
– other items	0.3	(3.1)
Income tax expense	**(89.6)**	**(99.7)**
Underlying effective tax rate[1]	**28.7%**	**31.1%**

[1] The calculation of the underlying effective tax rate excludes the non-controlling interests' profit of nil (31 December 2019: $1.8 million).

Analysis of income tax expense	31 Dec 2020 $m	31 Dec 2019 $m
Current income tax expense for the period	(19.6)	(86.8)
Current income tax benefit prior period adjustment	-	3.8
Deferred income tax expense	(70.1)	(13.8)
Deferred income tax benefit/(expense) prior period adjustment	0.1	(2.9)
Income tax expense	**(89.6)**	**(99.7)**
Income tax benefit on translation of foreign entities	13.0	1.7
Income tax expense on hedge of net investment in foreign entities	(17.0)	(1.1)
Income tax (expense)/benefit from other comprehensive income	**(4.0)**	**0.6**

Recognised deferred tax balances	31 Dec 2020 $m	30 Jun 2020 $m
Tax consolidated group losses	1.4	83.9
Non-tax consolidated group losses	7.0	8.2
DTA on losses	**8.4**	**92.1**

Unrecognised deferred tax balances	31 Dec 2020 $m	30 Jun 2020 $m
Non-tax consolidated group revenue losses – tax effected	7.4	7.4
Tax consolidated group capital losses – tax effected	56.2	56.2

Note 5 Financial assets – fair value through profit and loss

	31 Dec 2020 $m	30 Jun 2020 $m	31 Dec 2019 $m
Domestic sovereign bonds and semi-government bonds	8,178.3	8,610.3	7,046.3
Floating rate notes and corporate bonds	4,793.6	4,915.6	5,854.1
Residential mortgage and asset-backed securities	6,367.1	5,809.2	5,223.4
Non-SPV mortgage assets	121.1	139.8	281.4
Fixed income securities	**19,460.1**	**19,474.9**	**18,405.2**
Shares in listed and unlisted corporations	83.6	97.8	117.8
Unit trusts, managed funds and other	1,098.6	804.9	1,351.2
Equity securities	**1,182.2**	**902.7**	**1,469.0**
Units in listed and unlisted infrastructure trusts	51.3	55.9	520.2
Other infrastructure investments	315.8	324.2	319.8
Infrastructure investments	**367.1**	**380.1**	**840.0**
Indirect property investments in listed and unlisted trusts	85.5	76.3	99.7
Property securities	**85.5**	**76.3**	**99.7**
Total financial assets – fair value through profit and loss	**21,094.9**	**20,834.0**	**20,813.9**

Note 6 Investment and development property

	31 Dec 2020 $m	30 Jun 2020 $m	31 Dec 2019 $m
Investment property in use	3,656.7	3,679.7	3,698.9
Investment property under development	-	6.2	4.7
Total investment property	**3,656.7**	**3,685.9**	**3,703.6**
Development property held for sale[1]	6.7	-	-
Total investment and development property[2]	**3,663.4**	**3,685.9**	**3,703.6**

[1] Development property held for sale is recognised at fair value.
[2] Development property held for sale is considered current. All other investment property is considered non-current.

Accounting policy

Investment and development property is initially recognised at cost, including transaction costs. Subsequent to initial recognition, investment and development property is recognised at fair value.

Investment and development property is classified as held for sale if its carrying value will be recovered principally through a sale transaction rather than through continuing use. This condition is met only when management is committed to the sale, and the sale is highly probable to occur in the next 12 months. Investment and development property held for sale is carried at fair value, being the latest valuation available, or agreed sale price.

Gains or losses arising from changes in the fair values of investment properties are included in the statement of comprehensive income in the period in which they arise.

Investment and development properties are derecognised when they have either been disposed of or when the investment and development property is permanently withdrawn from use and no future benefit is expected from its disposal. Any gain or loss on the retirement or disposal of an investment and development property is recognised in the statement of comprehensive income in the year of retirement or disposal.

Where properties are debt financed, that finance is provided either by secured mortgages or by funding that contains a number of negative undertakings (including undertakings not to create or allow encumbrances, and undertakings not to incur financial indebtedness which ranks in priority to existing debt).

Impact of COVID-19

Across all sectors, particularly retail, some tenants are seeking rent relief as a result of the impact of the COVID-19 pandemic. Rent relief is granted after considering various factors and individual tenant circumstances. Rent relief occurs in respect of three categories: (i) current rent due and payable now; (ii) deferred rent, payable at a later date; or (iii) waived rent, not payable.

If relief is given for current and deferred rent, income will continue to be recognised on a straight line basis over the term of the lease. The resulting rent receivable assets recognised in the statement of financial position as at 31 December 2020 have been assessed for impairment.

Note 6 Investment and development property (continued)

Accounting policy (continued)

The methodology adopted for determining whether these rent receivable assets should be impaired is aligned to the requirements of AASB 9 *Financial Instruments*.

Any waived rent is capitalised and recognised on the statement of financial position from the effective date of the lease modification and amortised over the remaining lease term.

Investment property under development

When redevelopment of an existing investment property commences, it continues to be classified and measured as investment property when the asset is being redeveloped for continued future use as an investment property.

Investment property under construction is held at cost until an estimate of the fair value can be reliably determined.

Key estimates and assumptions

Independent valuations for all investment properties are conducted at least annually by suitably qualified valuers, and the Directors make reference to these independent valuations when determining fair value. For the period ended 31 December 2020, all investment properties were valued by external valuers.

Each independent valuer is appointed in line with the valuation policy, which requires that valuers are authorised to practise under the law of the relevant jurisdiction where the valuation takes place and have at least five years of continuous experience in the valuation of property of a similar type to the property being valued, and on the basis that they are engaged for no longer than two consecutive years on an individual property.

The valuer must have no pecuniary interest that could conflict with the valuation of the property, must be suitably indemnified, and must comply with the Australian Property Institute (API) Code of Ethics and Rules of Conduct (or foreign equivalent).

Fair value for the purposes of the valuation is market value as defined by the International Assets Valuation Standards Committee. In determining market value, valuers examine available market evidence and apply this analysis to both the traditional market capitalisation approach and the discounted cash flow approach (using market-determined risk-adjusted discount rates).

Valuers are required to provide valuation methodology and calculations for fair value including reference to annual net market income, comparable capitalisation rates, and property-specific adjustments. The values of investment property do not reflect anticipated enhancement from future capital expenditure.

Impact of COVID-19

As at 31 December 2020, the real estate markets to which the Group's investment properties belong were impacted by significant uncertainty caused by the COVID-19 pandemic. This has created valuation uncertainty and had an impact on the value of investment property as at 31 December 2020.

The valuation uncertainty has affected key inputs, assumptions and processes used in the valuation of the Group's investment properties, being:

- estimating the net income that a property can produce; and
- converting that income to value by applying investment rates of return that are derived from analysis of recent market transactions.

Income uncertainty

The impact of COVID-19 on the income-earning potential of the Group's properties is uncertain. The Group leases commercial space to a range of businesses from where they conduct their operations. Restrictions imposed by Government to combat COVID-19 has, in a majority of cases, impacted the ability for these businesses to operate effectively from their premises, or has affected their ability to operate in the usual manner prior to the onset of COVID-19.

In response to this and the Government's Code of Conduct for commercial tenancies, the Group is currently working through a cost-sharing program in compliance with the Code of Conduct for each tenant that has been affected. This involves the Group either deferring or waiving rent owed by the tenant depending on the individual circumstances. This program has had an impact for this reporting period and will continue to have an impact for the year ending 30 June 2021.

Rent receivable balances in respect of current and deferred rent recognised in the statement of financial position for the reporting period, have been assessed for impairment. An approach has been adopted which applies a lifetime expected credit loss and assesses all possible default events over the expected life of the receivables balance.

Note 6 Investment and development property (continued)

Key estimates and assumptions (continued)

An appropriate loss rate has then been determined after considering the following factors:

- the asset sector in which the affected rent receivable is recognised. Each sector is affected differently by COVID-19 and this needs to be reflected in any loss assumption;
- the ranking of tenants by most to least affected by COVID-19 impacts; and
- the ageing of rent receivables.

After taking these factors into consideration and assessing the overall progress of the cost-sharing program underway with tenants, an impairment of $2.8 million was recognised in the statement of comprehensive income for the period ended 31 December 2020 in relation to the rent receivable gross asset value of $14.0 million. This assessment was conducted based on reasonable and supporting information readily available, and considering current and expected future economic conditions.

Valuation uncertainty

Valuation uncertainty has also arisen from an inactive property investment market. An inactive market means a lack of transactional evidence demonstrating current market pricing. In these circumstances, the only inputs and metrics available to reliably estimate fair value relate to the market before COVID-19 occurred and the impact of COVID-19 on prices cannot be known with certainty until the market stabilises.

As a result of these income and investment uncertainties, the Group's independent valuers noted the difficulty in undertaking valuations at this time and, in the absence of relevant market evidence, they have adjusted valuation inputs and estimates to reflect the impact of COVID-19 on investment property value.

While these estimates have been formed by valuers after careful consideration and consultation with a range of reliable sources, it must be recognised that COVID-19 is a unique, rapidly evolving situation and critical events that could help determine the duration and depth of its impact remain unknown at the date of valuation.

In response to this valuation uncertainty, the Group determined that all directly held investment properties would be independently valued by external valuers at 31 December 2020. To reflect the impact of COVID-19 on investment property value, the valuers have generally adopted softer valuation inputs, including expanded capitalisation and discount rates, lower growth rates in the near term, lower market rental levels, increased vacancy rates and increased rental allowances. The valuers have also made deductions for the costs of estimated rent relief to tenants for occupancy disruption resulting from COVID-19 related impacts.

Note 7 Life contract liabilities

Fair value of life contract liabilities	31 Dec 2020 $m	30 Jun 2020 $m	31 Dec 2019 $m
Life investment contract liabilities – at fair value	5,520.5	5,867.8	6,428.9
Life insurance contract liabilities – at Margin on Services value	7,250.0	6,714.4	6,417.1
Reinsurance contract liabilities – at Margin on Services value	(0.8)	(1.0)	(0.7)
Total life contract liabilities	**12,769.7**	**12,581.2**	**12,845.3**

	Life investment contract liabilities		Life insurance contract liabilities		Outward reinsurance contract liabilities		Total life contract liabilities	
Movement in life contract liabilities	31 Dec 2020 $m	31 Dec 2019 $m	31 Dec 2020 $m	31 Dec 2019 $m	31 Dec 2020 $m	31 Dec 2019 $m	31 Dec 2020 $m	31 Dec 2019 $m
Balance at the beginning of the period	5,867.8	6,757.7	6,714.4	6,113.1	(1.0)	(0.6)	12,581.2	12,870.2
Deposits and premium receipts	1,302.3	1,275.8	904.0	692.8	-	-	2,206.3	1,968.6
Payments and withdrawals	(1,730.7)	(1,659.9)	(461.6)	(394.5)	-	-	(2,192.3)	(2,054.4)
Revenue per Note 1	23.8	(15.2)	(426.8)	(442.3)	0.2	(0.1)	(402.8)	(457.6)
Expenses per Note 2	57.3	70.5	520.0	448.0	-	-	577.3	518.5
Balance at the end of the period	**5,520.5**	**6,428.9**	**7,250.0**	**6,417.1**	**(0.8)**	**(0.7)**	**12,769.7**	**12,845.3**

Accounting policy

The operations of the Group include the selling and administration of life contracts through Challenger Life Company Limited (CLC). These contracts are governed under the *Life Insurance Act 1995* (the Life Act) and are classified as either life insurance contracts or life investment contracts. Life insurance and life investment contract liabilities are collectively referred to as life contract liabilities or policy liabilities.

Life investment contract liabilities

Life investment contracts are contracts regulated under the Life Act which do not meet the definition of life insurance contracts under AASB 1038 *Life Insurance Contracts* and similar contracts issued by entities operating outside of Australia.

For fixed term policies, the liability is based on the fair value of the income payments and associated expenses, being the net present value of the payments and expenses using an appropriate discount rate curve as determined by the Appointed Actuary.

Life insurance contract liabilities

Life insurance contracts are contracts regulated under the Life Act that involve the acceptance of significant insurance risk. Insurance risk is defined as significant if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (i.e. have no discernible effect on the economics of the transaction).

The financial reporting methodology used to determine the value of life insurance contract liabilities is referred to as Margin on Services (MoS). Under MoS, the excess of premiums received over payments to customers and expenses (the margin) is recognised over the life of the contract in a manner that reflects the pattern of risk accepted from the policyholder (the service) unless future margins are negative, in which case the future losses are recognised in the statement of comprehensive income in the period in which they occur. The planned release of this margin is recognised in the statement of comprehensive income as part of the life insurance contract premiums and related revenue.

Life insurance contract liabilities are usually determined using a projection method, whereby estimates of policy cash flows (premiums, payments and expenses) are projected into the future. The liability is calculated as the net present value of these projected cash flows using a risk-free discount rate curve.

The key areas of judgement in the determination of the actuarial assumptions are the duration of claims/policy payments, acquisition and maintenance expense levels, and economic assumptions for discount and inflation rates.

Life insurance premium revenue

Life insurance premiums are recognised as revenue when risk is transferred to the Group.

Note 7 Life contract liabilities (continued)

Life insurance claims expense

Life insurance claims expense is recognised in expenses when the liability to the policyholder under the contract has been established.

Inwards reinsurance

The Group has maintained inwards reinsurance arrangements during the period that meet the definition of a life insurance contract. The MoS methodology requires the present value of future cash flows arising from reinsurance contracts to be included in the calculation of life insurance contract liabilities.

Valuation

The MoS valuation, calculated in accordance with APRA Prudential Standards, results in the systematic release of planned margins over the life of the policy via a 'profit carrier'. The Group maintains life insurance contracts, including individual lifetime annuities, wholesale mortality, wholesale morbidity and longevity reinsurance. Annuity payments are used as the profit carrier for individual lifetime annuities; premium receipts or best estimate claim payments are used as the profit carrier for wholesale mortality, wholesale morbidity and longevity reinsurance.

Key assumptions applied in the valuation of life contract liabilities

Tax rates

The bases of taxation (including deductibility of expenses) are assumed to continue in accordance with legislation current at the reporting date.

Discount rates

Under APRA Prudential Standards and AASB 1038 *Life Insurance Contracts*, life insurance contract liabilities are calculated by discounting expected future cash flows at a risk-free rate, set at the Commonwealth Government Bond curve plus an illiquidity premium where applicable, or for foreign-denominated liabilities, a curve derived from the yields of highly liquid AAA-rated sovereign risk securities in the currency of the policy liabilities plus an illiquidity premium where applicable. The illiquidity premium is determined by reference to observable market rates including Australian sovereign debt, corporate, securitised and collateralised debt publicly placed in the domestic market, and market swap rates.

Life investment contract liabilities are calculated under the fair value through profit and loss provisions of AASB 9 *Financial Instruments*. The discount rates are determined based on the current observable, objective rates that relate to the nature, structure and term of the future liability cash flows.

For both insurance and investment contracts, the approach is the same as adopted at June 2020. Discount rates applied for Australian liabilities were between 0.3% - 2.5% (30 June 2020: 0.9% - 2.4%) per annum.

Expenses

Forecast expenses for the next year are allocated between acquisition, maintenance and investment based on the nature of the expense. Forecast maintenance expenses then are converted to a per-contract unit cost or percentage of account balance, depending on the nature of the expense.

Inflation

Inflation estimates are based on long-term expectations and reviewed at least annually for changes in the market environment based on a comparison of real and nominal yields of instruments of equivalent term and credit risk. The current assumption for Australia is 1.1% per annum for short-term inflation and 2.3% per annum for long-term inflation (30 June 2020: -0.2% short-term, 1.8% long-term).

Surrenders

For life investment contracts, no surrenders or voluntary discontinuances are assumed. For Australian life insurance contracts where a surrender value is payable on withdrawal, a rate of surrenders is assumed in line with Challenger's own experience on these products, currently between 0.0%-2.1% per annum (30 June 2020: 0.0%-2.1%). For inwards reinsurance of Japanese business, a rate of surrenders is assumed in line with local experience in relation to similar contracts, currently 3.5% per annum (30 June 2020: 3.5%).

Where policyholders have the option to commute a life insurance contract, the value of this option is included within the life contract liabilities. We also assume surrender rates based on past experience for this business which vary by product types and duration in-force for the contract.

Mortality

Base mortality rates for individual lifetime annuities are determined as a multiple of annuitant experience based on LML08 and LFL08 tables, adjusted for Challenger's own recent experience. LML08 and LFL08 are mortality tables developed by the Continuous Mortality Investigation (CMI) unit of the Institute and Faculty of Actuaries in the UK based on UK annuitant lives experience from 2007–2010. The tables refer to male and female lives respectively. Rates are adjusted for expected future mortality improvements based on observed and expected improvements. For the age ranges and cash flow projection periods that contribute the majority of CLC's exposure, rates of future mortality improvement applied are between 0.3%-2.5% per annum (30 June 2020: 0.3%-2.5%).

Base mortality rates for wholesale mortality and longevity reinsurance are determined as a multiple of pensioner mortality rates (based on the self-administered pension schemes or SAPS2 tables mortality investigation developed by the Institute and Faculty of Actuaries (UK) using United Kingdom data collected between 2004–2012). Rates are adjusted for expected future mortality improvements based on observed and expected improvements. For the age ranges and cash flow projection periods that contribute the majority of CLC's exposure, rates of future mortality improvement applied are between 0.6%-2.1% per annum (30 June 2020: 0.6%-2.1%). Base mortality rates for the inwards reinsurance of Japanese business are determined as a multiple of Japanese population mortality rates.

Mortality assumptions have been reviewed but not adjusted in light of the COVID-19 pandemic.

Note 7 Life contract liabilities (continued)

Valuation (continued)

Impact of changes in assumptions on life insurance contracts

Under MoS, changes in actuarial assumptions are recognised by adjusting the value of future profit margins in life insurance contract liabilities. Changes in future profit margins are released over future periods unless that product group is in an expected net loss position (loss recognition), in which case changes in assumptions are recognised in the statement of comprehensive income in the period in which they occur. The valuation impact of changes to discount rate assumptions as a result of market and economic conditions, such as changes in benchmark market yields, are recognised in the statement of comprehensive income in the period in which they occur.

Restrictions on assets

Financial assets held in CLC can only be used within the restrictions imposed under the Life Act. The main restrictions are that the assets in a statutory fund can only be used to meet the liabilities and expenses of that statutory fund, to acquire investments to further the business of the statutory fund or as distributions when capital adequacy requirements are met.

Statutory fund information

The life contract operations of CLC are conducted within four separate statutory funds as required by the Life Act. Both the shareholders' and policyholders' interests in these statutory funds are reported in aggregate in the financial report of the Group. Fund 1 is a non-investment-linked fund and Fund 3 is investment-linked. Both of these are closed to new business. Funds 2 and 4 are the principal operating funds of the Group. Fund 2 contains non-investment-linked contracts, including the Group's term annuity business, lifetime annuity policies and the related outwards reinsurance, plus the wholesale mortality, wholesale morbidity and longevity inwards reinsurance. Fund 4 contains inwards reinsurance of annuity business written in Japan.

Life contract liabilities for Funds 1, 2, 3 and 4 are:

Life contract liabilities	31 Dec 2020 $m	30 Jun 2020 $m
Statutory Fund 1	1.5	1.5
Statutory Fund 2	10,771.2	10,854.4
Statutory Fund 3	2.8	2.6
Statutory Fund 4	1,994.2	1,722.7
Total life contract liabilities	**12,769.7**	**12,581.2**

Current/non-current split for total life contracts

There is a fixed settlement date for the majority of life contract liabilities. Approximately $2,571.7 million on a discounted basis (30 June 2020: $2,661.5 million) of the life contract liabilities have a contractual maturity within 12 months of the reporting date. Based on assumptions applied for the 31 December 2020 valuation of life contract liabilities, $3,375.1 million of principal payments on fixed term and lifetime business are expected in the year to 31 December 2021 (expected in the year to 30 June 2021: $3,392.9 million).

Life insurance risk

The Group is exposed to longevity risk on its individual lifetime annuities (both direct and reinsured) and wholesale longevity reinsurance. Longevity risk is the risk that policyholders may live longer than expectations. The Group is exposed to mortality risk on the wholesale mortality reinsurance and reinsurance of fixed term business written in Japan. This is the risk that death rates in the reference portfolios exceed expectations. The Group is also exposed to morbidity risk on the wholesale morbidity reinsurance. That is the risk that morbidity rates in the reference portfolios exceed expectation. The Group manages the longevity risk with regular reviews of the portfolio to confirm continued survivorship of policyholders receiving income plus regular reviews of longevity experience to ensure that longevity assumptions remain appropriate. In addition, the Group has entered into reinsurance arrangements to manage longevity risk in respect of closed books of individual lifetime annuities.

The Group manages the mortality and morbidity risk with regular reviews of the portfolio to ensure that mortality and morbidity assumptions remain appropriate. The Company's insurance risk policy is approved by the Board and sets out the relevant risk limits for insurance exposures, to ensure the insurance risk portfolio is appropriately diversified and contains no significant concentrations of insurance risk.

Actuarial information

Mr M Considine FIAA, as the Appointed Actuary of CLC, is satisfied as to the accuracy of the data used in the valuations of life contract liabilities in the financial report and the tables in this note. The life contract liabilities have been determined at the reporting date in accordance with the Life Act, APRA Prudential Standards, AASB 1038 *Life Insurance Contracts* and AASB 9 *Financial Instruments*.

Note 8 Notes to statement of cash flows

Reconciliation of profit to operating cash flow	31 Dec 2020 $m	31 Dec 2019 $m
Profit for the period	**222.8**	**222.2**
Adjusted for		
Net realised and unrealised gains on investment assets	(278.8)	(58.6)
Share of associates' net profit	(16.1)	(12.8)
Change in life contract liabilities[1]	174.5	60.9
Depreciation and amortisation expense	7.4	7.8
Reversal of impairment in associates and other investments	-	8.9
Share-based payments	7.7	7.5
Dividends from associates	16.1	13.2
Change in operating assets and liabilities		
Decrease in receivables	35.5	44.9
(Increase)/decrease in other assets	(1.5)	6.8
Decrease in payables	(25.9)	(59.1)
Decrease in provisions	(3.7)	(2.2)
Increase/(decrease) in life contract liabilities	14.0	(85.8)
Increase in external unit holders' liabilities	615.7	739.4
Increase in net tax liabilities	82.8	47.9
Net cash flows from operating activities	**850.5**	**941.0**

[1] Changes relate to movements through the statement of comprehensive income.

Note 9 Contributed equity

	Six months to 31 December 2020		Year to 30 June 2020		Six months to 31 December 2019	
	No. of shares m	Value of shares $m	No. of shares m	Value of shares $m	No. of shares m	Value of shares $m
Analysis of contributed equity						
Ordinary shares issued and fully paid	675.6	2,459.5	667.5	2,424.7	612.0	2,157.9
CPP Trust shares treated as Treasury shares	(1.4)	(14.6)	(2.4)	(24.8)	(2.4)	(24.8)
CPP deferred share purchases treated as Treasury shares	(2.0)	(22.3)	(2.0)	(22.3)	(2.0)	(22.3)
Total contributed equity	**672.2**	**2,422.6**	**663.1**	**2,377.6**	**607.6**	**2,110.8**
Movements in contributed equity						
Ordinary shares						
Balance at the beginning of the period	667.5	2,424.7	611.6	2,155.3	611.6	2,155.3
Equity placement	8.1	34.8	55.2	264.1	-	-
Issued under dividend reinvestment plan	-	-	0.7	5.3	0.4	2.6
Balance at the end of the period	**675.6**	**2,459.5**	**667.5**	**2,424.7**	**612.0**	**2,157.9**
CPP Trust						
Balance at the beginning of the period	2.4	24.8	3.0	30.5	3.0	30.5
Shares purchased (including settled forwards)	-	-	0.8	8.8	0.8	8.8
Vested shares released to employees	(1.0)	(10.2)	(1.4)	(14.5)	(1.4)	(14.5)
Balance at the end of the period	**1.4**	**14.6**	**2.4**	**24.8**	**2.4**	**24.8**
CPP deferred share purchases						
Balance at the beginning of the period	2.0	22.3	2.8	31.1	2.8	31.1
CPP deferred share purchases	-	-	-	-	-	-
Settled forward purchases	-	-	(0.8)	(8.8)	(0.8)	(8.8)
Balance at the end of the period	**2.0**	**22.3**	**2.0**	**22.3**	**2.0**	**22.3**

Capital management

Share Purchase Plan (SPP)

During the period, the Company conducted a non-underwritten share purchase plan (SPP) raising $35.0 million with 8.1 million shares issued to retail shareholders at a price of $4.32 per share. Total issue costs (net of tax) were $0.2 million, resulting in net proceeds of $34.8 million. Of the proceeds from the SPP, $30.0 million was injected into CLC as Common Equity Tier 1 capital.

Dividend Reinvestment Plan (DRP)

As a result of the uncertain economic conditions caused by COVID-19, and to maintain a strong capital position of the Life business, no final dividend was declared for 2020. With no final dividend having been paid, the DRP was not in operation during the six months to 31 December 2020.

Internal Capital Adequacy Assessment Process (ICAAP) Summary Statement – CLC

CLC is a life insurance company regulated under the Life Act. The Life Act, via prudential standards issued by APRA, imposes minimum statutory capital requirements on all life insurance companies. Under these standards a life company must have in place an ICAAP, documented in an ICAAP Summary Statement. CLC complied with these requirements at all times during the period.

Prescribed Capital Amount (PCA)

CLC holds capital in order to ensure that under a range of adverse scenarios it can continue to meet its regulatory and contractual obligations to its customers. CLC is regulated by APRA and is required to hold a minimum level of regulatory capital.

CLC's regulatory capital base and PCA have been calculated in accordance with APRA's prudential capital standards.

While CLC does not target a specific PCA ratio, under current circumstances CLC's internal capital models result in a PCA ratio in the range of 1.3 to 1.6 times. This range can change over time and is dependent on numerous factors.

The PCA ratio at 31 December 2020 was 1.63 times (30 June 2020: 1.81 times), reflecting changes in asset allocation, net AUM growth, increased common equity Tier 1 capital, increased additional Tier 1 capital and changes in retained earnings.

Note 9 Contributed equity (continued)

Capital management (continued)

CLC's target surplus

CLC maintains a target level of capital representing APRA's PCA plus a target surplus. The target surplus is a management guide to the level of excess capital that CLC seeks to hold over and above APRA's minimum requirements. CLC's target surplus is set to ensure that it provides a buffer against adverse market conditions and having regard to CLC's credit rating.

CLC uses internal capital models to determine its target surplus, which are risk based and responsive to changes in CLC's asset allocation and market conditions.

Details of the CLC capital adequacy multiple can be seen below:

CLC capital	31 Dec 2020 $m	30 Jun 2020 $m	31 Dec 2019 $m
CLC's regulatory capital			
Common Equity Tier 1 regulatory capital	2,622.9	2,337.0	2,811.3
Additional Tier 1 regulatory capital	892.5	805.0	805.0
Tier 2 regulatory capital – subordinated debt[1]	402.7	396.7	406.2
CLC total regulatory capital base	**3,918.1**	**3,538.7**	**4,022.5**
Prescribed capital amount			
Asset risk charge[2]	2,290.2	1,842.8	2,523.6
Insurance risk charge	213.8	199.5	164.6
Operational risk charge	54.4	56.5	53.4
Aggregation benefit	(156.7)	(144.8)	(125.4)
CLC prescribed capital amount	**2,401.7**	**1,954.0**	**2,616.2**
CLC excess over prescribed capital amount	**1,516.4**	**1,584.7**	**1,406.3**
Capital adequacy ratio (times)	**1.63**	**1.81**	**1.54**
Common Equity Tier 1 ratio (times)	**1.09**	**1.20**	**1.07**

[1] Differs from $401.7 million (30 June 2020: $395.7 million) disclosed in Note 10 Interest bearing financial liabilities due to $1.0 million (30 June 2020: $1.0 million) of accrued interest.

[2] Asset risk charge includes the combined stress scenario adjustment and default stress.

Note 10 Interest bearing financial liabilities

	30 Jun 2020 Facility $m	30 Jun 2020 Opening balance $m	Cash flows Proceeds/ (repayments) $m	Non-cash movements Foreign Exchange $m	Non-cash movements Fair value changes $m	Non-cash movements Other $m	31 Dec 2020 Closing balance $m	31 Dec 2020 Facility $m
Bank loans								
Corporate[1]	400.0	50.0	-	-	-	-	50.0	400.0
Controlled property trusts[2,4]	453.8	453.8	(9.7)	(28.6)	1.2	0.7	417.4	417.4
Controlled infrastructure trusts[4]	185.8	185.8	(3.2)	-	-	-	182.6	206.0
Repurchase agreements	5,393.4	5,393.4	(427.1)	-	-	-	4,966.3	4,966.3
Total bank loans	**6,433.0**	**6,083.0**	**(440.0)**	**(28.6)**	**1.2**	**0.7**	**5,616.3**	**5,989.7**
Non-bank loans								
Subordinated debt	400.0	395.7	-	-	6.0	-	401.7	400.0
Challenger Capital Notes 1[4]	345.0	345.0	(297.5)	-	-	-	47.5	47.5
Challenger Capital Notes 2[4]	460.0	454.5	-	-	-	0.9	455.4	460.0
Challenger Capital Notes 3[4]	-	-	385.0	-	-	(6.6)	378.4	385.0
Total non-bank loans	**1,205.0**	**1,195.2**	**87.5**	**-**	**6.0**	**(5.7)**	**1,283.0**	**1,292.5**
Total interest bearing financial liabilities	**7,638.0**	**7,278.2**	**(352.5)[3]**	**(28.6)**	**7.2**	**(5.0)**	**6,899.3**	**7,282.2**
Current		5,468.9					5,042.8	
Non-current		1,809.3					1,856.5	
		7,278.2					**6,899.3**	

1 In March 2020, the Group elected to fully draw its $400.0 million banking facility in order to provide additional financial flexibility during the COVID-19 crisis. $350.0 million of this drawing was repaid in June 2020.

2 Total facility limit consists of non-redraw loan facility limits totalling $417.4 million (30 June 2020: $453.8 million).

3 Differs to statement of cash flows due to $32.1 million (30 June 2020: $134.8 million) net repayments relating to SPVs. Total cash proceeds comprise $385.0 million (30 June 2020: $1,344.9 million) proceeds from borrowing and $769.6 million (30 June 2020: $521.2 million) repayment of borrowings.

4 Held at amortised cost except for the controlled property trust loan in respect of County Court. The fair value of these are: Challenger Capital Notes 1 $46.9 million (30 June 2020:$340.9 million), Challenger Capital Notes 2 $471.3 million (30 June 2020: $457.7 million), Challenger Capital Notes 3 $401.2 million (30 June 2020: nil), controlled property trusts $437.1 million (30 June 2020: $474.9 million), controlled infrastructure trusts $186.6 million (30 June 2020: $189.8 million).

Repurchase agreements

CLC has entered into repurchase agreements with certain counterparties whereby fixed income securities are sold for cash while simultaneously agreeing to repurchase the fixed income security at a fixed price and fixed date in the future. These agreements finance bonds held for hedging purposes and are interest bearing, with interest factored into the price at which the bonds are repurchased and paid on repurchase. All agreements as at 31 December 2020 are current and all mature by April 2021. They will continue to be rolled into new agreements in the future.

CLC uses Australian Government and Semi-Government Bonds with repurchase agreements, interest rate swaps and bond futures to hedge movements in interest rates on its asset portfolio, annuity policy liabilities, Guaranteed Index Return mandates and the Challenger Index Plus Fund.

Challenger Capital Notes – 3

On 25 November 2020, the Company completed its third capital notes issue, Challenger Capital Notes 3 (Notes 3), raising $385 million of new debt funding in order to replace its 2014 capital notes issue (Notes 1).

Under the reinvestment offer, $237.5 million of Notes 1 holders elected to reinvest into the new Notes 3, and under the repurchase invitation, $60 million of Notes 1 were repurchased by the Company. Following the completion of the issue, $47.5 million of Notes 1 remain on issue and Challenger will consider its options to reduce the outstanding amount over time.

Notes 3 have similar structural characteristics to Challenger Capital Notes 1 and 2, including:

- quarterly, floating, discretionary, non-cumulative distributions based on a margin over 3-month BBSW;
- optional exchange whereby notes may be redeemed or resold for cash or converted to ordinary shares in the Company, at the Company's option, on the relevant Optional Exchange Date (or on an earlier date in certain circumstances), subject to APRA's prior written approval; and
- mandatory conversion to ordinary shares in the Company on the relevant Mandatory Conversion Date, subject to certain conditions being satisfied. If the conditions to mandatory conversion are not met on the relevant Mandatory Conversion Date, conversion will be deferred to a later date when the conditions are retested.

Like Notes 1 and 2, the costs associated with the issue of Notes 3 have been capitalised against the relevant liability and will be expensed to the statement of comprehensive income over the life of Notes 3. The Notes 3 issue does not constitute regulatory capital of the Company. The proceeds from the issue of Notes 3 were used to fund a subscription for notes issued by CLC. The issue of notes by CLC was approved by APRA and constitutes Additional Tier 1 capital of CLC.

Note 11 Dividends paid and proposed

	31 Dec 2020 $m	31 Dec 2019 $m
Dividends declared and paid during the year		
Final 30 June 2020 dividend: nil (30 June 2019: 18.0 cents 100% franked dividend)	-	109.7
Dividend proposed (not recognised as a liability at 31 December)		
2021 interim dividend: 9.5 cents 100% franked (2020 interim: 17.5 cents 100% franked)	64.0	106.7

A dividend reinvestment plan will be in operation for the 2021 interim dividend.

Dividend franking credits

Franking credits available to shareholders are $30.7 million (30 June 2020: $12.4 million), based on a tax rate of 30%. This amount is calculated from the balance of the franking account as at the end of the reporting period, adjusted for franking credits that will arise from the settlement, after the end of the reporting period, of current liabilities for income tax and interest on Challenger Capital Notes 1, 2 and 3. The impact of the proposed dividend will be to reduce the balance of the franking account by $27.4 million. All dividends are franked at a tax rate of 30%.

Note 12 Earnings per share

	31 Dec 2020 cents	31 Dec 2019 cents
Basic earnings per share	33.2	36.3
Diluted earnings per share	27.3	31.5
	$m	**$m**
Profit attributable to ordinary shareholders	222.8	220.4
Add back interest expense on Challenger Capital Notes 1, 2 and 3	12.6	14.4
Add back interest expense net of tax on CLC Subordinated Notes	3.1	4.5
Total earnings used in the calculation of diluted earnings per share	**238.5**	**239.3**
Number of shares	**Number**	**Number**
Weighted average of ordinary shares issued	674,558,206	611,800,663
Weighted average of Treasury shares	(3,710,222)	(4,721,804)
Weighted average ordinary shares for basic earnings per share	**670,847,984**	**607,078,859**
Adjusted for potential ordinary shares:		
Weighted average effect of Challenger Performance Plan	5,870,879	4,280,874
Weighted average effect of Challenger Capital Notes 1, 2 and 3	136,328,771	99,526,477
Weighted average effect of CLC Subordinated Notes	59,070,235	49,454,150
Weighted average ordinary shares for diluted earnings per share	**872,117,869**	**760,340,360**

Accounting policy

Basic earnings per share is calculated by dividing the total profit for the period attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the period. The number of ordinary shares outstanding is net of Treasury shares held by the Challenger Performance Plan (CPP) Trust or under CPP deferred share purchase agreements in respect of equity incentive plan awards to employees.

The weighted average number of Treasury shares for the period was 3,710,222 (31 December 2019: 4,721,804).

Accounting treatment of Capital Notes and subordinated debt

Challenger Capital Notes 1, 2 and 3 and subordinated debt are an effective source of funding for Challenger.

Each of the Capital Notes 1, 2 and 3 and subordinated debt have convertibility features which would result in these instruments converting to ordinary shares under certain circumstances, including APRA determining Challenger Life to be non-viable. It is Challenger's current intention to refinance each of these instruments at their respective call dates, or prior to the Mandatory Conversion Date, and therefore conversion to ordinary shares is unlikely.

However, under AASB 133 *Earnings per Share*, convertible debt is considered dilutive whenever the interest per potential ordinary share for each of these instruments is less than Challenger's basic EPS for the period. As such, a test is required at each reporting period to determine if they are included in the dilutive share count.

Diluted earnings per share is calculated by dividing the total adjusted profit attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the period adjusted for the effects of dilutive shares that may be converted under the terms of Challenger Capital Notes 1, 2 and 3 (Notes), CLC Subordinated Notes and shares granted under the Challenger Performance Plan (CPP).

The dilutive share count for Challenger's convertible debt (Challenger Capital Notes 1, 2 and 3 and CLC Subordinated Notes) is based on the following formula:

$$\frac{\text{Face value of debt}}{\text{Conversion factor x Challenger's 20-day VWAP}^{1}\text{ share price}}$$

The conversion factor on all Challenger's convertible debt is 99% of the weighted average Challenger share price over the last 20 days of trading (subject to a minimum VWAP floor) in each reporting period.

The profit attributable to ordinary shareholders is adjusted by $15.7 million in interest on the Notes and CLC Subordinated Notes (31 December 2019: $18.9 million) for the diluted calculation when the Notes and CLC Subordinated Notes are considered dilutive. Since the CPP Trust commenced operation in December 2006, no shares have been issued to the CPP Trust. Instead, shares are acquired by the CPP Trust to mitigate shareholder dilution.

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of authorisation of these financial statements.

[1] Volume weighted average price.

Note 13 Fair values of financial assets and liabilities

Fair value determination and classification

Fair value reflects the price that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The majority of the Group's financial instruments are held in the life insurance statutory funds of CLC and, as a result, are required by AASB 1038 *Life Insurance Contracts* to be designated at fair value through profit and loss where this is permitted under AASB 9 *Financial Instruments*.

Financial instruments measured at fair value are categorised under a three-level hierarchy, reflecting the availability of observable market inputs when estimating the fair value. If different levels of inputs are used to measure a financial instrument's fair value, the classification within the hierarchy is based on the lowest level that is significant to the fair value measurement. The three levels are:

Level 1	unadjusted quoted prices in active markets are the valuation inputs for identical assets or liabilities (i.e. listed securities).
Level 2	valuation inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) are used.
Level 3	there are valuation inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The unobservable inputs into the valuation of the Group's Level 3 assets and liabilities are determined based on the best information available, including the Group's own assessment of the assumptions that market participants would use in pricing the asset or liability. Examples of unobservable inputs are estimates about the timing of cash flows, discount rates, earnings multiples and internal credit ratings.

Valuation techniques

The majority of the Group's listed and unlisted fixed income securities, over-the-counter derivative financial instruments and interest bearing liabilities, including the subordinated debt issuance, are classified as Level 2. This recognises the availability of a quoted price, but not from an active market as defined by the standard.

Fixed income securities where market observable inputs are not available are classified as Level 3. The Group's derivative financial instruments are traded over-the-counter so, while they are not exchange traded, there is a market observable price. Most of the fixed income securities and all of the government/semi-government securities have market observable prices.

Externally-rated unlisted fixed income securities are valued by applying market observable credit spreads on similar assets with an equivalent credit rating. Internally-rated fixed income securities are Level 3, as the determination of an equivalent credit rating is a significant non-observable input.

Equity, infrastructure and property securities that are exchange traded are generally classified Level 1. Where quoted prices are available, but are not from an active market, they are classified Level 2. If market observable inputs are not available, they are classified Level 3. Valuations can make use of cash flow forecasts discounted using the applicable yield curve, earnings-multiple valuations or, for managed funds, the net assets of the trust per the most recent financial report.

External unit holders' liabilities are valued at the face value of the amounts payable and classified as Level 2. The portion of life investment contract liabilities classified as Level 2 represent products or product options for which the liability is determined based on an account balance, rather than a discounted cash flow as applied to the rest of the portfolio.

Cash and cash equivalents are carried at amortised cost. To determine a fair value where the asset is liquid or maturing within three months, the fair value is approximate to the carrying amounts. This assumption is applied to liquid assets and the short-term elements of all other financial assets and financial liabilities.

The mortgage SPVs have total equity attributable to residual income unitholders (RIU) at amortised cost of $0.5 million (30 June 2020: $0.1 million). The fair value of this RIU asset is $36.2 million (30 June 2020: $41.0 million) and would be classified as Level 3 in the fair value hierarchy.

Challenger Capital Notes 1, 2 and 3 have face values of $47.5 million, $460.0 million and $385.0 million respectively. The fair value of these notes is $46.9 million, $471.3 million and $401.2 million respectively and they are classified as Level 1 in the fair value hierarchy.

Valuation process

For financial instruments and investment properties categorised within Level 3 of the fair value hierarchy, the valuation process applied in valuing such instruments is governed by the CLC Practice Note on Investment Asset and Financial Liability Valuation. The Practice Note outlines the Valuation Committee's responsibilities in the valuation of investment assets and financial liabilities for the purposes of financial reporting. All significant Level 3 financial instruments are referred to the Valuation Committee which generally meets monthly, or more frequently if required.

All financial instruments and investment properties are measured on a recurring basis. The table on the following page summarises the financial instruments and investment properties measured at fair value at each level of the fair value hierarchy as at the statement of financial position date.

Note 13 Fair values of financial assets and liabilities (continued)

Valuation process (continued)

	Level 1 $m	Level 2 $m	Level 3 $m	Total $m
31 Dec 2020				
Derivative assets	-	1,042.4	-	1,042.4
Fixed income securities[1]	-	17,681.1	1,779.0	19,460.1
Equity and other alternatives	1.8	930.4	250.0	1,182.2
Infrastructure investments[1]	-	-	367.1	367.1
Property securities	-	-	85.5	85.5
Investment and development property	-	-	3,663.4	3,663.4
Total assets	**1.8**	**19,653.9**	**6,145.0**	**25,800.7**
Derivative liabilities	-	682.3	-	682.3
Interest bearing financial liabilities	919.4	422.1	-	1,341.5
External unit holders' liabilities	-	3,031.5	-	3,031.5
Life investment contract liabilities	-	47.8	5,472.7	5,520.5
Total liabilities	**919.4**	**4,183.7**	**5,472.7**	**10,575.8**
30 Jun 2020				
Derivative assets	-	1,111.9	0.6	1,112.5
Fixed income securities[1]	-	17,566.5	1,908.4	19,474.9
Equity and other alternatives	0.5	627.8	274.4	902.7
Infrastructure investments[1]	-	9.8	370.3	380.1
Property securities	-	-	76.3	76.3
Investment and development property	-	-	3,685.9	3,685.9
Total assets	**0.5**	**19,316.0**	**6,315.9**	**25,632.4**
Derivative liabilities	-	725.4	-	725.4
Interest bearing financial liabilities	798.6	422.7	-	1,221.3
External unit holders' liabilities	-	2,415.8	-	2,415.8
Life investment contract liabilities	-	49.9	5,817.9	5,867.8
Total liabilities	**798.6**	**3,613.8**	**5,817.9**	**10,230.3**
31 Dec 2019				
Derivative assets	-	819.3	0.6	819.9
Fixed income securities[1]	-	16,331.6	2,073.6	18,405.2
Equity and other alternatives	0.8	1,218.9	249.3	1,469.0
Infrastructure investments[1]	209.6	260.1	370.3	840.0
Property securities	-	-	99.7	99.7
Investment and development property	-	-	3,703.6	3,703.6
Total assets	**210.4**	**18,629.9**	**6,497.1**	**25,337.4**
Derivative liabilities	-	468.1	-	468.1
Interest bearing financial liabilities	833.2	438.6	-	1,271.8
External unit holders' liabilities	-	2,705.6	-	2,705.6
Life investment contract liabilities	-	55.6	6,373.3	6,428.9
Total liabilities	**833.2**	**3,667.9**	**6,373.3**	**10,874.4**

[1] The Group has exposures to structured entities (entities designed so that voting or similar rights are not the dominant factor in determining who controls the entity; for example, when any voting rights relate purely to administrative tasks) via investments in asset-backed finance vehicles (where it may act as a lender or purchaser of notes and/or residual income units) and securitisations (such as mortgages, finance leases and other types of collateralised vehicles). The Company assesses, at inception and at each reporting date, whether a structured entity should be consolidated based on the accounting policy. The maximum exposure to loss is limited to the reported fair value of the underlying securities plus any guaranteed undrawn commitments to the counterparties. At 31 December 2020 the carrying value of asset-backed financing assets was $86.5 million (30 June 2020: $91.1 million) with $13.0 million in undrawn commitments (30 June 2020: $32.0 million) and the carrying value of securitisations was $3,899.2 million (30 June 2020: $5,386.5 million) with $118.1 million in undrawn commitments (30 June 2020: $107.2 million).

Note 13 Fair values of financial assets and liabilities (continued)

Level 3 sensitivities

The following table shows the sensitivity of Level 3 financial instruments to a reasonable change in alternative assumptions in respect of the non-observable inputs into the fair value calculation:

	Level 3 value[1] $m	Positive impact $m	Negative impact $m	Valuation technique	Reasonable change in non-observable input[2,3]
31 Dec 2020					
Fixed income securities	1,779.0	11.7	(51.4)	Discounted cash flow	Primarily credit spreads
Interest bearing financial liabilities				Discounted cash flow	Primarily credit spreads
Equity and other alternatives	250.0	16.6	(17.8)	Pricing model	Earnings multiple, Mortality rate
Infrastructure investments	367.1	2.7	(2.7)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Property securities[4]	85.5	4.3	(4.3)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Investment contract liabilities	(5,472.7)	2.3	(2.3)	Discounted cash flow	Primarily expense assumptions
Investment and development property	3,663.4	166.5	(116.8)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Total Level 3	**672.3**	**204.1**	**(195.3)**		
30 Jun 2020					
Derivative assets	0.6	-	-	Discounted cash flow	Primarily credit spreads
Fixed income securities	1,908.4	23.1	(74.9)	Discounted cash flow	Primarily credit spreads
Equity and other alternatives	274.4	18.8	(20.1)	Pricing model	Earnings multiple, Mortality rate
Infrastructure investments	370.3	2.6	(2.6)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Property securities[4]	76.3	3.8	(3.8)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Investment contract liabilities	(5,817.9)	2.3	(2.3)	Discounted cash flow	Primarily expense assumptions
Investment and development property	3,685.9	165.3	(116.9)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Total Level 3	**498.0**	**215.9**	**(220.6)**		
31 Dec 2019					
Derivative assets	0.6	-	-	Discounted cash flow	Primarily credit spreads
Fixed income securities	2,073.6	8.5	(78.3)	Discounted cash flow	Primarily credit spreads
Equity and other alternatives	249.3	18.8	(20.2)	Pricing model	Earnings multiple, Mortality rate
Infrastructure investments	370.3	2.7	(2.7)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Property securities[4]	99.7	5.0	(5.0)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Investment contract liabilities	(6,373.3)	3.2	(3.2)	Discounted cash flow	Primarily expense assumptions
Investment and development property	3,703.6	183.7	(152.5)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Total Level 3	**123.8**	**221.9**	**(261.9)**		

1 The fair value of the asset or liability would increase/decrease if the credit spread discount rate or expense assumptions decrease/increase or if the other inputs increase/decrease.

2 Specific asset valuations will vary from asset to asset as each individual industry profile will determine appropriate valuation inputs to be utilised.

3 The effect of a change to reflect a reasonable possible alternative assumption was calculated by adjusting the credit spreads by a +/- one tier movement in internal credit rating bands, discount rates by between 50bps – 100bps, changing the valuation of the unlisted schemes by 5% and adjusting the expense assumption splits by 10%.

4 The effect of a change to reflect a reasonably possible alternative assumption was calculated by moving the capitalisation rate by 25bps (Australia) / 10bps (Japan).

Note 13 Fair values of financial assets and liabilities (continued)

Level 3 sensitivities (continued)

The COVID-19 pandemic has had a significant impact on the economy and continues to drive uncertainty across the commercial property market. Independent valuers have noted these uncertainties in respect of the assumptions applied in the course of performing the independent valuation assessments for the direct property portfolio as at the reporting date. As a result of this uncertainty, a further sensitivity analysis has been undertaken to assess the impact on fair value when the significant non-observable input (capitalisation rates) experience a more material movement. Under this additional sensitivity scenario, the capitalisation rate is moved by 50bps (Australia) / 20 bps (Japan), resulting in a positive impact of $325.7 million and a negative impact of $243.7 million across the direct property portfolio.

Fixed income also forms a material part of the level 3 asset class held by the Group. This portfolio primarily consists of internally rated securities where the valuation is derived from applying the market observable comparable spread. The key non-observable input in these valuations is the internally derived credit rating which is based upon credit assessment undertaken by the Risk division. The COVID-19 pandemic has impacted many businesses across various industries and the long term effects are difficult to assess and not all industries and businesses have been impacted equally. An assessment of the current impact of COVID-19 on the performance of the Level 3 component of the fixed income portfolio has been undertaken and that performance has not changed sufficiently to currently warrant any additional sensitivity being included.

Level 3 reconciliation

The following table shows a reconciliation of the movement in the fair value of financial instruments categorised within Level 3 of the fair value hierarchy during the period:

	31 Dec 2020		30 Jun 2020		31 Dec 2019	
	Assets $m	Liabilities $m	Assets $m	Liabilities $m	Assets $m	Liabilities $m
Balance at the beginning of the period	6,315.9	5,817.9	6,420.7	6,712.2	6,420.7	6,712.2
Fair value (losses)/gains	(80.2)	80.8	(187.5)	135.7	(16.4)	55.2
Acquisitions	634.6	1,305.8	2,764.2	1,992.4	1,543.6	1,251.4
Maturities and disposals	(725.3)	(1,731.8)	(2,666.0)	(3,022.4)	(1,436.1)	(1,645.5)
Transfers to other categories[1,2]	-	-	(15.5)	-	(14.7)	-
Balance at the end of the period	**6,145.0**	**5,472.7**	**6,315.9**	**5,817.9**	**6,497.1**	**6,373.3**
Unrealised (losses)/gains included in the statement of comprehensive income for assets and liabilities held at the statement of financial position date	(84.6)	137.6	(187.5)	135.7	(40.7)	(55.7)

[1] The Group transfers between levels of the fair value hierarchy at the end of the reporting period when there is a change in the observability of the pricing inputs or a change to valuation methodology.

[2] Transfers to/from other categories are due to changes in the market observability of inputs used in the valuation of financial instruments. There were no transfers between Level 1 and Level 2 during the reporting period. There were no transfers into Level 3 (30 June 2020: $2.5 million) and there were no transfers out of Level 3 and into Level 2 (30 June 2020: $18.0 million) during the reporting period.

Note 14 Collateral arrangements

Accounting policy

CLC receives collateral, where it is considered necessary, when entering into certain financial arrangements. The amount of collateral required is subject to management's credit evaluation of the counterparty which is performed on a case-by-case basis. At 31 December 2020, $478.4 million (30 June 2020: $471.8 million) of cash received from third parties as collateral is recorded in payables and $87.7 million (30 June 2020: $221.4 million) of collateral assets received from counterparties were repledged by the Company to third parties. Except in the event of default, collateral received can be called back by the counterparty in accordance with the financial arrangement. CLC is required to pledge collateral, as part of the standard terms of transactions, when entering into certain financial arrangements. Cash paid to third parties as collateral is recorded in receivables. Other financial assets transferred as collateral are not derecognised from the statements of financial position as the risks and rewards of ownership remain with CLC. At the balance sheet date the fair value of cash and financial assets pledged are as follows:

Collateral pledged as security	31 Dec 2020 $m	30 Jun 2020 $m
Cash	346.6	98.4
Other financial assets[1]	7,731.2	7,730.3
Total collateral pledged	**8,077.8**	**7,828.7**

[1] Includes assets sold under repurchase agreements. Please refer Note 10 Interest bearing financial liabilities for more information.

Note 15 Contingent liabilities, contingent assets and other commitments

Warranties

Over the course of its corporate activity, the Group has given, as a seller of companies and as a vendor of assets, including real estate properties, warranties to purchasers on several agreements that are still outstanding at 31 December 2020. Other than noted below, at the date of this report no material claims against these warranties have been received by the Group.

Parent entity guarantees and undertakings

The Company has extended the following guarantees and undertakings to entities in the Group:

1. a guarantee supporting the corporate banking facility and certain other financial commitments, such as hedging arrangements;
2. letters of support in respect of certain subsidiaries in the normal course of business. The letters recognise the Company's intention to provide support to those subsidiaries so that they can continue to meet their obligations;
3. Australian Financial Services Licence deeds of undertaking as an eligible provider; and
4. guarantees to support contractual commitments on warranties to certain third parties.

Third-party guarantees

Bank guarantees have been issued by a third-party financial institution on behalf of the Group and its subsidiaries for items in the normal course of business, such as rental contracts. The amounts involved are not considered to be material to the Group.

Contingent future commitments

CLC has made capital commitments to external counterparties for future investment opportunities, such as development or investment purchases. At 31 December 2020, there were potential future commitments totalling $506.3 million (30 June 2020: $419.7 million) in relation to these opportunities. The Group has made capital commitments to associates to subscribe for up to $7.1 million (30 June 2020: $7.2 million) of non-redeemable preference shares to enable them to meet their working capital requirements. Contractual obligations for future property repairs and maintenance are in place but cannot be quantified until required.

On 23 December 2020, Challenger entered into an agreement to acquire MyLifeMyFinance Limited, an Australian-based customer savings and loans bank, for an acquisition price of $35.0 million. The acquisition price is subject to a completion adjustment and based on a net asset value of $18.0 million. Challenger has paid a deposit of $1.8 million with the remaining $33.2 million expected to be settled in March 2021. The acquisition of MyLifeMyFinance Limited by Challenger remains subject to approval by both APRA and the Federal Treasurer.

Subsidiary guarantees

CLC has provided a guarantee to a third party regarding the performance of its subsidiary in respect of certain reinsurance arrangements.

Contingent tax assets and liabilities

From time to time, the Group has interactions and matters under review, audit or dispute with the Australian Taxation Office in relation to the taxation treatments of various matters, including reportable tax positions. Any potential tax liability resulting from these interactions is only provided for when it is probable that an outflow will occur and a reliable estimate of the amount can be made. No specific contingent liability amounts have been disclosed in relation to these matters as it is considered that it would be prejudicial to their conduct and outcome.

Other information

In the normal course of business, the Group enters into various contracts that could give rise to contingent liabilities in relation to performance obligations under those contracts. At the date of this report, the possibility of any outflow in settlement is remote.

Note 16 Subsequent events

At the date of this financial report no matter or circumstance has arisen that has, or may, significantly affect the Group's operations, the results of those operations, or the Group's state of affairs in future financial years which has not already been reflected in this report.

Directors' declaration

In accordance with a resolution of the Directors of Challenger Limited, we declare that, in the opinion of the Directors:

a) the financial statements and notes of Challenger Limited and its controlled entities (the Group) are in accordance with the *Corporations Act 2001*, including:

   (i) giving a true and fair view of the Group's financial position as at 31 December 2020 and of its performance for the six month period ended on that date; and

   (ii) complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001; and

b) there are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable.

On behalf of the Board

P Polson
Independent Chair

8 February 2021

R Howes
Managing Director and Chief Executive Officer

8 February 2021

Independent auditor's review report to the members of Challenger Limited

Report on the Half-Year Financial Report

Conclusion

We have reviewed the accompanying half-year financial report of Challenger Limited (the Company) and its subsidiaries (collectively the Group), which comprises the statement of financial position as at 31 December 2020, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the half-year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration.

Based on our review, which is not an audit, nothing has come to our attention that causes us to believe that the half-year financial report of the Group is not in accordance with the *Corporations Act 2001*, including:

a) giving a true and fair view of the consolidated financial position of the Group as at 31 December 2020 and of its consolidated financial performance for the half-year ended on that date; and

b) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.

Directors' Responsibility for the Half-Year Financial Report

The directors of the Company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the half-year financial report that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity* ("ASRE 2410"), in order to state whether, on the basis of the procedures described, anything has come to our attention that causes us to believe that the half-year financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the Group's consolidated financial position as at 31 December 2019 and its consolidated financial performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of the Group, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Independence

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.

Ernst & Young

T Johnson
Partner

Sydney
8 February 2021

G McKenzie
Partner

Sydney
8 February 2021

Additional information

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Richard Howes (Managing Director and Chief Executive Officer)
John M Green
Steven Gregg
Masahiko Kobayashi
Heather Smith
JoAnne Stephenson
Duncan West
Melanie Willis

Company secretary

Linda Matthews

Website

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Go electronic

Challenger can deliver all of your shareholder communications electronically. Just update your details via Computershare Investor Services.

Online digital version of this report

The 2021 Interim Financial Report is available at:

› **challenger.com.au/shareholder**

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