

1H21 Analyst Pack

Providing
our customers
with financial
security for
retirement



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2021 Interim Financial Report

can be downloaded from
Challenger's online
Shareholder Centre

› challenger.com.au/shareholder

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Important note

Information presented in the 1H21 Analyst Pack is presented on an operational (rather than statutory) basis to reflect a management view of the business. Challenger Limited (ACN 106 842 371) also provides statutory reporting as prescribed under the *Corporations Act 2001*. The 2021 Interim Financial Report is available from Challenger's shareholder centre at:

› www.challenger.com.au/shareholder

The 1H21 Analyst Pack is not audited. The statutory net profit after tax as disclosed in the consolidated profit and loss (page 12) has been prepared in accordance with Australian Accounting Standards and the *Corporations Act 2001*. Normalised net profit after tax, as disclosed in the consolidated profit and loss (page 12), has been prepared in accordance with a normalised profit framework, which is disclosed as part of the Operating and Financial Review in the Directors' Report in the 2021 Interim Financial Report. The 2021 Interim Financial Report and normalised profit framework have both been subject to a review performed by Ernst & Young.

Any forward-looking statements included in this document are, by nature, subject to significant uncertainties, risks and contingencies, of which many are outside the control of, and unknown to, Challenger, so that actual results or events may vary from those forward-looking statements, and the assumptions on which they are based.

Past performance is not an indicator of future performance. While Challenger has sought to ensure that information is accurate by undertaking a review process, it makes no representation or warranty as to the accuracy or completeness of any information or statement in this document. In particular, information and statements in this document do not constitute investment advice or a recommendation on any matter and should not be relied upon.

1H21 financial highlights¹

Group	<p>Normalised net profit before tax \$196m, down 30%</p> <p>Normalised net profit after tax \$137m, down 29%</p> <p>Statutory net profit after tax \$223m, up 1%</p> <p>Normalised EPS² 20.4 cents per share, down 35%</p> <p>Statutory EPS² 33.2 cents per share, down 9%</p> <p>Net income \$325m, down 23%</p> <p>Expenses \$127m, down 10%</p> <p>Normalised cost to income ratio 39.0%, up 550 bps</p> <p>Group assets under management \$96.1bn, up 11%</p> <p>Normalised Return On Equity (pre-tax) 11.5%, down 370 bps</p> <p>Statutory Return On Equity (post-tax) 13.0%, up 100 bps</p> <p>Half-year dividend 9.5 cents per share (fully franked), down 8.0 cents per share</p> <p>Normalised dividend payout ratio 46.6%</p>
Life	<p>Normalised Cash Operating Earnings (COE) \$244m, down 29%</p> <p>COE margin 2.55%, down 98 bps</p> <p>Expenses \$51m, down 13%</p> <p>Normalised EBIT³ \$193m, down 33%</p> <p>Total Life sales \$3.4bn, up 10%</p> <p>Total Life book growth \$709m, or 4.7% of opening liabilities</p> <p>Annuity sales \$2.2bn, up 12%, with domestic sales up 11% and Japan sales up 15%</p> <p>Annuity net book growth \$158m, or 1.3% of opening liabilities</p> <p>Average investment assets \$19.0bn, down 2%</p> <p>Normalised Return On Equity (pre-tax) 12.5%, down 430 bps</p> <p>Prescribed Capital Amount (PCA) ratio 1.63 times, down from 1.81 times at FY20</p> <p>Common Equity Tier 1 (CET1) ratio 1.09 times, down from 1.20 times at FY20</p> <p>Capital intensity 12.2%, up from 10.7% at FY20</p>
Funds Management	<p>Net income \$81m, up 5%</p> <p>Expenses \$46m, down 8%</p> <p>EBIT³ \$35m, up 26%</p> <p>Net flows \$6.4bn, up from \$1.9bn</p> <p>Funds Under Management (FUM) \$91.2bn, up 10%</p> <p>Return On Equity (pre-tax) 27.8%, up 400 bps</p>

¹ All percentage movements compare 1H21 to the prior corresponding period (1H20) unless otherwise stated.

² Earnings per share (EPS).

³ Earnings before interest and tax (EBIT).

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 years¹.

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 approximately \$3 trillion today² to almost \$7 trillion³ 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

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 annuities⁴, 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 years⁵. 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 \$70bn⁶ 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 (refer to page 30 for more detail). 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 and 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 ~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 million⁹. The acquisition is highly strategic and provides Challenger the opportunity to significantly expand its secure retirement income offering by entering Australia's ~\$1 trillion¹⁰ 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. Refer to page 5 for more detail on the MyLife MyFinance bank acquisition.

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 ¥50bn (equivalent to ~A\$670m¹¹) per year for a minimum of five years¹². 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 ~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.

Refer to page 29 for more detail on the MS Primary and MS&AD relationship.

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.

Funds Management

Funds Management focuses on building savings for retirement by providing investment strategies that seek to deliver superior investment returns. 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 \$3bn of cash and liquid investments at 1 July 2020, which are being progressively deployed into higher yielding investments over the course of FY21. 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.

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

Vision and strategy

Challenger's vision is to provide its customers with financial security for retirement, with four strategic pillars to ensure Challenger achieves its vision.



1H21 strategic progress

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 (refer to page 29 for more detail);
- Increasing focus on institutional sales (refer to page 6 for more detail); 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 ~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 (refer to page 5 for more detail) 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.

Extending customer reach and entering Australia's term deposit market

In December 2020, Challenger announced the acquisition of MyLifeMyFinance Limited (MLMF), an Australian-based customer savings and loans bank, for \$35 million¹.

The acquisition is highly strategic and provides Challenger the opportunity to significantly expand its secure retirement income offering, including entering Australia's ~\$1 trillion² 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 MLMF'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 guaranteed³, 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.

¹ Acquisition price subject to completion adjustments and based on a net asset value of \$18 million.

² APRA 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.

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 Treasurer¹, 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.

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%² 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
- 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 (refer Challenger Index Plus Fund liabilities on page 15).

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.

¹ Completion is subject to regulatory approvals, including approval under the *Financial Sector (Shareholdings) Act 1998 (Cth)*.

² Plan for Life – September 2020 – based on annuities under administration at 30 September 2020.

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 (refer to page 30).

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.

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 \$6.4bn, which included Fidante Partners' net inflows of \$5.8bn. Fidante Partners is the fastest growing active investment manager² 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 year³ and is the fastest growing Active ETF in Australia⁴.

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, inflow/outflows.

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 Protterra 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. Protterra 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\$500bn under management.

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 years¹. Since fund inception, 81% of Fidante Partners' funds have achieved either first or second quartile investment performance².

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).

¹ As at 31 December 2020. Percentage of Fidante Partners Australian boutiques meeting or exceeding performance benchmark.

² Mercer as at December 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.

1H21 progress:

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.

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.

Key performance indicators

	1H21	2H20	1H20	2H19	1H19	2H18	1H18
Earnings							
Normalised NPBT (\$m)	196.2	227.9	278.6	278.3	270.0	272.7	274.6
Normalised NPAT (\$m)	136.8	152.3	191.4	196.3	199.8	198.2	207.9
Statutory NPAT (\$m)	222.8	(636.4)	220.4	301.7	6.1	127.1	195.4
Underlying operating cash flow (\$m)	119.5	54.7	140.0	133.2	103.7	143.6	53.8
EBIT margin (%)	61.0%	61.9%	66.5%	67.5%	67.3%	66.8%	67.9%
Normalised cost to income ratio (%)	39.0%	38.1%	33.5%	32.5%	32.7%	33.2%	32.1%
Normalised effective tax rate (%)	30.3%	33.2%	31.3%	29.5%	26.0%	27.3%	24.3%
Earnings per share (cents)							
Basic – normalised	20.4	25.0	31.5	32.4	33.1	32.9	35.2
Basic – statutory	33.2	(104.4)	36.3	49.8	1.0	21.1	33.1
Diluted – normalised	17.5	21.1	27.7	27.8	30.1	30.9	33.8
Diluted – statutory	27.3	(104.4)	31.5	41.2	1.0	20.9	31.9
Return On Equity (%)							
Normalised ROE – pre-tax	11.5%	14.0%	15.2%	16.2%	15.6%	16.1%	16.8%
Normalised ROE – post-tax	8.0%	9.4%	10.4%	11.4%	11.5%	11.7%	12.7%
Statutory ROE – post-tax	13.0%	(39.2%)	12.0%	17.5%	0.3%	7.5%	11.9%
Capital management							
Net assets – average ¹ (\$m)	3,396	3,257	3,634	3,469	3,443	3,419	3,249
Net assets – closing (\$m)	3,513	3,250	3,716	3,600	3,388	3,485	3,470
Net assets per basic share (\$)	5.23	4.90	6.12	5.94	5.60	5.79	5.75
Net tangible assets (\$m)	2,877	2,619	3,079	3,019	2,793	2,893	2,878
Net tangible assets per basic share (\$)	4.28	3.95	5.07	4.98	4.61	4.81	4.77
Dividend (cps)	9.5	-	17.5	18.0	17.5	18.0	17.5
Dividend franking (%)	100.0	-	100.0	100.0	100.0	100.0	100.0
Normalised dividend payout ratio (%)	46.6%	-	55.5%	55.6%	52.9%	54.7%	49.7%
CLC PCA ratio (times)	1.63	1.81	1.54	1.53	1.54	1.53	1.49
CLC CET1 ratio (times)	1.09	1.20	1.07	1.06	1.04	1.05	1.02
Sales, net flows and assets under management							
Life annuity sales (\$m)	2,191.0	1,170.5	1,956.9	1,402.6	2,140.5	1,711.2	2,289.5
Other Life sales (\$m)	1,246.5	841.8	1,182.2	407.1	599.8	520.4	1,034.5
Total Life sales (\$m)	3,437.5	2,012.3	3,139.1	1,809.7	2,740.3	2,231.6	3,324.0
Life annuity net flows (\$m)	157.6	(344.7)	93.6	192.3	493.5	634.5	758.2
Life annuity book (\$m)	12,770	12,581	12,845	12,870	12,324	11,728	11,116
Life annuity book growth (%)	1.3%	(2.7%)	0.7%	1.6%	4.2%	6.2%	7.3%
Total Life net flows (\$m)	708.7	(607.8)	923.6	(108.9)	583.7	848.4	947.9
Total Life book ² (\$m)	15,801	14,997	15,551	14,836	14,496	13,863	13,025
Total Life book growth (%)	4.7%	(4.1%)	6.2%	(0.8%)	4.2%	7.1%	7.9%
Funds Management – net flows (\$m)	6,423.4	661.3	1,879.6	(1,461.3)	(977.1)	1,366.9	3,934.3
Total Group AUM (\$m)	96,087	85,237	86,339	81,770	78,386	81,143	76,523
Other							
Headcount – closing FTEs ³	709	735	717	687	675	676	682
Weighted average number of basic shares on issue (m)	670.8	609.6	607.1	605.7	604.4	602.2	591.1
Number of basic shares on issue (m)	672.2	663.1	607.6	605.8	605.4	601.7	603.3
Share price closing (\$)	6.44	4.41	8.09	6.64	9.49	11.83	14.03

¹ Net assets – average calculated on a monthly basis.

² Total Life book includes the Life annuity book and Challenger Index Plus Fund liabilities.

³ Full-time equivalent employees.

Consolidated profit and loss

\$m	1H21	2H20	1H20	2H19	1H19	2H18	1H18
Cash earnings	227.7	244.5	274.2	263.5	251.5	262.7	276.4
Normalised capital growth	16.3	49.6	70.6	77.0	78.1	70.8	59.7
Normalised Cash Operating Earnings (COE)	244.0	294.1	344.8	340.5	329.6	333.5	336.1
Net fee income	81.3	80.4	77.7	74.7	75.2	79.2	72.0
Other income	0.0	0.2	0.2	0.5	0.5	0.5	0.5
Total net income	325.3	374.7	422.7	415.7	405.3	413.2	408.6
Personnel expenses	(86.2)	(82.7)	(91.3)	(93.2)	(92.1)	(96.8)	(91.0)
Other expenses	(40.6)	(60.1)	(50.3)	(41.8)	(40.3)	(40.5)	(40.1)
Total expenses	(126.8)	(142.8)	(141.6)	(135.0)	(132.4)	(137.3)	(131.1)
Normalised EBIT	198.5	231.9	281.1	280.7	272.9	275.9	277.5
Interest and borrowing costs	(2.3)	(4.0)	(2.5)	(2.4)	(2.9)	(3.2)	(2.9)
Normalised profit before tax	196.2	227.9	278.6	278.3	270.0	272.7	274.6
Normalised tax	(59.4)	(75.6)	(87.2)	(82.0)	(70.2)	(74.5)	(66.7)
Normalised profit after tax	136.8	152.3	191.4	196.3	199.8	198.2	207.9
Investment experience after tax	87.1	(788.7)	38.4	105.4	(193.7)	(63.5)	(12.5)
Significant items after tax ¹	(1.1)	-	(9.4)	-	-	(7.6)	-
Statutory net profit after tax	222.8	(636.4)	220.4	301.7	6.1	127.1	195.4
Performance analysis							
Normalised EPS – basic (cents)	20.4	25.0	31.5	32.4	33.1	32.9	35.2
Shares for basic EPS calculation (m)	670.8	609.6	607.1	605.7	604.4	602.2	591.1
Normalised cost to income ratio (%)	39.0%	38.1%	33.5%	32.5%	32.7%	33.2%	32.1%
Normalised tax rate (%)	30.3%	33.2%	31.3%	29.5%	26.0%	27.3%	24.3%
Total net income analysis (%)							
Cash earnings (Life)	70.0%	65.2%	64.9%	63.4%	62.1%	63.6%	67.7%
Normalised capital growth (Life)	5.0%	13.2%	16.7%	18.5%	19.3%	17.1%	14.6%
Net fee income (Funds Management)	25.0%	21.5%	18.4%	18.0%	18.5%	19.2%	17.6%
Other income (Corporate)	0.0%	0.1%	0.0%	0.1%	0.1%	0.1%	0.1%
Normalised EBIT by division (\$m)							
Life	192.8	238.9	285.8	285.7	277.9	279.7	283.0
Funds Management	35.3	29.8	27.9	24.8	26.1	30.8	27.1
Corporate	(29.6)	(36.8)	(32.6)	(29.8)	(31.1)	(34.6)	(32.6)
Normalised EBIT	198.5	231.9	281.1	280.7	272.9	275.9	277.5

¹ 1H21 significant items (after-tax) of \$1m represents transaction costs associated with the MyLife MyFinance bank acquisition (refer to page 5 for more detail). 1H20 significant items (after-tax) of \$9m represents the write-off of a Fidante Partners boutique intangible asset and wind-up costs following the closure of the FME Asset Management boutique investment manager. 2H18 significant items (after-tax) of \$8m represents one-off expenses, including the impairment of residual software and a Fidante Partners boutique following its closure and restructure costs, offset by one-off revenue, including partial writeback of deferred consideration in respect of the acquisition of Fidante Partners Europe.

Consolidated profit and loss (continued)

Normalised profit after tax

1H21 normalised profit after tax was \$137m and decreased by \$55m (29%) from \$191m in 1H20. The decrease reflects lower normalised profit before tax (down \$83m), partially offset by lower normalised tax (down \$28m).

Normalised earnings per share (EPS)

Normalised EPS decreased by 35% on 1H20 to 20.4 cps. The decrease reflects lower normalised profit after tax (down 29%) and a higher average number of basic shares on issue (up 10%).

The weighted average number of basic shares on issue in 1H21 was 671m shares, up 64m shares on 1H20. The weighted average number of basic shares increased predominantly as a result of the \$305m institutional placement and share purchase plan announced in June 2020.

Net income

1H21 net income was \$325m and decreased by \$97m (down 23%) on 1H20, with:

- Life normalised Cash Operating Earnings (COE) decreased by \$101m as a result of repositioning the portfolio to more defensive settings during the COVID-19 pandemic market sell-off and lower normalised capital growth assumptions applied from 1 July 2020; and
- Funds Management fee income increased by \$4m from higher FUM-based revenue, partially offset by lower performance fees.

Expenses

1H21 total expenses were \$127m and decreased by \$15m (down 10%) on 1H20. Personnel expenses reduced by \$5m from lower variable reward costs and other expenses reduced by \$10m as a result of lower marketing, travel and entertainment and occupancy costs.

The 1H21 normalised cost to income ratio was 39.0% and increased by 550 bps on 1H20. The increase in the cost to income ratio was driven by lower net income (down 23%), partially offset by lower expenses (down 10%).

Normalised EBIT

1H21 normalised EBIT was \$199m, down \$83m (29%) on 1H20. Lower Life EBIT (down \$93m) was partially offset by higher Funds Management EBIT (up \$7m) and higher Corporate EBIT (up \$3m).

Life EBIT decreased by \$93m (down 33%) to \$193m and reflected lower normalised COE (down \$101m) partially offset by lower expenses (down \$8m).

Funds Management EBIT increased by \$7m (up 26%) to \$35m, from higher FUM based management fees (up \$8m), higher Fidante Partners performance fees (up \$1m) and lower expenses (down \$4m), partially offset by lower transaction fees (down \$6m).

Corporate EBIT increased by \$3m (up 9%) due to lower expenses.

Normalised Return On Equity (ROE)

1H21 normalised ROE (pre-tax) was 11.5% and decreased by 370 bps on 1H20. Lower normalised ROE reflects lower normalised profit before tax (down 30%) and lower average Group net assets, which were 7% lower than 1H20 following the pandemic related market sell-off in 2H20.

Normalised tax

Normalised tax was \$59m in 1H21 and decreased by \$28m on 1H20. The lower normalised tax reflects lower normalised net profit before tax and a lower normalised effective tax rate.

The normalised effective tax rate in 1H21 was 30.3%, down from 31.3% in 1H20. The effective tax rate is similar to Australia's statutory tax rate of 30% and includes offshore earnings, which are generally taxed below 30%, and interest payments on the various Challenger Capital Notes, which are generally not tax deductible.

Investment experience after tax

Challenger Life Company Limited (CLC) is required by Australian Accounting Standards to value investment assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on investment assets and liabilities being recognised in the profit and loss. Challenger is generally a long-term holder of assets due to them being held 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.

Changes in macroeconomic variables impact the value of Life's assets and liabilities, with the impact included as investment experience.

Investment experience also includes new business strain, being the requirement to apply the risk-free discount rate plus an illiquidity premium to value annuity liabilities, rather than the actual interest rate paid on annuity liabilities (refer to page 56 for more detail).

1H21 investment experience was a gain of \$87m (after-tax) reflecting the partial unwind of pandemic related investment market losses incurred in FY20. Refer to page 25 for more detail, including investment experience by asset class.

Significant items

1H21 significant items were \$1m (after-tax) and represent initial transaction costs associated with the MyLife MyFinance acquisition (refer to page 5 for more detail).

Total transaction and integration costs over FY21 for the MyLife MyFinance acquisition will be reported as a significant item and are expected to be approximately \$5m (post-tax).

Statutory net profit after tax

Statutory net profit after tax includes after-tax investment experience and significant one-off items.

Statutory profit after tax was \$223m in 1H21, an increase of \$2m (1%) and includes:

- Normalised net profit after tax of +\$137m;
- Life investment experience of +\$87m (refer to page 25 for more detail); and
- Significant items of -\$1m.

Dividends

Dividend policy

Challenger targets a dividend payout ratio in the range of between 45% to 50% of normalised profit after tax and aims to frank dividends to the maximum extent possible.

In April 2020 following the immediate impact of COVID-19, APRA wrote to all authorised deposit taking institutions (ADIs) and insurers noting APRA's expectation that ADIs and insurers limit dividends given the uncertain outlook.

The Challenger Board did not declare a final FY20 dividend and prioritised maintaining a strong capital position during the COVID-19 pandemic.

With an improved economic outlook and more stable investment market conditions, the Challenger Board recommenced paying shareholder dividends in 1H21.

1H21 Dividend

The Challenger Board has declared a fully franked interim dividend of 9.5 cps, representing a normalised dividend payout ratio of 46.6%, which is within Challenger's dividend payout ratio guidance range.

Challenger's franking account balance at 31 December 2020 was \$21m. This amount is calculated from the balance of the franking account as at the end of the period, adjusted for franking credits that will arise from the settlement of current income tax liabilities and interest on Challenger Capital Notes.

Dividend Reinvestment Plan (DRP)

Challenger operates a DRP, providing an effective way for shareholders to reinvest their dividends and increase their shareholding without incurring transaction costs.

Under the terms of the DRP, new Challenger shares will be issued based on a 10-day Challenger volume-weighted average price (VWAP), with no share price discount applied. The DRP participation rate for interim FY20 dividend (paid in March 2020) was 2% of issued capital and reduced the cash payout by approximately 2%.

FY21 outlook

Normalised profit before tax guidance

Challenger's FY21 normalised profit before tax guidance is a range of between \$390m and \$440m.

A key consideration in setting FY21 guidance is the progressive deployment of Life's \$3bn of cash at liquids (at 1 July 2020) into higher returning investments over the course of FY21 to enhance Life's earnings and returns.

The deployment has progressed as planned to 31 December 2020, which is expected to result in normalised profit before tax being more weighted to 2H21 over 1H21.

Challenger's FY21 initial normalised profit before tax guidance also assumed up to \$22m of rental abatements will be provided to support Life's property tenants through the COVID-19 situation. The property portfolio is performing better than anticipated at the start of the year and so the forecast rental abatement impact for FY21 is now estimated to be between \$10m and \$12m. Refer to page 37 for additional detail on Life rental abatements.

The COVID-19 situation and its impacts on markets create an inherently uncertain environment. This could, among other things, impact the speed of deployment of Life's capital and therefore impact normalised net profit before tax guidance.

Normalised Return On Equity (ROE) target

Challenger's medium term normalised ROE (pre-tax) target has been set as the Reserve Bank of Australia (RBA) cash rate plus a margin of 14%. Using a ROE target linked to the RBA cash rate removes the direct impact of interest rate changes from the ROE target.

In 1H21, the average RBA cash rate was 20 bps, resulting in Challenger's normalised ROE target being 14.2%.

Challenger's 1H21 normalised ROE was 11.5% and was below Challenger's target reflecting the progressive deployment of higher levels of cash and liquid investments.

Expense management

Challenger's business is highly efficient and very scalable. As a result, Challenger is one of Australia's most efficient financial services companies. Challenger does not target a specific normalised cost to income ratio or range. However, given the uncertain economic outlook as a result of the COVID-19 situation, Challenger is maintaining ongoing disciplined expense management with FY21 expenses expected to be lower than FY20.

1H21 total expenses were \$127m, down 10% on 1H20.

Normalised effective tax rate target

The 1H21 normalised effective tax rate was 30.3% and is broadly in line with Australia's 30% corporate tax rate.

Over the medium term, Challenger expects a normalised effective tax rate of approximately 30%.

Dividend

Challenger targets a dividend payout ratio of between 45% and 50% of normalised profit after tax and seeks to frank the dividend to the maximum extent possible. However, the actual dividend payout ratio and franking will depend on prevailing market conditions and capital allocation priorities at the time.

The 1H20 normalised dividend payout ratio was 46.6%.

Credit ratings

In November 2020, Standard & Poor's Global Ratings (S&P) completed its annual ratings review and affirmed both Challenger Life Company Limited's (CLC) and Challenger Limited's credit ratings.

S&P ratings are as follows:

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

Group balance sheet¹

\$m	1H21	FY20	1H20	FY19	1H19	FY18	1H18
Assets							
Life investment assets							
Fixed income and cash ²	14,821.1	13,970.6	12,956.7	12,459.8	12,014.5	11,727.8	11,076.5
Property ²	3,316.2	3,292.1	3,337.8	3,382.0	3,739.4	3,840.5	3,654.6
Equity and Infrastructure ^{2,3}	604.2	393.4	2,035.9	2,042.3	1,778.3	1,600.8	1,551.3
Alternatives ³	892.5	647.2	1,338.8	1,126.3	1,092.1	916.0	757.7
Life investment assets	19,634.0	18,303.3	19,669.3	19,010.4	18,624.3	18,085.1	17,040.1
Cash and cash equivalents (Group cash)	136.6	146.1	141.2	91.5	87.7	84.9	121.9
Receivables	127.7	163.0	121.2	182.7	167.7	198.3	155.1
Derivative assets	450.1	522.9	403.3	331.2	158.7	150.7	243.4
Investment in associates	63.3	63.0	56.1	58.1	53.4	62.4	54.2
Other assets	61.4	65.8	60.3	76.6	57.0	50.6	53.3
Fixed assets	25.1	25.9	27.3	28.3	29.7	31.2	32.2
Right-of-use lease assets ⁴	37.9	32.4	34.4	-	-	-	-
Tax assets	-	43.1	-	-	-	-	-
Goodwill and intangibles	597.5	598.0	602.0	581.2	594.9	592.9	591.3
Less Group/Life eliminations ⁵	(36.3)	(41.0)	(44.8)	(62.4)	(63.5)	(73.7)	(83.8)
Total assets	21,097.3	19,922.5	21,070.3	20,297.6	19,709.9	19,182.4	18,207.7
Liabilities							
Payables	162.4	191.4	189.6	256.1	306.5	303.8	249.1
Tax liabilities	39.7	-	204.8	158.2	31.8	89.0	95.2
Derivative liabilities	143.7	136.2	118.8	227.0	276.3	229.6	158.7
Subordinated debt	401.7	395.7	404.9	403.9	400.6	403.7	405.3
Challenger Capital Notes	881.6	799.5	798.3	796.5	794.7	793.0	791.2
Group debt	50.0	50.0	-	-	-	-	-
Lease liabilities ⁴	72.4	67.6	70.2	-	-	-	-
Provisions	31.8	35.5	17.0	19.2	16.1	14.6	13.6
Life annuity liabilities	12,769.7	12,581.2	12,845.3	12,870.2	12,323.7	11,728.3	11,115.8
Challenger Index Plus Fund liabilities	3,031.5	2,415.8	2,705.6	1,966.2	2,172.3	2,135.0	1,909.3
Total liabilities	17,584.5	16,672.9	17,354.5	16,697.3	16,322.0	15,697.0	14,738.2
Group net assets	3,512.8	3,249.6	3,715.8	3,600.3	3,387.9	3,485.4	3,469.5
Equity							
Contributed equity	2,422.6	2,377.6	2,110.8	2,093.7	2,090.2	2,051.7	2,071.0
Reserves	(55.5)	(50.9)	(61.0)	(52.4)	(66.0)	(33.3)	(47.5)
Retained earnings	1,145.7	922.9	1,666.0	1,559.0	1,363.7	1,467.0	1,446.0
Total equity	3,512.8	3,249.6	3,715.8	3,600.3	3,387.9	3,485.4	3,469.5

¹ Excludes consolidation of Special Purpose Vehicles (SPVs) and non-controlling interests.

² Fixed income, property and infrastructure are reported net of debt.

³ Commencing in 1H21, Life's investment portfolio categories have been amended to more accurately reflect Life's portfolio composition. The equities and infrastructure categories were combined, and absolute return funds and insurance-related investments reclassified from equities to alternatives. Comparatives have been restated.

⁴ Reflects the adoption of AASB 16 Leases on 1 July 2019.

⁵ Group/Life eliminations represent the fair value of the SPV residual income notes (i.e. NIM) held by Challenger Life Company Limited.

Change in Group net assets

\$m	1H21	FY20	1H20	FY19	1H19	FY18	1H18
Opening net assets	3,249.6	3,715.8	3,600.3	3,387.9	3,485.4	3,469.5	2,888.1
Statutory net profit after tax	222.8	(636.4)	220.4	301.7	6.1	127.1	195.4
Dividends paid	-	(106.7)	(109.7)	(106.4)	(109.4)	(106.1)	(99.5)
New share issue	34.8	266.8	2.6	3.4	3.4	3.3	503.3
Reserve movements	(4.6)	10.1	(8.6)	13.7	(32.7)	14.2	(31.0)
CPP ¹ Trust movements	10.2	-	14.5	-	35.1	(22.6)	13.2
Transition of new leasing standard ²	-	-	(3.7)	-	-	-	-
Closing net assets	3,512.8	3,249.6	3,715.8	3,600.3	3,387.9	3,485.4	3,469.5

¹ The Challenger Performance Plan (CPP) Trust.

² Reflects the adoption of AASB 16 Leases on 1 July 2019.

Issued share capital, dilutive share count and earnings per share

	1H21	2H20	1H20	2H19	1H19	2H18	1H18
Earnings per share (cents)							
Basic – normalised	20.4	25.0	31.5	32.4	33.1	32.9	35.2
Basic – statutory	33.2	(104.4)	36.3	49.8	1.0	21.1	33.1
Diluted – normalised	17.5	21.1	27.7	27.8	30.1	30.9	33.8
Diluted – statutory	27.3	(104.4)	31.5	41.2	1.0	20.9	31.9
Number of shares (m)							
Basic share count	672.2	663.1	607.6	605.8	605.4	601.7	603.3
CPP ¹ Trust treasury shares	3.4	4.4	4.4	5.8	5.8	9.2	7.3
Total issued shares	675.6	667.5	612.0	611.6	611.2	610.9	610.6
Movement in basic share count							
Opening	663.1	607.6	605.8	605.4	601.7	603.3	561.9
CPP ¹ Trust deferred share purchase	-	-	-	-	(0.8)	(2.0)	(2.0)
Net Treasury shares (acquired)/released	1.0	-	1.4	-	4.2	0.1	4.8
New share issues	8.1	55.5	0.4	0.4	0.3	0.3	38.6
Closing	672.2	663.1	607.6	605.8	605.4	601.7	603.3
Movement in CPP Trust Treasury shares							
Opening	4.4	4.4	5.8	5.8	9.2	7.3	10.1
Shares vested to participants	(1.0)	-	(1.4)	-	(4.2)	(0.1)	(5.6)
CPP ¹ Trust deferred share purchase	-	-	-	-	0.8	2.0	2.0
Shares bought into CPP Trust	-	-	-	-	-	-	0.8
Closing	3.4	4.4	4.4	5.8	5.8	9.2	7.3
Weighted average number of shares (m)							
Basic EPS shares							
Total issued shares	674.6	614.0	611.8	611.4	611.0	610.9	599.4
Less CPP ¹ Trust Treasury shares	(3.8)	(4.4)	(4.7)	(5.7)	(6.6)	(8.7)	(8.3)
Shares for basic EPS calculation	670.8	609.6	607.1	605.7	604.4	602.2	591.1
Diluted shares for normalised EPS							
Shares for basic EPS calculation	670.8	609.6	607.1	605.7	604.4	602.2	591.1
Add dilutive impact of unvested equity awards	5.9	4.2	4.3	2.9	7.1	10.5	11.9
Add dilutive impact of Capital Notes	136.3	145.5	99.5	117.8	85.1	65.6	57.8
Add dilutive impact of subordinated notes	59.1	59.1	49.5	58.5	42.3	32.6	5.9
Shares for diluted normalised EPS calculation	872.1	818.4	760.4	784.9	738.9	710.9	666.7
Diluted shares for statutory EPS							
Shares for basic EPS calculation	670.8	609.6	607.1	605.7	604.4	602.2	591.1
Add dilutive impact of unvested equity awards	5.9	-	4.3	2.9	7.1	10.5	11.9
Add dilutive impact of Capital Notes	136.3	-	99.5	117.8	-	65.6	57.8
Add dilutive impact of subordinated notes	59.1	-	49.5	58.5	-	32.6	5.9
Shares for diluted statutory EPS calculation	872.1	609.6	760.4	784.9	611.5	710.9	666.7
Summary of shares rights (m)							
Hurdled Performance Share Rights							
Opening	9.8	10.2	7.2	7.4	8.2	8.2	10.2
New grants	7.4	-	3.9	-	2.2	-	2.0
Vesting/forfeiture	(1.1)	(0.4)	(0.9)	(0.2)	(3.0)	-	(4.0)
Closing	16.1	9.8	10.2	7.2	7.4	8.2	8.2
Deferred Performance Share Rights							
Opening	2.1	2.1	2.5	2.6	2.8	2.9	3.7
New grants	1.8	-	1.1	-	1.4	-	1.3
Vesting/forfeiture	(1.0)	-	(1.5)	(0.1)	(1.6)	(0.1)	(2.1)
Closing	2.9	2.1	2.1	2.5	2.6	2.8	2.9

¹ The Challenger Performance Plan (CPP) Trust.

Issued share capital

Issued share capital and diluted share count

The number of Challenger Limited shares listed on the ASX at 31 December 2020 was 676m shares. The number of shares on issue increased by 8m shares in 1H21 with new shares issued under Challenger's share purchase plan (SPP), which was completed in July 2020. The SPP followed an institutional placement that raised \$270 million and was completed in June 2020.

The basic number of shares used to determine Challenger's normalised and statutory EPS is based on requirements set out in Australian Accounting Standards, as follows:

- the basic share count is reduced for Treasury shares;
- the dilutive share count includes unvested equity awards made to employees under the Challenger Performance Plan (CPP); and
- the dilutive share count considers convertible instruments (e.g. Challenger Capital Notes 1, Challenger Capital Notes 2, Challenger Capital Notes 3 and subordinated debt) as determined by a probability of vesting test (refer to page 18 for more detail on the accounting treatment).

Treasury shares

The CPP Trust was established to purchase shares to satisfy Challenger's employee equity obligations arising from hurdle and deferred performance share rights issued under employee remuneration structures.

Shares are acquired by the CPP Trust to mitigate shareholder dilution and provide a mechanism to hedge the cash cost of acquiring shares in the future to satisfy vested equity awards.

The CPP Trust typically acquires physical shares on-market or via forward share purchase agreements. The use of forward share purchase agreements was implemented to increase capital efficiency. Shares held by the CPP Trust and share forward purchase agreements are classified as Treasury shares.

It is expected that should equity awards vest in the future, the CPP Trust will satisfy equity requirements via a combination of Treasury shares and settlement of forward purchase agreements. As such, it is not anticipated that new Challenger shares will be issued to meet future vesting obligations of equity awards.

Weighted average share count

The basic weighted average number of shares used to determine both the normalised and statutory basic EPS increased by 61m shares (up 10%) in 1H21 to 671m shares.

The increase reflects the weighted impact of 61m new shares issued following the institutional placement and SPP announced in June 2020.

The weighted average number of shares used to determine both the statutory and normalised diluted EPS increased by 54m shares (up 7%) in 1H21 to 872m shares.

The increase primarily reflects a higher basic weighted average number of shares on issue (refer above), the issue of Challenger Capital Notes 3 net of the repurchase of Challenger Capital Notes 1 (refer to pages 42 and 43) and a lower dilutive impact from Challenger debt instruments as a result of the increase in Challenger's share price used to calculate potential dilution. Refer to page 18 for more detail.

Dilutive share count and earnings per share

Dilutive share count

Dilutive impact of unvested equity awards

Challenger's approach to executive remuneration includes providing equity awards to ensure alignment between key employees and shareholders.

Hurdled Performance Share Rights (HPSRs) vest over a period of up to five years, with vesting subject to meeting total shareholder return performance hurdles and continued employment.

A portion of variable remuneration is awarded in Deferred Performance Share Rights (DPSRs) which vest over a period of up to four years, subject to continued employment.

The dilutive impact of these awards in any given period is based on the probability of future vesting.

Accounting treatment of Capital Notes and subordinated debt

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

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

However, under Australian Accounting Standards, 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 to be undertaken each reporting period to determine if they are included in the dilutive share count.

Dilutive impact of Capital Notes and subordinated debt

The dilutive share count for Challenger's convertible debt (Challenger Capital Notes and subordinated debt) is based on the following formula:

$$\frac{\text{Face value of debt}}{\text{Conversion factor} \times \text{Challenger's 20-day volume weighted average price}}$$

The conversion factor for all of Challenger's convertible debt is 99%.

The simple average of the volume weighted average Challenger share price over the last 20 days in each reporting period, subject to a minimum VWAP floor, is used to determine the dilutive impact. The simple average of Challenger's 20-day volume weighted average share price (VWAP) leading up to 31 December 2020 was \$6.03.

Mandatory conversion of Challenger's convertible debt is subject to a VWAP floor, being 50% of the issue date VWAP. As a result, under mandatory conversion, the VWAP floor for mandatory conversion is as follows:

Issue	Issue date	Face value	VWAP floor
Challenger Capital Notes 1	9 Oct 2014	\$47m	\$3.6140
Challenger Capital Notes 2	7 Apr 2017	\$460m	\$6.1500
Challenger Capital Notes 3	25 Nov 2020	\$385m	\$2.5700
Subordinated debt	24 Nov 2017	\$400m	\$6.8400
Total		\$1,292m	

For both Challenger Capital Notes 2 and subordinated debt, the minimum VWAP floor price was higher than the average Challenger 20-day volume weighted average share price leading up to 31 December 2020 (\$6.03). Therefore, the VWAP floor is used at 31 December 2020 to determine the dilutive share count for both Challenger Capital Notes 2 and subordinated debt and the average Challenger 20-day volume weighted average share price is used to determine the potential dilutive impact from Challenger Capital Notes and Challenger Capital Notes 3.

Earnings per share

Normalised diluted EPS

The normalised basic EPS for 1H21 of 20.4 cps is greater than the interest cost per potential ordinary share for each of the Challenger Capital Notes, Challenger Capital Notes 2, Challenger Capital Notes 3 and subordinated debt. As a result, all debt instruments were considered to be dilutive in 1H21.

The weighted average number of shares used to determine the normalised diluted EPS increased by 54m shares in 1H20.

The increase is due to:

- increase in weighted average number of basic shares on issue to reflect the institutional placement and Share Purchase Plan announced in June 2020, which raised \$305m of new shareholder equity;
- an \$87m increase in face value of debt following the issuance of Challenger Capital Notes 3 and partial repurchase of Capital Notes 1 (refer to pages 42 and 43 for more detail); partially offset by
- a reduction in the dilutive impact of the remaining Challenger Capital Notes 1 as a result of an increase in Challenger's weighted average share price over the last 20 days of 1H21. The volume weighted average share price was \$6.03, up from \$4.98 in FY20. The higher Challenger share price results in a lower number of potential shares being issued should the debt ever convert to shareholder equity.

To determine the normalised diluted EPS, the normalised profit after tax is increased by \$16m of interest expense in relation to Challenger Capital Notes 1, Challenger Capital Notes 2, Challenger Capital Notes 3 and subordinated debt.

Consolidated operating cash flow

\$m	1H21	2H20	1H20	2H19	1H19	2H18	1H18
Receipts from customers	323.8	348.8	334.5	364.6	336.3	333.7	336.5
Dividends received	33.6	20.3	45.7	34.1	67.6	41.0	53.8
Interest received	310.3	327.0	384.9	367.0	413.4	364.5	385.6
Interest paid	(234.3)	(415.6)	(270.6)	(362.7)	(366.5)	(296.9)	(275.0)
Payments to suppliers and employees	(304.9)	(258.9)	(305.6)	(258.0)	(303.5)	(253.6)	(294.7)
Income tax (paid) / refunded	(9.0)	33.1	(48.9)	(11.8)	(43.6)	(45.1)	(152.4)
Underlying operating cash flow	119.5	54.7	140.0	133.2	103.7	143.6	53.8
Net annuity policy capital receipts/(payments)	157.6	(344.7)	93.6	192.1	493.7	634.5	758.2
Net other Life capital receipts/(payments)	551.1	(263.1)	830.0	(301.2)	90.2	214.0	189.6
(Purchase)/Proceeds of investments	(358.6)	(568.5)	(899.2)	333.8	(1,238.6)	(1,447.0)	(1,032.7)
Capital expenditures	(3.4)	(3.3)	(6.0)	(18.5)	(41.4)	(53.5)	(16.4)
Net equity placement proceeds	34.8	264.1	-	-	-	-	499.8
Net (repayments)/proceeds from borrowings	(387.9)	825.7	(5.7)	35.6	470.7	476.4	62.3
Receipts/(Payments) for Treasury shares	2.4	(4.5)	(3.8)	(7.8)	(39.7)	(1.9)	(34.8)
Net dividends paid	-	(103.9)	(107.1)	(103.0)	(106.0)	(102.8)	(96.0)
Net non-operating cashflows SPV's	(3.5)	(19.8)	(8.5)	(22.0)	(21.9)	(18.1)	(27.1)
Other cash flow	(7.5)	(218.0)	(106.7)	109.0	(393.0)	(298.4)	302.9
Net increase/(decrease) in cash and cash equivalents	112.0	(163.3)	33.3	242.2	(289.3)	(154.8)	356.7

Underlying operating cash flow

Underlying operating cash flow excludes cash flows that are capital in nature, such as annuity sales and annuity capital payments, and investing and financing-related cash flows.

1H21 underlying operating cash flow was \$120m. 1H21 underlying operating cash flow was \$17m lower than normalised net profit after tax mainly due to non-cash normalised capital growth of \$16m.

Net annuity policy capital receipts

1H21 net annuity policy capital receipts were +\$158m and comprised:

- annuity sales of \$2,191m; less
- annuity capital payments of \$2,033m.

Annuity capital payments represent the return of capital to annuitants and exclude interest payments.

1H21 annuity net flows (+\$158m) represents annuity book growth of +1.3% for the half year and is calculated as 1H21 annuity total net flows divided by the opening period annuity liability of \$12,581m.

1H21 annuity net flows (+\$158m) benefitted from an increase in sales (up 12% on 1H20), partially offset by a higher maturity rate. The maturity rate in 1H21 was 16%, which is expected to reduce to between 11% and 12% in 2H21.

Net other Life capital receipts

1H21 net other Life capital receipts were +\$551m and comprised:

- other Life sales of \$1,247m; less
- other Life capital payments of \$695m.

1H21 other Life net flows benefitted from higher sales (up 5% on 1H20), however were partially offset by higher maturities and repayments (up 97% on 1H20).

1H21 total Life book growth was +4.7% (1H20 +6.2%) and can be calculated as total 1H21 net flows (+\$709m) divided by the sum of the opening period liabilities of \$14,997m (Life annuity liabilities and Challenger Index Plus Fund liabilities – refer to page 21 for more detail).

Life financial results

\$m	1H21	2H20	1H20	2H19	1H19	2H18	1H18
Investment yield – policyholders' funds	375.3	398.4	442.1	438.8	432.5	433.6	435.4
Interest expense	(204.2)	(227.8)	(245.8)	(255.3)	(260.1)	(250.7)	(234.7)
Distribution expense	(4.8)	(4.8)	(5.7)	(7.3)	(11.0)	(10.4)	(11.7)
Other income ¹	19.4	31.2	16.0	15.3	18.3	12.0	10.8
Product cash margin	185.7	197.0	206.6	191.5	179.7	184.5	199.8
Investment yield – shareholders' funds	42.0	47.5	67.6	72.0	71.8	78.2	76.6
Cash earnings	227.7	244.5	274.2	263.5	251.5	262.7	276.4
Normalised capital growth	16.3	49.6	70.6	77.0	78.1	70.8	59.7
Normalised Cash Operating Earnings	244.0	294.1	344.8	340.5	329.6	333.5	336.1
Personnel expenses	(34.4)	(32.0)	(36.6)	(34.8)	(34.1)	(33.9)	(33.8)
Other expenses	(16.8)	(23.2)	(22.4)	(20.0)	(17.6)	(19.9)	(19.3)
Total expenses	(51.2)	(55.2)	(59.0)	(54.8)	(51.7)	(53.8)	(53.1)
Normalised EBIT	192.8	238.9	285.8	285.7	277.9	279.7	283.0
Asset and liability experience ²	120.6	(1,157.3)	54.9	164.1	(234.3)	(60.5)	15.5
New business strain ²	3.9	30.9	1.0	2.6	(35.9)	(21.5)	(37.4)
Total investment experience	124.5	(1,126.4)	55.9	166.7	(270.2)	(82.0)	(21.9)
Net profit after investment experience before tax	317.3	(887.5)	341.7	452.4	7.7	197.7	261.1
Reconciliation of investment experience to capital growth							
Asset and liability experience	120.6	(1,157.3)	54.9	164.1	(234.3)	(60.5)	15.5
Normalised capital growth	16.3	49.6	70.6	77.0	78.1	70.8	59.7
Asset and liability capital growth	136.9	(1,107.7)	125.5	241.1	(156.2)	10.3	75.2
Performance analysis							
Cost to income ratio ³ (%)	21.0%	18.8%	17.1%	16.1%	15.7%	16.1%	15.8%
Net assets – average ⁴ (\$m)	3,065	2,982	3,388	3,164	3,151	3,127	2,959
Normalised ROE (pre-tax) (%)	12.5%	16.1%	16.8%	18.2%	17.5%	18.0%	19.0%

¹ Other income includes Accurium revenue and Life Risk revenue (premiums net of claims).

² Investment experience comprises asset and liability experience and net new business strain. Refer to page 56 for more detail.

³ Cost to income ratio calculated as total expenses divided by normalised COE.

⁴ Net assets – average calculated on a monthly basis.

Life financial results

\$m	1H21	2H20	1H20	2H19	1H19	2H18	1H18
Sales							
Fixed term sales	1,844.4	966.8	1,746.0	990.9	1,698.9	1,278.6	1,867.2
Lifetime sales	346.6	203.7	210.9	411.7	441.6	432.6	422.3
Life annuity sales	2,191.0	1,170.5	1,956.9	1,402.6	2,140.5	1,711.2	2,289.5
Maturities and repayments	(2,033.4)	(1,515.2)	(1,863.3)	(1,210.3)	(1,647.0)	(1,076.7)	(1,531.3)
Life annuity flows	157.6	(344.7)	93.6	192.3	493.5	634.5	758.2
Closing Life annuity book	12,769.7	12,581.2	12,845.3	12,870.2	12,323.7	11,728.3	11,115.8
Annuity book growth¹	1.3%	(2.7%)	0.7%	1.6%	4.2%	6.2%	7.3%
Other Life sales	1,246.5	841.8	1,182.2	407.1	599.8	520.4	1,034.5
Other maturities and repayments	(695.4)	(1,104.9)	(352.2)	(708.3)	(509.6)	(306.5)	(844.8)
Other Life flows	551.1	(263.1)	830.0	(301.2)	90.2	213.9	189.7
Closing Challenger Index Plus Fund liabilities	3,031.5	2,415.8	2,705.6	1,966.2	2,172.3	2,135.0	1,909.3
Other Life net book growth	22.8%	(13.4%)	42.2%	(14.1%)	4.2%	12.7%	11.2%
Total Life sales	3,437.5	2,012.3	3,139.1	1,809.7	2,740.3	2,231.6	3,324.0
Total maturities and repayments	(2,728.8)	(2,620.1)	(2,215.5)	(1,918.6)	(2,156.6)	(1,383.2)	(2,376.1)
Total Life net flows	708.7	(607.8)	923.6	(108.9)	583.7	848.4	947.9
Closing total Life book ³	15,801.2	14,997.0	15,550.9	14,836.4	14,496.0	13,863.3	13,025.1
Total Life book growth¹	4.7%	(4.1%)	6.2%	(0.8%)	4.2%	7.1%	7.9%
Assets							
Closing investment assets	19,634	18,303	19,669	19,010	18,624	18,085	17,040
Fixed income and cash	14,328	13,691	12,836	12,241	11,802	11,380	10,984
Property	3,299	3,308	3,336	3,535	3,661	3,714	3,388
Equity and infrastructure ²	437	1,089	2,027	1,817	1,789	1,561	1,437
Alternatives ²	914	977	1,244	1,122	1,040	927	661
Average investment assets⁴	18,978	19,065	19,443	18,715	18,292	17,582	16,470
Liabilities							
Closing liabilities	17,095	16,198	16,761	16,045	15,702	15,072	14,235
Annuities and Challenger Index Plus Fund	15,324	15,499	15,341	14,646	14,194	13,530	12,568
Capital Notes	830	805	805	805	805	805	805
Subordinated debt	401	400	406	405	405	407	401
Average liabilities⁴	16,555	16,704	16,552	15,856	15,404	14,742	13,774
Margins⁵							
Investment yield – policyholders' funds	3.92%	4.20%	4.52%	4.73%	4.69%	4.97%	5.25%
Interest expense	(2.13%)	(2.40%)	(2.51%)	(2.75%)	(2.82%)	(2.87%)	(2.83%)
Distribution expense	(0.05%)	(0.05%)	(0.06%)	(0.08%)	(0.12%)	(0.12%)	(0.14%)
Other income	0.20%	0.33%	0.16%	0.16%	0.20%	0.14%	0.13%
Product cash margin	1.94%	2.08%	2.11%	2.06%	1.95%	2.12%	2.41%
Investment yield – shareholders' funds	0.44%	0.50%	0.70%	0.78%	0.78%	0.89%	0.92%
Cash earnings	2.38%	2.58%	2.81%	2.84%	2.73%	3.01%	3.33%
Normalised capital growth	0.17%	0.52%	0.72%	0.83%	0.84%	0.82%	0.72%
Normalised Cash Operating Earnings (COE)	2.55%	3.10%	3.53%	3.67%	3.57%	3.83%	4.05%

¹ Book growth percentage represents net flows for the period divided by opening book value for the financial year.

² Commencing in 1H21, Life's investment portfolio categories have been amended to more accurately reflect Life's portfolio composition. The equities and infrastructure categories were combined, and absolute return funds and insurance-related investments reclassified from equities to alternatives. Comparatives have been restated.

³ Life annuity liabilities and Challenger Index Plus Fund liabilities.

⁴ Average investment assets and average liabilities calculated on a monthly basis.

⁵ Ratio of normalised COE components divided by average investment assets.

Life financial results

Life quarterly sales and investment assets

\$m	Q2 21	Q1 21	Q4 20	Q3 20	Q2 20	Q1 20
Life sales						
Fixed term sales	819	1,025	480	487	999	747
Lifetime sales ¹	139	208	98	106	116	95
Life annuity sales	958	1,233	578	593	1,115	842
Maturities and repayments	(900)	(1,133)	(926)	(590)	(1,023)	(840)
Life annuity flows	58	100	(348)	3	92	2
Annuity book growth²	0.5%	0.8%	(2.7%)	0.0%	0.7%	0.0%
Other Life sales	903	344	486	356	246	936
Other maturities and repayments	(366)	(330)	(783)	(322)	(180)	(172)
Other Life flows	537	14	(297)	34	66	764
Other Life net book growth	22.2%	0.6%	(15.2%)	1.7%	3.4%	38.9%
Total Life sales	1,861	1,577	1,064	949	1,361	1,778
Total maturities and repayments	(1,266)	(1,463)	(1,709)	(912)	(1,203)	(1,012)
Total Life net flows	595	114	(645)	37	158	766
Total Life book growth²	3.9%	0.8%	(4.3%)	0.2%	1.0%	5.2%
Life						
Fixed income and cash ³	14,821	14,260	13,971	14,571	12,957	13,076
Property ³	3,316	3,303	3,292	3,320	3,338	3,288
Equity and Infrastructure ^{3,4}	604	398	393	392	2,036	2,034
Alternatives ⁴	893	987	647	677	1,338	1,285
Total Life investment assets	19,634	18,948	18,303	18,960	19,669	19,683
Average Life investment assets⁵	19,323	18,625	18,393	19,696	19,693	19,253

¹ Lifetime sales includes CarePlus, a product that pays income for life and is specifically designed for the aged care market.

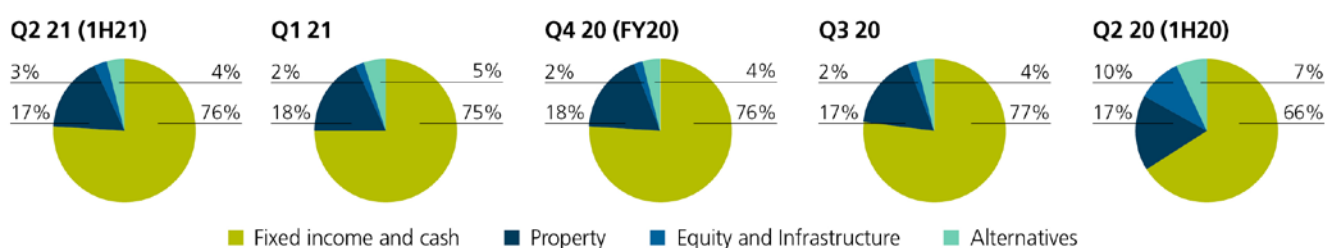
² Book growth percentage represents net flows for the period divided by opening book value for the financial year.

³ Fixed income, property and infrastructure reported net of debt.

⁴ Commencing in 1H21, Life's investment portfolio categories have been amended to more accurately reflect Life's portfolio composition. The equities and infrastructure categories were combined, and absolute return funds and insurance-related investments reclassified from equities to alternatives. Comparatives have been restated.

⁵ Average Life investment assets calculated on a monthly basis.

Life asset allocation



Life financial results

Life focuses on the retirement spending phase of superannuation by providing products that convert retirement savings into safe and secure income for life. Challenger Life is Australia's leading provider of annuities¹.

Life's annuity products appeal to retirees as they provide security and certainty of guaranteed² income while protecting against risks of market downturns and inflation. Lifetime annuities also 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 invested in high-grade fixed income. These investments generate reliable investment income to fund retirement incomes paid to customers.

Life is a market leader in Australian retirement incomes, with a 80%¹ annuity market share, and has won the Association of Financial Advisers 'Annuity Provider of the Year' for the last 12 years and was recognised at the Plan For Life Excellence Awards as the winner of the Overall Longevity Cover Excellence Award for 2020.

Challenger is the dominant Australian retirement income brand and is recognised by 90%³ of advisers as a leader in retirement incomes.

Life is also expanding its relationships with institutional clients, including the profit-for-member sector of Australia's superannuation system, which currently represents ~40%⁴ 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.

Life's products are distributed in Australia via both independent financial advisers and financial advisers tied to the administrative platforms serviced by the major banks and hubs. Life's products are available on leading independent investment and administration platforms.

Life is expanding its customer reach and diversifying its product offering by entering Australia's ~\$1 trillion⁵ term deposit market following the announcement of the acquisition of MyLife MyFinance in December 2020. MyLife MyFinance is an Australian-based customer savings and loans bank that will provide Challenger the opportunity to significantly expand its secure retirement income offering by leveraging Challenger's leading retirement income brand and engaging with customers directly and earlier in their retirement savings journey.

Life also has an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary), a leading provider of foreign currency annuities in Japan (refer to page 29 for more detail).

The Life business includes Accurium, one of Australia's largest providers of self-managed superannuation fund (SMSF) actuarial certificates. Life also participates in wholesale reinsurance longevity and mortality transactions (refer to page 25 for more detail).

CLC is an APRA-regulated entity and its financial strength is rated by Standard & Poor's with an 'A' rating and stable outlook. CLC's capital strength is outlined on pages 44 and 45.

Normalised EBIT and ROE

Life's normalised EBIT was \$193m in 1H21 and decreased by \$93m (33%) on 1H20. The decrease in EBIT reflects a \$101m reduction in normalised Cash Operating Earnings (COE), partially offset by an \$8m decrease in expenses.

Life's normalised ROE (pre-tax) was 12.5% in 1H21 and decreased by 430 bps on 1H20 and 360 bps on 2H20, mainly driven by lower normalised capital growth and more defensive investment portfolio settings in 1H20

During the COVID-19 pandemic, Life is prioritising maintaining a strong capital position and repositioned its investment portfolio in 2H20 to more defensive settings.

Life has a strong regulatory capital position, with \$1.5bn of excess regulatory capital above APRA's minimum requirement at 31 December 2020, resulting in a PCA ratio of 1.63 times, which is above Life's internal capital targets. Refer to pages 44 and 45 for more details on CLC's excess capital position.

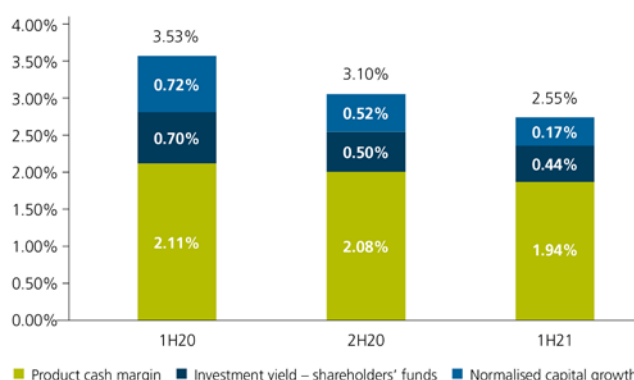
Life's strong capital position provides flexibility to progressively deploy Life's excess cash and liquid investments progressively over FY21.

Normalised Cash Operating Earnings (COE) and COE margin

1H21 normalised COE was \$244m and decreased by \$101m (29%) on 1H20. Normalised COE reduced mainly as a result of a lower COE margin, which was 98 bps lower than 1H20 as a result of moving to more defensive investment portfolio settings following the COVID-19 pandemic.

1H21 normalised COE was \$50m lower than 2H20, representing a 17% reduction in normalised COE and driven by a 55 bps reduction in Life's COE margin (refer to page 24 for more detail).

Life COE margin composition



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

² The word 'guaranteed' means payments are guaranteed by Challenger Life Company Limited (CLC) from assets of its relevant statutory fund.

³ Market Pulse Adviser Study, December 2020.

⁴ APRA Quarterly Superannuation Performance Statistics, September 2020.

⁵ APRA Authorised Deposit-taking Institutions Monthly Statistics.

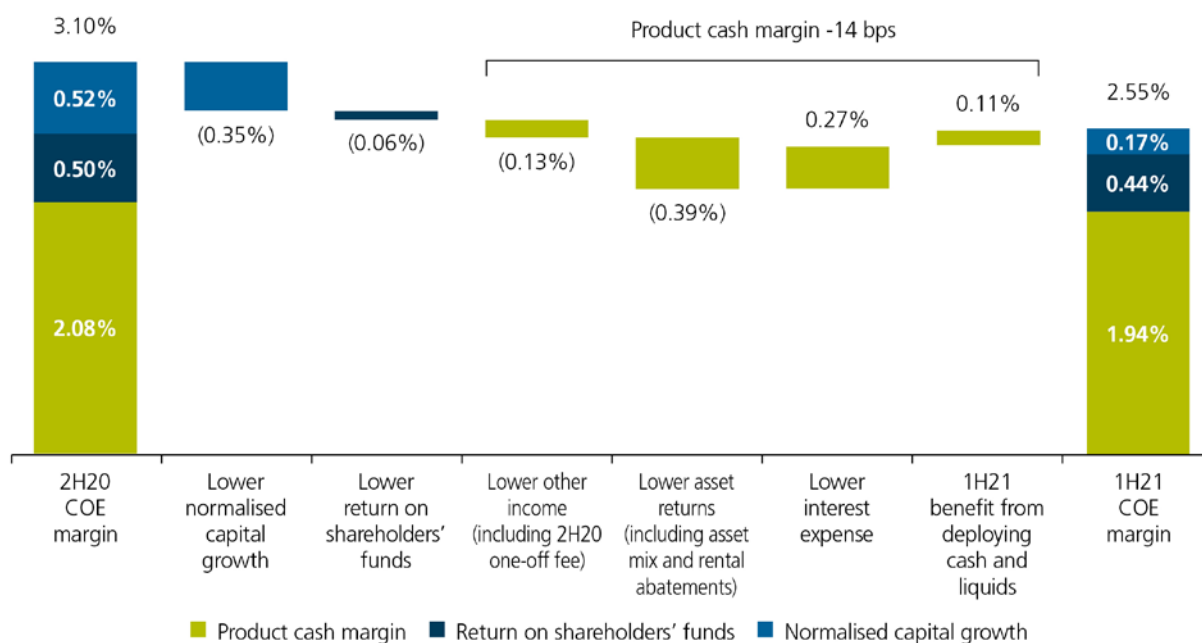
2H20 to 1H21 COE margin

Life's 1H21 COE margin was 2.55% and decreased by 55 bps on 2H20 as a result of:

- Lower normalised capital growth (-35 bps): The decline reflects moving to a more defensive portfolio allocation during 2H20 and a reduction in the alternatives normalised growth assumption, which reduced from 3.5% to 0%.
- Lower return on shareholder capital (-6 bps): Reflects lower interest rates, with shareholder capital not hedged for movements in interest rates. For example, the 3-month bank bill rate in 1H21 was 33 bps lower than 2H20.
- Lower product cash margin -14 bps: The product cash margin represents the return on annuities and institutional products, less associated interest and direct distribution costs plus other income. The product cash margin fell from 2H20 due to:
 - Lower other income (-13bps): 2H20 included the one-off recognition of a \$10m fee in relation to the termination of a contract resulting in additional 2H20 normalised cash earnings;
 - Lower investment yield on policyholder funds (-39bps): Reflects lower earnings on investment assets backing annuity and institutional business, including the impact from repositioning the investment portfolio to more defensive settings in 2H20. For example, equities, infrastructure and alternatives accounted for 11% of Life's average 2H20 shareholder investment assets, which reduced to 7% in 1H21, with a corresponding increase in average cash and liquid investments. Average 1H21 cash and liquids represented 13% of Life's investment assets, up from 11% in 2H20.

Lower investment yield on policyholder funds also includes rental abatements to support Life's tenants through the pandemic (refer to page 37 for more detail);

- Lower interest and distribution expense (+27 bps): Reflects lower annuity rates following a reduction in interest rates; and
- 1H21 benefit from deploying cash and liquids (+11 bps): Following the repositioning of Life's investment portfolio in 2H20, Life held \$3.0 of cash and liquid investments at 30 June 2020. The majority of this balance is being progressively deployed over FY21 to enhance returns. The deployment has progressed as planned and Life is on-track to rotate its excess cash and liquids balance to higher returning investments. The 2H21 product cash margin is forecast to benefit by between 20 bps and 30 bps from the continued and progressive deployment and timing of investment returns.



Life Risk

Life Risk revenue represents premiums net of expected claims on wholesale reinsurance longevity and mortality transactions.

Undertaking wholesale longevity and mortality transactions is a natural business extension for the Life business. Life is participating in established markets, has specialised expertise and is taking a disciplined approach to the wholesale Life Risk opportunity.

1H21 Life normalised COE includes \$16m of income from Life Risk transactions, representing the release of profit and expense margins, up from \$13m in 1H20 and down from \$28m in 2H20.

The reduction on 2H20 is a result of 2H20 including an additional \$10m of income in relation to the termination of a contract at the request of a client, resulting in the one-off recognition in 2H20.

The present value of future profits arising from the Life Risk portfolio was \$824m at 31 December 2020, in line with \$829m at 30 June 2020.

The Life Risk portfolio has an average duration of 17 years.

Accurium

Accurium is one of Australia's leading providers of SMSF actuarial certificates. An actuarial certificate is required by a SMSF when one (or more) members are in the retirement phase of superannuation and one (or more) are in the savings (accumulation) phase of superannuation.

Accurium's 1H21 revenue was \$4m, up \$1m on 1H20 and is included in other income within Life's normalised COE.

Expenses

1H21 Life expenses were \$51m and decreased by \$8m on 1H20. The decrease in expenses was driven by lower personnel expenses (down \$2m) and other expenses (down \$6m). Other expenses reduced as a result of lower marketing, travel and project related expenses.

Despite the reduction in expenses, Life's 1H21 cost to income ratio was 21.0% and increased by 390 bps on 1H20, as a result of lower normalised COE.

Investment experience overview

Challenger Life is required by accounting standards and prudential standards to value all assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on assets and policy liabilities being recognised in the statutory profit and loss, particularly during periods of increased market volatility. As Challenger is generally a long-term holder of assets, due to them being held to match the term of liabilities, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements.

Investment experience removes the volatility arising from asset and liability valuation movements to better reflect the underlying performance of the Life business.

Investment experience includes both asset and liability experience and net new business strain.

1H21 investment experience was a gain of \$125m (pre-tax), comprising a \$121m asset and policy liability gain and a \$4m gain in relation to new business strain.

	Actual capital growth	Normalised capital growth	Investment experience
Fixed income	213	25	238
Property	(10)	(33)	(43)
Equity and infrastructure	42	(8)	34
Alternatives	-	-	-
Policy liability	(108)	-	(108)
Assets and policy liability experience	137	(16)	121
New business strain	4	-	4
Total investment experience (pre-tax)	141	(16)	125

Assets and policy liability experience

Assets and policy liability experience is calculated as the difference between actual investment gains/losses (both realised and unrealised) and normalised capital growth in relation to assets, plus any economic and actuarial assumption changes in relation to policy liabilities for the period.

Assets and policy liability experience includes the impact of changes in macroeconomic variables on the valuation of Life's assets and liabilities and assumption changes to bond yields and inflation factors, expense assumptions and other factors applied in the valuation of life contract liabilities.

Assets and policy liability experience was \$121m in 1H21, comprising:

- Fixed income (+\$238m) – representing actual capital growth of \$200m, \$13m following the recovery of prior period credit defaults and normalised capital growth of \$25m.
The actual capital growth of \$200m reflects the contraction in global credit spreads and the reversal of a significant portion of FY20 unrealised valuation losses from the COVID-19 pandemic when credit spreads expanded significantly.
- Property (-\$43m) – reflects the revaluation of Life's property portfolio, with all properties independently valued in 1H21. Carrying values across the direct property portfolio were relatively stable, however less than the 2% per annum normalised capital growth assumption for property.
- Equity and infrastructure (+\$34m) – reflects higher domestic and international equity markets following a rally in global equity markets, which exceeded Challenger's normalised growth assumption for equities and infrastructure of 4% per annum.
- Alternatives (\$0m) – reflects valuation outcomes in line with Challenger's normalised growth assumption of 0% per annum for alternatives.
- Policy liability (-\$108m) – includes -\$172m as a result of the illiquidity premium adjustment (refer below), partially offset by a \$64m gain on policy liabilities. The policy liability gain reflects changes in economic and actuarial assumptions, including changes to bond yields and interest rates used to hedge policy liabilities, expected inflation rates and expense assumptions on policy liabilities.

Illiquidity premium

In accordance with prudential standards and Australian Accounting Standards, Challenger Life values term annuities at fair value and lifetime annuities using a risk-free discount rate, both of which are based on the Australian Government bond curve plus an illiquidity premium.

Movements in credit spreads impact the fair value of assets as well as the illiquidity premium which forms part of the discount rate used to value policy liabilities.

The illiquidity premium used to value policy liabilities is calculated in accordance with AASB 1038 *Life Insurance Contracts* and AASB 139 *Financial Instruments: Recognition and Measurement*.

New business strain

Life offers annuity rates to customers that are higher than the rates used to value liabilities. As a result, a loss is recognised when issuing a new annuity contract due to using lower discount rates together with the inclusion of an allowance for future maintenance expenses in the liability.

New business strain is a non-cash item and, subsequently, reverses over the future period of the contract. The new business strain reported in the period represents the non-cash loss on new sales net of reversal of the new business strain of prior period sales.

The 1H21 net new business strain was a gain of \$4m (1H20 \$1m gain) reflecting the unwind of new business strain on prior period sales exceeding the new business strain on 1H21 annuity sales.

Life sales and AUM

Total Life sales

Total Life sales were \$3.4bn in 1H21 and increased by 10% on 1H20 with all key product categories increasing. 1H21 Life sales include:

- Domestic annuity sales of \$1.6bn, up \$0.2bn or 11%;
- Japanese annuity sales of \$0.5bn, up \$0.1bn or 15%; and
- Other Life sales of \$1.2bn, up \$0.1bn or 5%.

Domestic annuity sales

Life has been focused on diversifying its distribution, including its annuity relationship with MS Primary in Japan, a renewed focus on institutional sales opportunities and working with a wider range on independent financial advice networks.

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.

There have been a range of regulatory changes that have had a significant impact on the economics of financial advice practices. Regulatory changes include a shift away from commissions to fee-for-service, which is resulting in lower revenue per client, and the best interest duty which is increasing focus on holistic advice over transaction advice.

The major banks are generally exiting or reducing their exposure to wealth management, which is dramatically reducing the number of financial advisers aligned to the wealth management operations of major banks.

Advisers are either migrating from licensees aligned to the major banks to independent adviser networks or leaving the industry all together.

These industry changes have impacted Challenger's annuity sales, especially term annuity sales, which were well supported by advisers aligned to the major banks over the past few years.

Adviser movement across the industry has now stabilised and the adverse impact on Challenger's domestic term sales has been reflected in term sales and the scope for further impacts has reduced.

Japanese annuity sales

In November 2016, Challenger formed an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary), a leading provider of foreign dollar annuity and life insurance products in Japan (refer to page 29 for more information). The MS Primary annuity relationship provides access to the Japanese foreign currency annuities market and is helping to diversify Challenger's distribution channels and product offering.

MS Primary annuity sales are included in term annuity sales and were \$543m in 1H21, up 15% from \$471m in 1H20.

Term annuity sales

1H21 term annuity sales were \$1.8bn and increased by \$98m or 6% on 1H20. Term annuity sales comprise domestic sales of \$1,301m (up \$26m or up 2%) and MS Primary sales of \$543m (up \$73m or up 15%).

Australian fixed term sales have been impacted over the past few years by structural changes in the Australian wealth management and financial adviser market following the Royal Commission, particularly the reduction in advisers at the wealth management operations of the major banks. The impact of adviser movement across the bank-aligned and independent advice market has now stabilised, with major banks accounting for ~13% of 1H21 domestic fixed term annuity sales, which was broadly consistent with the contribution in FY20.

Domestic term annuity sales are benefiting from Challenger's institutional sales team focusing on new client opportunities who are attracted to guaranteed returns in the low interest rate environment. 1H21 domestic term annuity sales include \$190m of institutional term annuity sales, down from \$300m in 1H20. Excluding the institutional term annuity sales, domestic term annuity sales increased by 14% on 1H20.

MS Primary annuity sales are included in term annuity sales and increased by 15% to \$543m and include reinsurance of both Australian dollar and US dollar-denominated annuities. MS Primary sales represented 25% of Challenger's 1H21 total annuity sales.

Under the reinsurance arrangements, MS Primary will provide Challenger an amount of reinsurance, across both Australian and US dollar annuities, of at least ¥50bn (currently ~A\$670m¹) per year for a minimum of five years. This is subject to review in the event of a material adverse change for either MS Primary or Challenger.

Lifetime annuity sales

Lifetime annuity sales were \$347m in 1H21 and increased by 64% (\$136m) from 1H20. 1H21 lifetime sales comprise Liquid Lifetime sales of \$273m and CarePlus sales of \$74m.

Lifetime sales increased by \$136m on 1H20 and include \$114m 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.

Liquid Lifetime sales also include initial RBA Cash Linked option sales, which has been specifically designed for customers and advisers that may be concerned with investing in a lifetime annuity in a low interest rate environment. This product was launched in late FY20.

CarePlus is a lifetime annuity specifically designed for aged care customers. CarePlus sales were \$74m in 1H21, an increase of \$6m (up 9%) on 1H20.

During the COVID-19 pandemic, there has been a delay in retirees entering aged care, which is impacting growth in CarePlus sales.

¹ Based on the exchange rate as at 1 July 2020.

Focus on long-term annuity sales

Challenger is focused on growing its long-term annuity business as it embeds significant value for Challenger shareholders.

Of 1H21 annuity sales, a record 41% were either lifetime annuities or long-term MS Primary annuities, up from 35% in 1H20.

Lifetime and long-term MS Primary annuities accounted for just over 46% of total annuities in force at 31 December 2020, up from 22% five years ago (1H16).

Long-term annuity business is attractive for Challenger as it:

- lengthens the annuity book tenor;
- improves the maturity outlook;
- assists future book growth;
- enhances overall book quality; and
- allows investing in longer term, less liquid assets, generating an illiquidity premium.

New business tenor

With Challenger's focus on long-term annuities, the tenor of new business sales has been increasing. New business tenor over the past five years has increased from approximately 6 years in FY16 to approximately 9 years in 1H21.

New business tenor is benefiting from an increase in the portion of long-term annuity sales, being either domestic lifetime annuities or fixed rate MS Primary (Japan) sales.

Other Life sales

Other Life sales represent Challenger's Index Plus range of products which provide customers a guaranteed return and is typically backed by high-grade liquid fixed income.

Other Life sales were \$1.2bn in 1H21 and increased on 1H20 by 5%. Other Life sales are benefiting from a broader client base seeking to maximise returns in the low interest rate environment.

Life book liability maturity profile

The annuity maturity rate, which represents annuity maturities and repayments (excluding interest payments) divided by the opening period annuity liability, was 16% in 1H21, up from 14% in 1H20.

The maturity rate is expected to be approximately 27% to 28% in FY21, with approximately 60% of full year maturities falling into the first half of FY21.

With Challenger's ongoing focus on longer term annuity sales, it is expected that the maturity rate will reduce over the next few years.

Net book growth

Life annuity book growth

1H21 Life annuity net flows (i.e. annuity sales less capital repayments) were +\$158m.

Based on the opening Life annuity book liability (\$12,581m), 1H21 annuity book growth was +1.3%, up from +0.7% in 1H20.

Annuity net book growth was higher than the prior period due to higher sales more than offsetting the higher maturity levels, which are expected to moderate.

Other Life book growth

Other Life net flows (i.e. other Life sales less capital repayments) represent net flows on Challenger's Index Plus products. In 1H21, Other Life net flows were +\$551m and drove a 25% increase in Index Plus Fund liabilities during the half year.

Across both annuity and institutional Index Plus business, 1H21 net flows were +\$709m for the half year and represented total book growth of 4.7%¹ for the half.

Average AUM

Life's average investment assets were \$19.0bn in 1H21 and decreased by 2% (\$0.5bn) on 1H20. The decrease in average investment assets reflects lower average shareholder net assets (down \$0.3bn) and Life's net flows.

¹ Based on total Life net flows of \$709m divided by Life book of \$14,997m (being opening period annuity book of \$12,581m and opening period Challenger Index Plus book of \$2,416m).

Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary) and MS&AD relationship

Consistent with Challenger's strategy to diversify its range of products and expand its distribution relationships, in November 2016 Challenger commenced an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary).

MS Primary provides annuity and life insurance products to Japanese customers and is part of MS&AD Insurance Group Holdings Inc. (MS&AD), a Nikkei 225 company.

Japan has one of the world's most rapidly ageing populations which is looking for income from longer dated products due to the low Japanese interest rate environment. This has driven significant demand for foreign currency annuities.

In August 2016, MS Primary launched an innovative Australian dollar product with a 20-year fixed rate in Japan. The product is being distributed through the Japanese bancassurance channel.

In relation to reinsuring this product, from 1 November 2016, Challenger commenced issuing Australian dollar fixed rate annuities with a 20-year term to support the reinsurance agreement with MS Primary. Challenger provides a guaranteed interest rate and assumes the investment risk on a portion of each new policy issued by MS Primary.

During FY18, Challenger and MS Primary developed a new Australian dollar lifetime annuity product for the Japanese market, with Challenger reinsuring a portion of each new policy issued by MS Primary.

In March 2019, Challenger and MS&AD announced an expansion to its strategic relationship. Under the expanded strategic relationship, from 1 July 2019, Challenger commenced a quota share reinsurance of US dollar-denominated annuities issued in the Japanese market by MS Primary.

MS Primary will provide to Challenger an amount of reinsurance, across both Australian and US dollar annuities, of at least ¥50bn (~A\$670m¹) per year for a minimum of five years. This is subject to review in the event of a material adverse change for either MS Primary or Challenger.

The MS Primary annuity portfolio is invested in broadly similar key asset classes that Challenger currently invests in and is accounted for under Australian Generally Accepted Accounting Principles and Challenger's normalised profit framework, consistent with Challenger's Life business.

MS Primary is responsible for marketing and providing the products in Japan, including making payments to policyholders. Challenger guarantees a rate to MS Primary, which effectively includes Challenger's contribution toward marketing, distribution and administration costs in Japan. As such, for these products Challenger incurs limited distribution and operational costs as part of its direct expense base.

Under the reinsurance agreement, the guaranteed interest rate on new business can be revised and there are mechanisms to regulate volumes between MS Primary and Challenger. The agreement also includes the usual termination rights for both parties, including material breach, failure to make payments and events that may be triggered by changes in MS Primary's regulatory environment.

MS Primary sales represented 25% of Challenger Life's 1H21 total annuity sales, up from 24% in 1H20.

MS&AD's subsidiary, MS Primary, is a key Challenger strategic partner in both co-development and distribution of annuity products.

As part of the strategic relationship, MS&AD has become a significant investor in Challenger and as at 31 December 2020, held ~15% of Challenger's issued capital.

In August 2019, a representative from MS&AD and in December 2019, an Alternate Director joined the Challenger Limited Board.

¹ Based on the exchange rate as at 1 July 2020.

Retirement income regulatory reforms

The Government has noted the retirement phase of the superannuation system is currently underdeveloped and there is limited availability and take-up of products that manage the risks people face in retirement, in particular the risk of outliving their savings. Currently, most people invest their superannuation savings in an account-based pension and withdraw only legislated minimum amounts, without being aware of all choices in retirement.

The Australian Government is progressing a range of reforms to enhance the retirement phase of superannuation.

These reforms include:

- removing impediments to longevity product development through the Retirement Income Streams Review, which came into effect on 1 July 2017;
- introducing new means test rules for lifetime products from 1 July 2019; and
- creating a Retirement Income Framework.

The Government also commissioned an independent review of the retirement income system (the Retirement Income Review), following a recommendation by the Productivity Commission, to improve understanding of its operation and the outcomes it is delivering for Australian retirees.

Means test rules for lifetime products

The means test rules govern the eligibility and level of access to the Government-provided age pension and are based on a retiree's level of income and/or assets owned. The current rules commenced on 1 July 2019 and have been designed to support the use of innovative lifetime income products that will help retirees manage the risk of outliving their savings, while ensuring a fair and consistent means test treatment for all retirement income products.

Complying products are assessed under the income test at 60% of all pooled lifetime product payments, and under the asset test at 60% of the purchase price of the product until age 84, or a minimum of five years, and then 30% for the rest of the person's life.

Retirement Income Covenant

The Government announced in 2018 that it would introduce a Retirement Income Covenant in the *Superannuation Industry (Supervision) Act 1993*, which would require superannuation trustees to have a retirement income strategy in place for their members.

The Government released a position paper on the Retirement Income Covenant in May 2018. The position paper notes the proposed Retirement Income Framework is intended to:

- enable individuals to increase their standard of living in retirement through increased availability and take-up of products that more efficiently manage longevity risk, and in doing so increase the efficiency of the superannuation system and better align the system with its objective; and
- enable trustees to provide individuals with an easier transition into retirement by offering retirement income products that balance competing objectives of high income, flexibility and risk management.

In May 2020, the Government announced the deferral of the Retirement Income Covenant, which had been scheduled to commence on 1 July 2020. The Retirement Income Covenant is now scheduled to commence on 1 July 2022 and will require trustees to consider the needs and preferences of their members and ensure retirees have greater choice in how they take their superannuation benefits in retirement. The deferral is to allow continued consultation, and legislative drafting to take place following the COVID-19 pandemic and to allow drafting of the principles-based covenant to be informed by the Retirement Income Review.

Retirement Income Review

In December 2018, the Productivity Commission recommended an independent review of the role of compulsory superannuation in the broader retirement incomes system. The Government commissioned the review in September 2019, and the final report was released in November 2020.

The Retirement Income Review confirms Australia's retirement income system is effective, sound and its costs are broadly sustainable. The review makes three over-arching observations:

- the three pillars of the existing retirement income system, being the Age Pension, compulsory superannuation and voluntary savings, continue to provide effective support to Australian retirees and are sustainable in the long term;
- there is a need to improve understanding of the system so that all Australians can make the most of their assets in retirement; and
- that the system would benefit from a clear objective in order to guide future policy and provide a framework for assessing its performance.

The review highlights the importance of helping people optimise their retirement income by drawing down their savings. The report noted the benefits of advancing the Retirement Income Covenant.

Life balance sheet

\$m	1H21	FY20	1H20	FY19	1H19	FY18	1H18
Assets							
Life investment assets							
Cash and equivalents	2,083.3	3,002.7	760.0	361.0	1,518.3	1,671.6	950.1
Asset-backed securities	6,964.8	6,385.1	6,289.3	5,293.3	5,062.2	4,763.1	4,542.2
Corporate credit	5,773.0	4,582.8	5,907.4	6,805.5	5,434.0	5,293.1	5,584.2
Fixed income and cash (net)	14,821.1	13,970.6	12,956.7	12,459.8	12,014.5	11,727.8	11,076.5
Australian – Office	1,947.9	1,912.7	1,919.4	1,833.9	2,097.1	2,011.3	1,855.6
Australian – Retail	709.1	709.3	751.2	883.3	954.1	954.8	962.5
Australian – Industrial	189.5	187.5	193.3	185.2	180.4	159.5	152.0
Japanese	366.8	390.1	359.5	325.6	314.6	297.4	234.0
Other	102.9	92.5	114.4	154.0	193.2	417.5	450.5
Property (net)	3,316.2	3,292.1	3,337.8	3,382.0	3,739.4	3,840.5	3,654.6
Equity and Infrastructure ¹	604.2	393.4	2,035.9	2,042.3	1,778.3	1,600.8	1,551.3
Alternatives ¹	892.5	647.2	1,338.8	1,126.3	1,092.1	916.0	757.7
Life investment assets	19,634.0	18,303.3	19,669.3	19,010.4	18,624.3	18,085.1	17,040.1
Other assets (including intangibles)	896.0	1,178.4	915.9	702.3	560.9	509.5	644.1
Total assets	20,530.0	19,481.7	20,585.2	19,712.7	19,185.2	18,594.6	17,684.2
Liabilities							
Life annuity book	12,769.7	12,581.2	12,845.3	12,870.2	12,323.7	11,728.3	11,115.8
Challenger Index Plus Fund liabilities	3,031.5	2,415.8	2,705.6	1,966.2	2,172.3	2,135.0	1,909.3
Subordinated debt	401.7	395.7	404.9	403.9	400.6	403.7	405.3
Challenger Capital Notes	892.5	805.0	805.0	805.0	805.0	805.0	805.0
Other liabilities	269.8	345.6	350.6	348.5	412.9	317.7	296.1
Total liabilities	17,365.2	16,543.3	17,111.4	16,393.8	16,114.5	15,389.7	14,531.5
Net assets	3,164.8	2,938.4	3,473.8	3,318.9	3,070.7	3,204.9	3,152.7

¹ Commencing in 1H21, Life's investment portfolio categories have been amended to more accurately reflect Life's portfolio composition. The equities and infrastructure categories were combined, and absolute return funds and insurance-related investments reclassified from equities to alternatives. Comparatives have been restated.

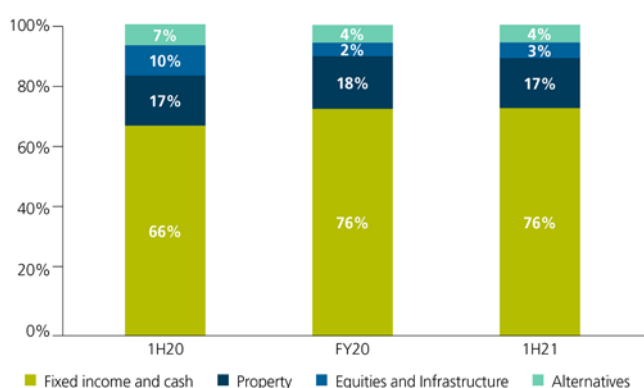
Life investment portfolio overview

Life maintains a high-quality investment portfolio in order to generate cash flows to meet future annuity obligations.

Life reviews its investment asset allocation based on the relative value of different asset classes, expected ROE and tenor of annuity sales as Life maintains a cash flow matched portfolio. Accordingly, Life's investment asset allocation may vary from time to time.

Life's investment assets are as follows:

\$m	31 Dec 2020	30 June 2020
Fixed income and cash	76%	76%
Property	17%	18%
Equity and infrastructure	3%	2%
Alternatives	4%	4%



Life investment portfolio repositioned

During the COVID-19 pandemic in 2H20, Challenger Life actively managed its investment portfolio and repositioned its portfolio to more defensive settings, which reduced capital intensity and increased Life's excess capital position. Exposure to equities, infrastructure and sub-investment grade fixed income was reduced and higher levels of liquidity were maintained. At 30 June 2020, Life held ~\$3bn of cash and liquids, with ~\$2.5bn available to be deployed into higher returning investments.

Life's cash and liquids balance at 31 December 2020 was approximately \$2.1bn, down from \$3.0bn at 30 June 2020. The \$0.9bn reduction reflects the progressive deployment of the opening cash and liquids balance in 1H21 offset by new cash proceeds received from Challenger Index sales late in the second quarter of 1H21.

Life investment portfolio from 30 June 2020

Commencing in FY21, Life's investment portfolio categories have been amended to more accurately reflect Life's investment portfolio following changes in portfolio composition in 2H20.

From 1 July 2020, the equity and infrastructure categories have been combined and represent 3% of Life's investment assets, and absolute return funds and insurance-related investments have been reclassified from equities to alternatives, as both are relatively uncorrelated to equity market returns.

Normalised growth assumptions have been updated for both the category changes and to ensure they reflect both the nature of the investments and long-term expected investment returns. Refer to page 55 for normalised growth assumptions.

Fixed income portfolio overview

Life's fixed income and cash portfolio was \$14.8bn (net of debt) at 31 December 2020 and increased by 6% from \$14.0bn at 30 June 2020.

The fixed income and cash portfolio represented 76% of Life's total investment assets at 31 December 2020 and comprises approximately 1,200 different securities.

Challenger manages credit risk by maintaining a high-quality investment portfolio and applying a rigorous investment process. The fixed income portfolio is diversified across industries, rating bands, asset classes and geographies.

Life's policy liability cash flows are generally long term in nature, and contracted, providing the opportunity to invest in longer dated and less liquid fixed income investments, allowing Life to earn an illiquidity premium on fixed income.

Life targets to hold at least 75% of fixed income as investment grade (i.e. BBB or higher). At 31 December 2020, 86% of the fixed income portfolio was investment grade, up from 85% at 30 June 2020.

A total of 85% of the fixed income portfolio is externally rated (Standard & Poor's, Fitch or Moody's) with the remainder internally rated based on methodologies calibrated to Standard & Poor's or Moody's ratings framework.

The fixed income and cash portfolio is predominantly Australian focused, with approximately 70% of the fixed income portfolio invested in Australian-based securities.

Approximately 15% of Life's fixed income portfolio represents fixed income investments originated directly by Challenger. Direct fixed income origination includes senior secured loans, asset-backed securities and commercial real estate lending. Life's direct origination capability provides opportunities to capture additional earnings, including illiquidity premiums.

The average direct fixed income illiquidity premium generated over the last five years has been between 1% and 2% and has remained attractive throughout the COVID-19 pandemic.

Fixed income credit default experience

Challenger's normalised growth assumption for fixed income is -35 bps, representing an allowance for credit default losses. In 1H21, the credit default loss recognised in investment experience was positive 9 bps (+\$13m), representing the recovery of prior period credit defaults.

Over the past five financial years, the average credit default loss experience recognised in investment experience has been -20 bps per annum.

Detailed disclosure of Life's fixed income portfolio is included on pages 33 to 36. The fixed income disclosures include the following tables:

1. Table 1 – Fixed income portfolio overview;
2. Table 2 – Fixed income portfolio by credit rating;
3. Table 3 – Fixed income portfolio by rating type;
4. Table 4 – Fixed income portfolio by industry sector; and
5. Table 5 – Fixed income portfolio by geography and credit rating.

Table 1: Fixed income portfolio overview

31 December 2020		\$m	% portfolio	
Liquids		2,083	14%	Includes cash and equivalents and Government Bonds (net of repurchase agreements).
	Residential Mortgage-Backed Securities (RMBS)	3,612	25%	RMBS expertise developed when Challenger was Australia's largest non-bank securitiser of RMBS (via Mortgage Management business sold in 2009). Also includes NIM notes.
Asset-Backed Securities (ABS)	Other ABS	2,272	15%	Financing secured against underlying assets. Asset security includes motor vehicle, equipment and consumer finance.
	Senior Secured Loans	744	5%	Senior debt secured by collateral and typically originated by Challenger.
	Aviation Finance	134	1%	Secured commercial aircraft financing.
	CMBS	203	1%	Commercial mortgage-backed securities (CMBS).
	Banks and Financials	1,200	8%	Corporate loans to banks, insurance companies and fund managers.
	Infrastructure	1,397	10%	Long-dated inflation-linked bonds issued by Public Private Partnership projects and loans to infrastructure companies.
Corporate Credit	Non-Financial Corporates	2,255	15%	Traded commercial loans to non-financial corporates (includes exposures to retail, construction, hotels, media, mining and health care).
	Commercial Real Estate	921	6%	Loans secured against commercial real estate assets and typically originated by Challenger.
Total		14,821	100%	

Table 2: Fixed income portfolio by credit rating

31 December 2020 (\$m)	Investment grade						Non-investment grade			Total
	Liquids	AAA	AA	A	BBB	Total	BB	B or lower	Total	\$m
Liquids										
Government bonds ¹	2,030	-	-	-	-	2,030	-	-	-	2,030
Covered bonds	53	-	-	-	-	53	-	-	-	53
Asset-Backed Securities										
RMBS	-	1,972	583	562	296	3,413	126	73	199	3,612
Other ABS	-	886	350	188	178	1,602	505	165	670	2,272
Senior Secured Bank Loans	-	323	62	60	175	620	113	11	124	744
Aviation Finance	-	-	-	45	55	100	15	19	34	134
CMBS	-	29	23	76	56	184	13	6	19	203
Corporate Credit										
Banks and Financials	-	-	107	332	734	1,173	17	10	27	1,200
Infrastructure	-	-	117	474	733	1,324	57	16	73	1,397
Non-Financial Corporates	-	13	36	304	1,029	1,382	304	569	873	2,255
Commercial Real Estate	-	30	5	381	386	802	79	40	119	921
Total	2,083	3,253	1,283	2,422	3,642	12,683	1,229	909	2,138	14,821
Fixed income portfolio (%)	14%	22%	9%	16%	25%	86%	8%	6%	14%	100%
Average duration (years)	-	1.8	2.4	3.2	2.6	2.5	2.0	2.6	2.3	2.5

31 December 2020 (%)	Investment grade						Non-investment grade			Total
	Liquids	AAA	AA	A	BBB	Total	BB	B or lower	Total	%
Liquids										
Government bonds ¹	100%	-	-	-	-	100%	-	-	-	100%
Covered bonds	100%	-	-	-	-	100%	-	-	-	100%
Asset-Backed Securities										
RMBS	-	55%	16%	16%	7%	94%	4%	2%	6%	100%
Other ABS	-	39%	15%	8%	9%	71%	22%	7%	29%	100%
Senior Secured Bank Loans	-	43%	8%	8%	24%	83%	16%	1%	17%	100%
Aviation Finance	-	-	-	34%	41%	75%	11%	14%	25%	100%
CMBS	-	14%	11%	37%	29%	91%	6%	3%	9%	100%
Corporate Credit										
Banks and Financials	-	-	9%	28%	61%	98%	1%	1%	2%	100%
Infrastructure	-	-	8%	34%	53%	95%	4%	1%	5%	100%
Non-Financial Corporates	-	1%	2%	13%	45%	61%	14%	25%	39%	100%
Commercial Real Estate	-	3%	1%	41%	42%	87%	9%	4%	13%	100%
Total	14%	22%	9%	16%	25%	86%	8%	6%	14%	100%

¹ Gross Government Bonds are shown net of \$2,184m of Australian Government Bonds and \$2,783m of Australian Semi-Government Bonds, that are held via repurchase agreements. Government Bonds refinanced with repurchase agreements are used to hedge movements in interest rates. Refer to page 42 for more detail.

Table 3: Fixed income portfolio by rating type

31 December 2020 (\$m)	Investment grade						Non-investment grade			Total
	Liquids	AAA	AA	A	BBB	Total	BB	B or lower	Total	\$m
Liquids										
Externally rated	2,083	-	-	-	-	2,083	-	-	-	2,083
Internally rated	-	-	-	-	-	-	-	-	-	-
Asset-Backed Securities										
Externally rated	-	3,117	979	731	427	5,254	311	132	443	5,697
Internally rated	-	93	39	199	334	665	461	142	603	1,268
Corporate Credit										
Externally rated	-	43	264	1,452	2,750	4,509	130	188	318	4,827
Internally rated	-	-	1	40	131	172	327	447	774	946
Total	2,083	3,253	1,283	2,422	3,642	12,683	1,229	909	2,138	14,821
Externally rated	100%	97%	97%	90%	87%	93%	36%	35%	36%	85%
Internally rated	-	3%	3%	10%	13%	7%	64%	65%	64%	15%

31 December 2020 (%)	Investment grade						Non-investment grade			Total
	Liquids	AAA	AA	A	BBB	Total	BB	B or lower	Total	%
Liquids										
Externally rated	100%	-	-	-	-	100%	-	-	-	100%
Internally rated	-	-	-	-	-	-	-	-	-	-
Asset-Backed Securities										
Externally rated	-	55%	17%	13%	7%	92%	6%	2%	8%	100%
Internally rated	-	7%	3%	16%	26%	52%	37%	11%	48%	100%
Corporate Credit										
Externally rated	-	1%	5%	30%	57%	93%	3%	4%	7%	100%
Internally rated	-	-	-	4%	14%	18%	35%	47%	82%	100%
Total	14%	22%	9%	16%	25%	86%	8%	6%	14%	100%

Table 4: Fixed income portfolio by industry sector

31 December 2020 (\$m)	Investment grade						Non-investment grade			Total
	Liquids	AAA	AA	A	BBB	Total	BB	B or lower	Total	\$m
Industrials and consumers	-	1,224	480	596	1,424	3,724	854	705	1,559	5,283
Residential property	-	1,946	551	548	335	3,380	137	83	220	3,600
Banks, financials & insurance	53	23	107	346	752	1,281	17	10	27	1,308
Government	2,030	-	-	-	-	2,030	-	-	-	2,030
Commercial property	-	60	28	458	396	942	81	36	117	1,059
Infrastructure and utilities	-	-	117	474	734	1,325	57	16	73	1,398
Other	-	-	-	-	1	1	83	59	142	143
Total	2,083	3,253	1,283	2,422	3,642	12,683	1,229	909	2,138	14,821

31 December 2020 (%)	Investment grade						Non-investment grade			Total
	Liquids	AAA	AA	A	BBB	Total	BB	B or lower	Total	%
Industrials and consumers	-	23%	9%	11%	27%	70%	16%	14%	30%	100%
Residential property	-	54%	15%	15%	10%	94%	4%	2%	6%	100%
Banks, financials & insurance	4%	2%	8%	26%	58%	98%	1%	1%	2%	100%
Government	100%	-	-	-	-	100%	-	-	-	100%
Commercial property	-	6%	3%	43%	37%	89%	8%	3%	11%	100%
Infrastructure and utilities	-	-	8%	34%	53%	95%	4%	1%	5%	100%
Other	-	-	-	-	1%	1%	58%	41%	99%	100%
Total	14%	22%	9%	16%	25%	86%	8%	6%	14%	100%

Table 5: Fixed income portfolio by geography and credit rating

31 December 2020 (\$m)	Investment grade						Non-investment grade			Total
	Liquids	AAA	AA	A	BBB	Total	BB	B or lower	Total	\$m
Australia	1,989	2,448	870	1,476	1,936	8,719	931	793	1,724	10,443
United States	53	209	82	503	1,185	2,032	117	70	187	2,219
United Kingdom	-	237	98	162	254	751	7	-	7	758
Europe	3	118	128	118	190	557	69	4	73	630
New Zealand	-	195	69	121	54	439	65	39	104	543
Rest of world	38	46	36	42	23	185	40	3	43	228
Total	2,083	3,253	1,283	2,422	3,642	12,683	1,229	909	2,138	14,821

31 December 2020 (%)	Investment grade						Non-investment grade			Total
	Liquids	AAA	AA	A	BBB	Total	BB	B or lower	Total	%
Australia	19%	23%	8%	14%	19%	83%	9%	8%	17%	100%
United States	2%	9%	4%	23%	54%	92%	5%	3%	8%	100%
United Kingdom	-	31%	13%	21%	34%	99%	1%	-	1%	100%
Europe	-	19%	20%	19%	30%	88%	11%	1%	12%	100%
New Zealand	-	36%	13%	22%	10%	81%	12%	7%	19%	100%
Rest of the world	17%	20%	16%	18%	10%	81%	18%	1%	19%	100%
Total	14%	22%	9%	16%	25%	86%	8%	6%	14%	100%

Property portfolio overview

Life's property portfolio principally comprises directly held properties and is diversified across office, retail and industrial properties.

Life's property portfolio was \$3.3bn (net of debt) at 31 December 2020. All direct properties were independently valued in 1H21, with valuations relatively stable on 30 June 2020 valuations. Indirect properties were also revalued during 1H21.

Property represented 17% of Life's investment portfolio at 31 December 2020.

Life's property portfolio is mainly focused on domestic properties that provide long-term income streams. Australian properties accounted for 89% of the portfolio, and Australian office 59%.

Challenger Life has a policy that all directly owned properties are independently valued each year. Given the economic uncertainty as a result of the COVID-19 pandemic, all properties were independently valued in June 2020 and December 2020.

In FY20, there were significant property write-downs to reflect the uncertainty as a result of the COVID-19 pandemic. The average valuation write-down across the portfolio was ~5%, with Australian retail properties reduced by ~8%.

Life maintains a more defensive property portfolio than the broader listed real estate trust market, with a focus on long-term income streams. Australian office accounts for 59% of the portfolio, with the Australian Government a major tenant accounting for ~31% of 1H21 gross rental income¹.

Australian direct retail assets account for 22% of the direct portfolio and comprise eight grocery-anchored convenience-based shopping centres. Approximately half of the rental income is derived from major supermarket chains or major Australian banks or essential services.

The weighted average cap rate on Life's Australian direct portfolio² was 5.82% at 31 December 2020, down 7 bps from 2H20.

Property includes a net \$367m exposure to Japanese property (11% of the portfolio), consisting of suburban shopping centres that are focused on non-discretionary retailing. Over half of the Japanese rental income comes from supermarkets or pharmacies.

The property portfolio generates long-term cash flows to match long-term liabilities, with a weighted average lease expiry of six years and 54% of leasing area having contracted leases expiring in FY25 and beyond. The portfolio had an occupancy rate of 93% at 31 December 2020, unchanged for the half year.

Approximately 61% of contracted leases have either annual fixed increases or inbuilt increases based on inflation outcomes (e.g. CPI).

During the COVID-19 pandemic, Life is supporting its commercial property tenants with rental abatements. This involves either deferring or waiving rent owed by the tenant depending on individual circumstances.

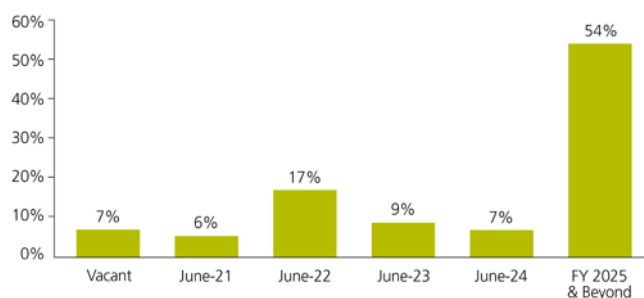
The estimated impact of the rental abatement program for FY21 is a reduction in net rental income of between \$10m and \$12m compared to FY20. This outcome may change, depending on COVID-19 restrictions and economic impacts, which are inherently uncertain.

Full details of Life's property portfolio are listed on pages 38 to 40.

Property portfolio summary

% of total portfolio	1H21	1H20
Australian office	59%	58%
Australian retail	22%	23%
Australian industrial	6%	6%
Other	2%	2%
Australian total	89%	89%
Japanese retail	11%	11%
Other (including offshore)	-	-
Total	100%	100%

Portfolio lease expiry overview³



¹ Represents total gross passing Government income relative to entire property portfolio.

² Excluding the Victorian County Court.

³ Direct property portfolio and jointly held assets only and development assets.

Direct property portfolio overview¹

31 December 2020		Office	Retail	Industrial	Total
Total rent (%) ²		51%	42%	7%	100%
WALE ³ (years)		6.0	6.4	3.1	6.0
Tenant credit ratings					
	AAA	18%	0%	0%	18%
	AA	16%	1%	0%	17%
	A	1%	2%	0%	3%
	BBB	2%	9%	3%	14%
	BB	6%	12%	3%	21%
	B or below	2%	7%	1%	10%
	Not rated	1%	9%	0%	10%
	Vacant	5%	2%	0%	7%
	Total	51%	42%	7%	100%
% of total gross net					
	Investment grade	37%	12%	3%	52%
	Non-investment grade	9%	28%	4%	41%
	Vacant	5%	2%	0%	7%

¹ Direct property portfolio and jointly held assets only and excludes Australian REITs and development assets.

² Includes vacant floors/suites available for lease.

³ Weighted Average Lease Expiry (WALE) assumes tenants do not terminate leases prior to expiry of specified lease term.

Direct property investments

31 December 2020		Acquisition date ¹	Total cost (\$m) ²	Carrying value (\$m)	Cap rate 1H21 (%) ³	Last external valuation date
Australia						
Office						
	6 Chan Street (formerly DIBP Building), ACT	01 Dec 01	128.2	241.0	5.25	31 Dec 20
	14 Childers Street, ACT	01 Dec 17	97.5	88.0	6.50	31 Dec 20
	35 Clarence Street, NSW	15 Jan 15	153.6	226.0	5.25	31 Dec 20
	45 Benjamin Way (formerly ABS Building), ACT	01 Jan 00	149.4	225.0	5.63	31 Dec 20
	82 Northbourne Avenue, ACT	01 Jun 17	62.1	53.5	6.00	31 Dec 20
	215 Adelaide Street, QLD	31 Jul 15	253.7	225.0	6.00	31 Dec 20
	565 Bourke Street, VIC	28 Jan 15	106.6	145.0	5.00	31 Dec 20
	839 Collins Street, VIC	22 Dec 16	212.0	243.5	4.75	31 Dec 20
	County Court, VIC	30 Jun 00	218.7	324.0	n/a	31 Dec 20
	Discovery House, ACT	28 Apr 98	102.7	153.0	5.50	31 Dec 20
	Executive Building, TAS	30 Mar 01	34.9	49.0	6.50	31 Dec 20
Retail						
	Bunbury Forum, WA	03 Oct 13	155.9	81.0	7.50	31 Dec 20
	Channel Court, TAS	21 Aug 15	85.8	76.8	7.75	31 Dec 20
	Gateway, NT	01 Jul 15	123.6	105.7	6.34	31 Dec 20
	Golden Grove, SA	31 Jul 14	158.1	146.0	6.25	31 Dec 20
	Karratha, WA	28 Jun 13	56.0	45.3	7.50	31 Dec 20
	Kings Langley, NSW	29 Jul 01	16.4	23.5	6.00	31 Dec 20
	Lennox, NSW	27 Jul 13	63.0	61.0	6.75	31 Dec 20
	North Rocks, NSW	18 Sep 15	185.9	170.0	6.25	31 Dec 20
Industrial						
	21 O'Sullivan Circuit, NT	27 Jan 16	47.7	31.4	8.25	31 Dec 20
	31 O'Sullivan Circuit, NT	27 Jan 16	29.2	26.0	7.75	31 Dec 20
	Cosgrave Industrial Park, Enfield, NSW	31 Dec 08	92.3	132.1	4.75	31 Dec 20
Total Australia			2,533.3	2,871.8	5.82	

¹ Acquisition date represents the date of Challenger Life Company Limited's (CLC's) initial acquisition or consolidation of the investment vehicle holding the asset.

² Total cost represents the original acquisition cost plus additions less full and partial disposals since acquisition date.

³ The capitalisation rate is the rate at which net market income is capitalised to determine the value of the property. The rate is determined with regard to market evidence.

Direct property investments

31 December 2020		Acquisition date ¹	Total cost (\$m) ²	Carrying value (\$m)	Cap rate 1H21 (%) ³	Last external valuation date
Japan						
Retail						
	Aeon Kushiro	31 Jan 10	30.5	35.8	5.40	31 Dec 20
	Carino Chitosedai	31 Jan 10	118.4	130.5	4.60	31 Dec 20
	Carino Tokiwadai	31 Jan 10	77.6	79.2	4.60	31 Dec 20
	DeoDeo Kure	31 Jan 10	32.2	32.9	5.60	31 Dec 20
	Fitta Natalie Hatsukaichi	28 Aug 15	11.7	13.9	6.00	31 Dec 20
	Izumiya Hakubaicho	31 Jan 10	69.6	72.7	5.00	31 Dec 20
	Kansai Super Saigo	31 Jan 10	13.2	13.7	5.30	31 Dec 20
	Kojima Nishiarai	31 Jan 10	12.2	15.3	4.10	31 Dec 20
	Kotesashi Towers	28 Nov 19	25.2	22.6	5.07	31 Dec 20
	Life Asakusa	31 Jan 10	27.8	36.7	4.20	31 Dec 20
	Life Higashi Nakano	31 Jan 10	32.9	38.7	4.40	31 Dec 20
	Life Nagata	31 Jan 10	25.2	29.0	4.90	31 Dec 20
	MaxValu Tarumi	28 Aug 15	17.0	19.3	5.60	31 Dec 20
	Seiyu Miyagino	31 Jan 10	9.8	11.3	5.20	31 Dec 20
	TR Mall Ryugasaki	30 Mar 18	86.7	92.0	5.60	31 Dec 20
	Valor Takinomizu	31 Jan 10	27.0	24.9	5.50	31 Dec 20
	Valor Toda	31 Jan 10	42.5	43.3	5.10	31 Dec 20
	Yaoko Sakato Chiyoda	31 Jan 10	19.8	21.2	4.90	31 Dec 20
	Yorktown Toride	05 Mar 20	31.9	27.2	5.10	31 Dec 20
Industrial						
	Aeon Matsusaka XD	26 Sep 19	14.7	13.9	5.70	31 Dec 20
Total Japan			725.9	774.1	5.00	
Europe						
Retail						
	Aulnay sous Bois, Avenue de Savigny, France	31 Dec 08	20.3	10.8	7.75	31 Dec 20
Total Europe			20.3	10.8	7.75	
Total overseas			746.2	784.9	5.03	
Development						
	Maitland, NSW	06 Dec 06	5.7	6.7	n/a	31 Dec 20
Total development			5.7	6.7		
Total direct portfolio investments			3,285.2	3,663.4	5.64	

¹ Acquisition date represents the date of Challenger Life Company Limited's (CLC's) initial acquisition or consolidation of the investment vehicle holding the asset.

² Total cost represents the original acquisition cost plus additions less full and partial disposals since acquisition date.

³ The capitalisation rate is the rate at which net market income is capitalised to determine the value of the property. The rate is determined with regard to market evidence.

Equity and infrastructure portfolio overview

Life's equity and infrastructure portfolio of \$0.6bn increased by \$0.2bn in 1H21. The increase reflects equities purchased during the half as part of Life's progressive deployment of excess cash and liquid investments, partially offset by a \$19m reduction in infrastructure investments.

Equity and infrastructure represented 3% of Life's total investment assets at 31 December 2020, up from 2% at 30 June 2020.

Challenger maintains a more diversified equities portfolio, with beta and low beta investments. For beta investments, the total return is expected to be correlated to the MSCI World Net Daily Total Return Index.

Challenger seeks infrastructure assets that generate reliable and consistent cash flows, which are preferably inflation linked, giving rise to sustainable income growth over time.

The infrastructure portfolio is held entirely in unlisted investments, predominantly utility and renewable energy assets.

Australian infrastructure accounted for 72% of infrastructure investments with the remainder diversified across geographic regions and sectors.

Equity and infrastructure portfolio

31 December 2020	Domestic	Offshore	Total
Equity beta	58	71	129
Low beta	40	251	291
Infrastructure	133	51	184
Total equity & infrastructure	231	373	604

30 June 2020	Domestic	Offshore	Total
Equity beta	52	80	132
Low beta	49	10	59
Infrastructure	147	56	203
Total equity & infrastructure	248	146	394

Alternatives portfolio overview

Life's alternatives portfolio of \$0.9bn increased by \$0.2bn in 1H21 driven by an increase in absolute return fund investments.

The alternatives portfolio includes absolute return funds and insurance-related investments. These investments are expected to have a low correlation to listed equity markets.

The absolute return portfolio includes systematic global macro funds and market-neutral long/short equity funds. Investment returns are expected to have a lower correlation to listed equity markets. Over the long term, the total return on Life's absolute return portfolio is expected to be broadly correlated to the Société Générale CTA Index.

For insurance-related investments, there is no appropriate index that can be used to track total returns

Alternatives portfolio

31 December 2020	Domestic	Offshore	Total
Absolute return funds	-	661	661
General insurance	-	130	130
Life insurance	-	102	102
Total alternatives	-	893	893

30 June 2020	Domestic	Offshore	Total
Absolute return funds	38	342	380
General insurance	-	157	157
Life insurance	-	110	110
Total alternatives	38	609	647

Challenger Life Company Limited (CLC) debt facilities

\$m	1H21	FY20	1H20	FY19	1H19	FY18	1H18
Repurchase agreements	4,966.3	5,393.4	4,460.0	4,448.5	4,397.4	3,816.0	3,387.9
Controlled property debt	420.4	458.0	455.0	466.6	476.9	560.5	491.9
Subordinated debt	401.7	395.7	404.9	403.9	400.6	403.7	405.3
Challenger Capital Notes	892.5	805.0	805.0	805.0	805.0	805.0	805.0
Infrastructure debt	182.6	185.8	189.0	192.0	194.7	197.2	199.2
Other finance	0.7	0.7	0.7	13.2	13.9	15.0	16.0
Total CLC debt facilities	6,864.2	7,238.6	6,314.6	6,329.2	6,288.5	5,797.4	5,305.3

Life debt facilities

Life debt facilities include debt which is non-recourse to the broader Challenger Group and secured against assets held in Challenger Life investment vehicles, including direct properties and infrastructure investments.

Life debt facilities decreased by \$374m during 1H21 due to a decrease in repurchase agreements used to hedge interest rate movements (down \$427m) and a decrease in debt secured by property investments (down \$38m), partially offset by an \$87m increase in debt following the issuance of Challenger Capital Notes 3 and repurchase of Challenger Capital Notes 1 (refer to pages below for more information).

Repurchase agreements

Repurchase agreements at 31 December 2020 were \$5.0bn down from \$5.4bn at 30 June 2020.

Life enters into repurchase agreements 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. The use of repurchase agreements is part of Challenger's strategy to hedge interest rate movements.

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

Derivatives such as interest rate swaps and bond futures are self-financing, whereas the use of bonds requires repurchase agreement financing.

Subordinated debt

In November 2017, Challenger Life Company Limited (CLC) issued \$400m of Tier 2 subordinated notes. The subordinated notes fully qualify as Tier 2 regulatory capital under APRA's prudential standards and are floating rate notes, paying interest at a margin of 2.10% above the 90-day Bank Bill rate.

The subordinated notes mature in November 2042, with CLC having the option to redeem the notes in November 2022, subject to APRA approval.

The subordinated notes qualify 100% as Tier 2 regulatory capital until November 2038.

The subordinated notes include a holder conversion option, allowing the noteholder to convert the notes into Challenger ordinary shares in November 2024 if CLC has not already called the subordinated notes in November 2022.

If CLC exercises its option to redeem, there will be no conversion of subordinated debt to Challenger ordinary shares and no subsequent shareholder dilution.

Capital Notes

Over the past six years, Challenger has issued three separate tranches of subordinated, unsecured convertible notes (Challenger Capital Notes 1, Challenger Capital Notes 2 and Challenger Capital Notes 3), with proceeds used to fund qualifying CLC Additional Tier 1 regulatory capital.

For Challenger Capital Notes, Challenger has an option to redeem or repurchase all or some of the Challenger Capital Notes for their face value at a future date and it is not Challenger's intention that these debt instruments will convert into ordinary sharers.

Challenger Capital Notes 1 (ASX code: CGFPA)

In October 2014, Challenger issued Challenger Capital Notes 1 to the value of \$345m. Challenger Capital Notes 1 pay a margin of 3.40% above the 90-day bank bill rate, with the total distribution reduced by available franking credits.

Challenger intended to exercise its option to redeem the Capital Notes 1 and concurrently launch a replacement Notes offer on the Optional Exchange Date of 25 May 2020. However, investment markets leading up to this date were significantly disrupted and volatile as a result of the COVID-19 pandemic.

Given the unprecedented market conditions, APRA confirmed that Challenger could repurchase all or some of the Challenger Capital Notes 1 on any future quarterly distribution date up to 25 May 2022.

In October 2020, Challenger therefore announced a new Challenger Capital Notes Offer (Challenger Capital Notes 3) with the proceeds to be used to repay Challenger Capital Notes 1.

In November 2020, Challenger announced the successful completion of the Challenger Capital Notes 3 Offer, which raised \$385m, of which \$298m was used to partially repurchase Challenger Capital Notes 1.

It was Challenger's intention to fully repurchase all Challenger Capital Notes 1 with the proceeds of Challenger Capital Notes 3; however, noteholders were not required to participate in the repurchase invitation given the Optional Exchange Date had passed. As a result, at 31 December 2020 approximately \$47m of Challenger Capital Notes 1 remained on issue. Challenger will consider its options to reduce the remaining size of Challenger Capital Notes 1 on offer, including undertaking further repurchases. However, there is no guarantee Challenger will be able to repurchase all remaining notes on issue.

Challenger Capital Notes 1 will continue to trade on ASX until Wednesday 25 May 2022, at which point Challenger must convert any Challenger Capital Notes 1 that remain outstanding into Challenger ordinary shares in accordance with the mandatory conversion conditions under the Challenger Capital Notes 1 Terms.

Challenger Capital Notes 2 (ASX code: CGFPB)

In April 2017, Challenger issued Challenger Capital Notes 2, to the value of \$460m. Challenger Capital Notes 2 pay a margin of 4.40% above the 90-day bank bill rate, with the total distribution reduced by available franking credits.

Challenger Capital Notes 2 are convertible to ordinary shares at any time before May 2025 on the occurrence of certain events, and mandatorily convert to ordinary shares thereafter, in both cases subject to meeting certain conditions.

Challenger may choose to redeem or resell (rather than convert) Challenger Capital Notes 2 on the occurrence of some of the events referred to above, including on the Optional Exchange Date of 22 May 2023 (subject to certain conditions being met). If Challenger exercises its option to redeem or resell, there will be no conversion of Challenger Capital Notes 2 to Challenger ordinary shares and no subsequent shareholder dilution.

Challenger Capital Notes 3 (ASX code: CGFPC)

In November 2020, Challenger issued Challenger Capital Notes 3, to the value of \$385m. Challenger Capital Notes 3 pay a margin of 4.60% above the 90-day bank bill rate, with the total distribution reduced by available franking credits.

Challenger Capital Notes 3 are convertible to ordinary shares at any time before May 2028 on the occurrence of certain events, and mandatorily convert to ordinary shares thereafter, in both cases subject to meeting certain conditions.

Challenger may choose to redeem or resell (rather than convert) Challenger Capital Notes 3 on the occurrence of some of the events referred to above, including on the Optional Exchange Date of 25 May 2026 (subject to certain conditions being met). If Challenger exercises its option to redeem or resell, there will be no conversion of Challenger Capital Notes 3 to Challenger ordinary shares and no subsequent shareholder dilution.

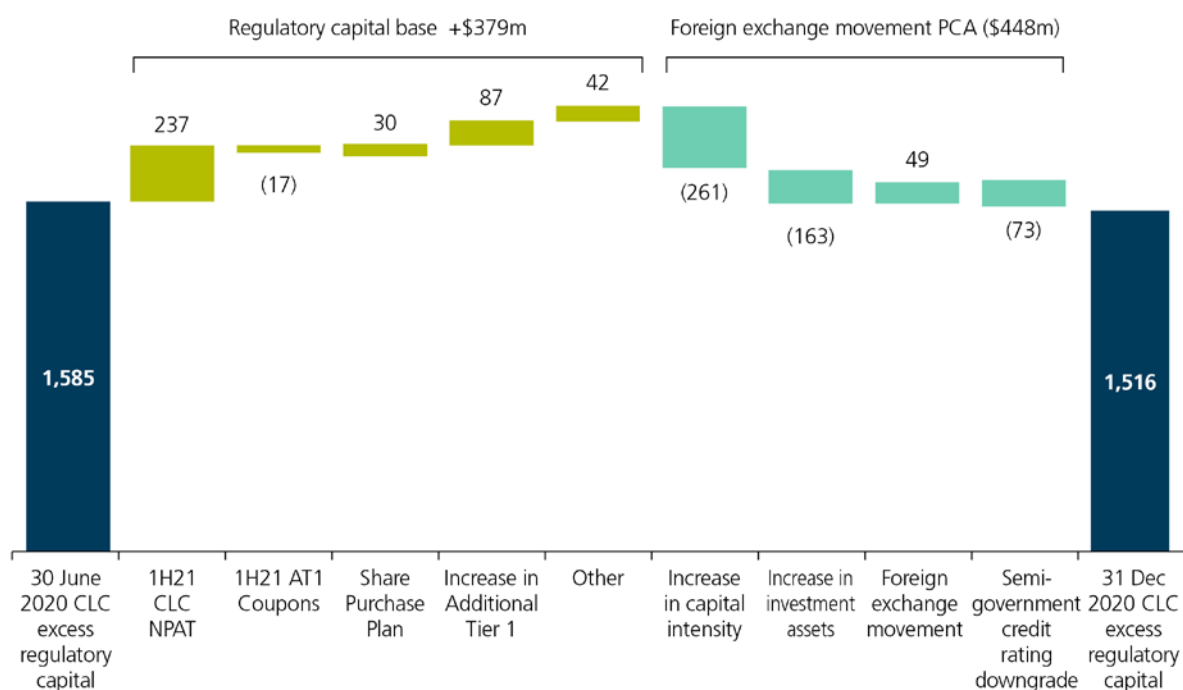
Challenger Life Company Limited (CLC) regulatory capital

\$m	1H21	FY20	1H20	FY19	1H19	FY18	1H18
CLC regulatory capital							
Common Equity Tier 1 (CET1) regulatory capital	2,622.9	2,337.0	2,811.3	2,789.4	2,517.6	2,677.8	2,638.4
Additional Tier 1	892.5	805.0	805.0	805.0	805.0	805.0	805.0
Tier 2 regulatory capital – subordinated debt ¹	402.7	396.7	406.2	405.3	402.2	405.4	406.8
CLC total regulatory capital base	3,918.1	3,538.7	4,022.5	3,999.7	3,724.8	3,888.2	3,850.2
CLC Prescribed Capital Amount (PCA)							
Asset risk charge	2,290.2	1,842.8	2,523.6	2,539.5	2,355.2	2,484.7	2,502.4
Insurance risk charge	213.8	199.5	164.6	135.3	83.3	70.0	164.9
Operational risk charge	54.4	56.5	53.4	51.8	47.5	46.4	42.8
Aggregation benefit	(156.7)	(144.8)	(125.4)	(104.0)	(64.8)	(54.8)	(125.7)
CLC PCA	2,401.7	1,954.0	2,616.2	2,622.6	2,421.2	2,546.3	2,584.4
CLC excess over PCA	1,516.4	1,584.7	1,406.3	1,377.1	1,303.6	1,341.9	1,265.8
PCA ratio (times)	1.63	1.81	1.54	1.53	1.54	1.53	1.49
Tier 1 ratio (times)	1.46	1.61	1.38	1.37	1.37	1.37	1.33
CET1 ratio (times)	1.09	1.20	1.07	1.06	1.04	1.05	1.02
Capital intensity ratio (%) ²	12.2%	10.7%	13.3%	13.8%	13.0%	14.1%	15.2%

¹ 1H21 Tier 2 regulatory capital - subordinated debt (\$402.7m) differs to the Group balance sheet (\$401.7m) due to accrued interest and amortised costs (\$1.0m).

² Capital intensity ratio is calculated as CLC PCA divided by Life closing investment assets.

Movement in CLC excess regulatory capital and Group cash (\$m)



Challenger Life Company Limited (CLC) regulatory capital

Capital management

CLC holds capital to ensure that under a range of adverse scenarios it can continue to meet its regulatory requirements and contractual obligations to customers.

CLC is regulated by APRA and is required to hold a minimum level of regulatory capital.

CLC's regulatory capital base and prescribed capital amount (PCA) have been calculated based on APRA prudential capital standards.

CLC's regulatory capital base

CLC's regulatory capital base at 31 December 2020 was \$3.9bn and increased by \$379m in 1H21. The increase reflects CLC's statutory profit for the half year with no dividend paid by CLC to the Challenger Group, an increase in Additional Tier 1 capital following the launch of Challenger Capital Notes 3 and partial replacement of Challenger Capital Notes 1 (refer to pages 42 and 43 for more detail), and proceeds from the Share Purchase Plan announced in June 2020.

CLC's Prescribed Capital Amount (PCA)

In response to the significant market sell-off in 2H20 and in order to maintain a strong capital position, Challenger actively managed its investment portfolio and repositioned its portfolio to more defensive settings that reduced capital intensity and increased Life's excess capital position. As a result, Life's cash and liquids balance at 30 June 2020 was ~\$3bn, with ~\$2.5bn excess to be progressively deployed over FY21 into higher returning investments, which will increase CLC's capital intensity. CLC's capital intensity, as measured by the ratio of PCA to investment assets, increased by 150 bps to 12.2% in 1H21 as a result of the partial redeployment the cash and liquids balance.

CLC's PCA at 31 December 2020 was \$2.4bn and increased by \$448m in 1H21, reflecting:

- increase in capital intensity (+\$261m) from deploying cash and liquids;
- growth in investment assets (+\$163m);
- higher capital intensity following a downgrade in credit ratings for the New South Wales and Victorian semi-governments debt exposures (+\$73m); partially offset by
- foreign exchange movements (-\$49m).

CLC's excess capital position

CLC's excess capital above PCA at 31 December 2020 was \$1.5bn and decreased by \$68m in 1H21, with the impact of an increase in capital intensity and growth in investment assets largely offset by an increase in CLC's regulatory capital base.

CLC's capital ratios at 31 December 2020 were as follows:

- PCA ratio 1.63 times – down 18 points from 30 June 2020;
- Common Equity Tier 1 (CET1) ratio 1.09 times – down 11 points from 30 June 2020; and
- Total Tier 1 ratio 1.46 times – down 15 points from 30 June 2020.

APRA's prudential standards require Total Tier 1 capital to be at least 80% of the PCA and CET1 capital to be at least 60%

of the PCA. Both Challenger's Total Tier 1 capital ratio (1.46 times) and CET1 capital ratio (1.09 times) are well in excess of APRA's minimum requirements.

CLC maintains a target level of capital representing APRA's PCA plus a target surplus. The target surplus is a level of excess capital CLC seeks to carry over and above APRA's minimum requirement to ensure it provides a buffer for adverse market or insurance risk experience.

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.

CLC does not target a specific PCA ratio. CLC's target PCA ratio range is a reflection of internal capital models, not an input to them and reflects asset allocation, business mix and economic circumstances. The target surplus produced by these internal capital models currently corresponds to a PCA ratio of between 1.3 times to 1.6 times. This range may change over time.

Given Challenger's increased franchise size, including growth in CLC's annuity business, Challenger currently intends to operate toward the top end of CLC's target PCA ratio range.

In assessing CLC's capital targets, the internal capital models consider various constraints, including the total capital base (which is assessed by the PCA ratio) and CET1 requirements. The target surplus produced by the internal capital models currently corresponds to a CET1 ratio of between 0.8 times to 1.1 times. This ratio may change over time.

Challenger announced the acquisition of MyLife MyFinance, an Australian based savings and loans bank in December 2020 for \$35 million¹. The acquisition is subject to APRA and Federal Treasurer approval and expected to settle in March 2021 once approval has been obtained. The acquisition price and capital requirements, including regulatory capital to support growth, will be funded by a planned \$100m distribution from CLC. This will reduce the PCA and CET1 ratios of CLC by approximately 4 points on a pro-forma 1H21 basis.

Additional Tier 1 regulatory capital and subordinated debt

In November 2020, Challenger issued Challenger Capital Notes 3, to the value of \$385m with the majority of the proceeds (\$298m) used to redeem Challenger Capital Notes 1. As a result, CLC's Additional Tier 1 increased by \$87m in 1H21.

In November 2017, CLC issued new Tier 2 subordinated notes (\$400m) which fully qualify as Tier 2 regulatory capital under APRA's prudential standards.

Further details on Challenger's convertible debt instruments is included on pages 42 and 43.

Group cash

In addition to CLC's excess regulatory capital, Challenger maintains cash at a Group level, which can be utilised to meet regulatory requirements. Group cash at 31 December 2020 was \$137m and was down \$10m in 1H21.

Challenger has additional financial flexibility, including a \$400m Group Banking facility, which was drawn by \$50m at 31 December 2020.

¹ Acquisition price subject to completion adjustments and based on a net asset value of \$18 million.

Profit and equity sensitivities

\$m	Change in variable	Profit/(loss) after tax 1H21	Change in equity 1H21	Profit/(loss) after tax FY20	Change in equity FY20
Credit risk					
Fixed income assets (change in credit spreads) ¹	+50 bps	(122.9)	(122.9)	(102.9)	(102.9)
	-50 bps	122.9	122.9	102.9	102.9
Policy liabilities (illiquidity premium change in credit spreads)	+50 bps	82.5	82.5	77.8	77.8
	-50 bps	(82.5)	(82.5)	(77.8)	(77.8)
Property risk					
Direct and indirect properties	+1%	26.1	26.1	26.3	26.3
	-1%	(26.1)	(26.1)	(26.3)	(26.3)
Equity and infrastructure risk					
Equity and Infrastructure investments	+10%	42.3	42.3	27.6	27.6
	-10%	(42.3)	(42.3)	(27.6)	(27.6)
Alternatives risk					
Alternatives investments	+10%	62.5	62.5	45.3	45.3
	-10%	(62.5)	(62.5)	(45.3)	(45.3)
Life Insurance risk					
Mortality, morbidity and longevity²					
Life insurance contract liabilities	+50%	(29.8)	(29.8)	(35.7)	(35.7)
	-50%	29.8	29.8	35.7	35.7
Interest rate risk					
Change in interest rates	+100 bps	(1.0)	(1.0)	0.5	0.5
	-100 bps	1.0	1.0	(0.5)	(0.5)
Foreign exchange risk					
British pound	+10%	-	-	0.4	0.4
	-10%	-	-	(0.4)	(0.4)
US dollar	+10%	0.9	0.9	2.2	2.2
	-10%	(0.9)	(0.9)	(2.2)	(2.2)
Euro	+10%	-	-	0.2	0.2
	-10%	-	-	(0.2)	(0.2)
Japanese yen	+10%	-	-	-	1.0
	-10%	-	-	-	(1.0)

¹ Credit risk sensitivities excludes Australian Government Bonds, Australian Semi-Government bonds and exposures with an Australian Government guarantee.

² Mortality, morbidity and longevity life insurance contract liabilities sensitivity is net of any reinsurance with third parties.

Profit and equity sensitivities set out the expected impact from changes in a range of economic and investment market variables on Challenger's statutory earnings and balance sheet. These sensitivities represent the after-tax impact on statutory profit, assuming a tax rate of 30%.

The sensitivities are not forward looking and make no allowance for events occurring after 31 December 2020. If using these sensitivities as forward looking, an allowance for changes post-31 December 2020, such as sales, asset growth and changes in asset allocation, should be made.

These sensitivities assess changes in economic, insurance and investment markets on the valuation of assets and liabilities, which, in turn, impact earnings. The earnings impact is included in investment experience and does not take into consideration the impact of any under- or over-performance of normalised growth assumptions for each asset category. Refer to page 55 for normalised growth assumptions.

These sensitivities do not include the indirect impact on fees for the Funds Management business.

Refer to the risk management framework for additional detail on how to apply the profit and equity sensitivities.

Risk management framework

CLC is required under APRA prudential standards to maintain regulatory capital in order to ensure that under a range of adverse scenarios it can continue to meet its regulatory and contractual obligations to customers.

Challenger is exposed to a variety of financial risks, including market risk (credit spread risk, currency risk, interest rate risk, equity risk), credit default risk, life insurance risk, liquidity risk and operational risk.

The management of these risks is fundamental to Challenger's business and building long-term shareholder value.

Challenger's Board is responsible, in conjunction with senior management, for the management of risks associated with the business and implementing structures and policies to adequately monitor and manage these risks.

The Board has established the Group Risk Committee (GRC) and Group Audit Committee (GAC) to assist in discharging its risk management responsibilities. In particular, these committees assist the Board in setting the appropriate risk appetite and for ensuring Challenger has an effective risk management framework that is able to manage, monitor and control the various risks to which the business is exposed.

The Executive Risk Management Committee (ERMC) is an executive committee, chaired by the Chief Risk Officer (CRO), which assists the GRC, GAC and Board in discharging their risk management obligations by implementing the Board-approved risk management framework.

On a day-to-day basis, the Risk division, which is separate from the operating segments of the business, has responsibility for monitoring the implementation of the risk framework, including the monitoring, reporting and analysis of the various risks faced by the business, and providing effective challenge to activities and decisions that may materially affect Challenger's risk profile.

Risk appetite

Challenger's risk appetite statement provides that, subject to acceptable returns and limits, Challenger can retain exposure to credit risk, property risk, equity and infrastructure risk, life insurance risk and other active trading strategies.

Accept exposure (subject to appropriate returns)	Minimise exposure
✓ Credit default risk	✗ Asset and liability mismatch risk
✓ Property risk	✗ Foreign exchange risk
✓ Equity and infrastructure risk	✗ Interest rate risk
✓ Life insurance risk	✗ Inflation risk
✓ Other active trading strategies	✗ Liquidity risk
	✗ Licence risk
	✗ Operational risk

Asset and liability mismatch risk

Challenger's asset allocation strategy is based on running a cash flow-matched portfolio of assets and liabilities and to minimise the risk of cash flow mismatch. Annuity cash payments are generally met from contracted investment cash flows together with assets held in Challenger's liquidity pool, which are continually rebalanced through time.

Credit default risk

Credit default risk is the risk of loss in value of an investment due to a counterparty failing to discharge its contractual obligations when they fall due.

Challenger's approach to credit management utilises a credit risk framework to ensure that the following principles are adhered to:

- credit risk management team separation from risk originators;
- recognition of the different risks in the various businesses;
- credit exposures being systematically controlled and monitored;
- credit exposures being regularly reviewed in accordance with existing credit procedures; and
- ensuring credit exposures include the impact from derivative transactions.

Challenger makes use of external ratings agencies (Standard & Poor's, Fitch, Moody's) to determine credit ratings.

Where a counterparty or debt obligation is rated by multiple external ratings agencies, Challenger will use Standard & Poor's ratings where available.

All credit exposures with an external rating are also reviewed internally and cross-referenced to the external rating, if applicable.

Where external credit ratings are not available, internal credit ratings are assigned by appropriately qualified and experienced credit personnel who operate separately from the asset originators.

Credit spread risk sensitivity

Challenger is exposed to price movements resulting from credit spread fluctuations through its fixed income securities (net of subordinated debt) and the fair value of annuity and other liabilities.

As at 31 December 2020, a 50 bps increase/decrease in credit spreads would have resulted in an unrealised loss/gain of \$123m (after-tax) on fixed income investments (net of debt).

In accordance with prudential standards and Australian Accounting Standards, Challenger Life values term annuities at fair value, and lifetime annuities using a risk-free discount rate, both of which are based on the Australian Government bond curve plus an illiquidity premium. Movements in fixed income credit spreads impact the illiquidity premium.

As at 31 December 2020, a 50 bps increase/decrease in credit spreads would have resulted in an unrealised gain/loss of \$83m (after-tax) on the fair value of annuity liabilities.

Property risk

Property risk is the potential impact of movements in the market value of property investments on Challenger's profit and loss.

Property risk sensitivity

Challenger is exposed to movements in the market value of property investments, through both directly held investment properties and property securities.

The property sensitivities included on page 46 show the impact of a change in property valuations at balance date and are based on Life's gross property investments of \$3.7bn (net investments of \$3.3bn plus debt of \$0.4bn). A 1% move in the direct and indirect property portfolio at 31 December 2020 would result in a \$26m (after-tax) movement in property valuations.

Equity and infrastructure risk

Challenger is exposed to movements in the market value of equities and infrastructure investments.

Life maintains listed equity beta and low beta investments and unlisted private equity investments.

Life maintains unlisted infrastructure investments, predominantly in renewable energy and utilities and does not currently hold any listed infrastructure exposures.

Equity and infrastructure risk sensitivity

The equity and infrastructure risk sensitivities included on page 46 show a 10% move in the equity and infrastructure portfolio at 31 December 2020 would have resulted in a \$42m (after-tax) movement in the valuation of equity and infrastructure investments.

Life has strategies in place to reduce the impact of investment markets on the valuation of its equity investments, including a collar strategy. As a result, a 10% movement in equity markets is expected to have a smaller impact on the valuation of Life's equity investments.

Alternatives risk

Alternatives risk is the potential impact of movements in the market value of alternative investments. Alternative investments include exposure to equity markets through absolute return strategies and insurance related investments, both expected to have a low correlation to listed equity markets.

Challenger holds alternative investments as part of its investment portfolio in order to provide diversification.

Alternatives risk sensitivity

The alternatives risk sensitivity on page 46 assumes a 10% market move in the alternatives portfolio at 31 December 2020 would have impacted the valuation by \$63m (after-tax).

Liquidity risk

Liquidity risk is the risk Challenger will encounter difficulty in raising funds to meet cash commitments associated with financial instruments and contracted payment obligations to annuitants. This may result from either the inability to sell financial assets at face value, a counterparty failing to repay

contractual obligations, or the inability to generate cash inflows as anticipated.

Challenger's Liquidity Management Policy aims to ensure that it has sufficient liquidity to meet its obligations on a short, medium and long-term basis. In setting the level of liquidity, Challenger considers new business activities in addition to current contracted obligations.

In determining the required levels of liquidity, Challenger considers:

- minimum cash requirements;
- collateral and margin call buffers;
- Australian Financial Services Licence requirements;
- cash flow forecasts;
- associated reporting requirements;
- other liquidity risks; and
- contingency plans.

Required annuity cash outflows are met from contracted investment cash flows together with assets in Challenger's liquidity pool. As a result, cash flows are well matched and continue to be rebalanced through time.

Life insurance risk

Lifetime annuities provide guaranteed payments to customers for life. Through selling lifetime annuities and assuming wholesale reinsurance agreements, CLC is assuming longevity risk, which is the risk annuitants live longer, in aggregate, than expected. This is in contrast to mortality risk, which is the risk that people die earlier than expected. CLC is exposed to mortality and morbidity risks on its wholesale mortality reinsurance business.

CLC is required under APRA prudential standards to maintain regulatory capital in relation to the longevity, mortality and morbidity risks. CLC manages some of its longevity risk exposure by using reinsurance for a closed lifetime annuity portfolio. CLC regularly reviews the portfolio for longevity experience to ensure longevity assumptions remain appropriate.

Mortality and morbidity rates are based on industry standards, which are adjusted for CLC's own recent experience and include an allowance for future mortality improvements.

CLC assumes future mortality rates for individual lifetime annuities will improve by between 0.3% and 2.5% per annum, depending on different age cohorts and sex. This has the impact of increasing the life expectancy of a male aged 65 from 22 years (per the base mortality rates) to 25 years.

Mortality, morbidity and longevity sensitivities

The mortality sensitivities on page 46 set out the expected impact of an improvement in mortality. This is in addition to the mortality improvements Challenger already assumes.

A 50% increase in the annual mortality improvement rates already assumed would increase the life expectancy of a male aged 65 from 25 years to 26 years and increase the policy liability valuation by \$30m (after-tax).

Interest rate sensitivity

The impact of movements in interest rates on Challenger's profit and loss and balance sheet are set out on page 46.

The sensitivities assume the change in variable occurs on 31 December 2020 and are based on assets and liabilities held at that date.

The impact of movements in interest rates is minimised through the use of interest rate swaps, Australian Government bonds, Semi-Government bonds and bond futures. As a result, the interest rate sensitivities show Challenger's profit is not materially sensitive to changes in base interest rates.

The sensitivities do not include the impact of changes in interest rates on earnings from CLC's shareholder capital as investment earnings are earned over the period, whereas the sensitivities assume a change in interest rates occurred on 31 December 2020.

Foreign exchange risk

It is Challenger's policy to seek to hedge the exposure of all balance sheet items for movements in foreign exchange rates.

Currency exposure arises primarily in relation to Life's investments in Europe (including the United Kingdom), Japan and the United States. As a result, currency risk arises primarily from fluctuations in the value of the euro, British pound, Japanese yen and US dollar against the Australian dollar.

In order to minimise foreign currency exchange rate risk, Challenger enters into foreign currency derivatives to limit Challenger's exposure to currency movements.

Foreign exchange sensitivity

The impact of movements in foreign currencies on Challenger's profit and loss and balance sheet are set out on page 46. As a result of foreign currency derivatives in place, Challenger's profit and loss is not materially sensitive to movements in foreign currency rates.

Challenger invests with a range of third-party managers, for example absolute return fund managers. While Challenger does not actively seek to take foreign exchange risk, some foreign exchange exposure can be embedded in those third-party managed portfolios.

Funds Management financial results

\$m	1H21	2H20	1H20	2H19	1H19	2H18	1H18
Fidante Partners							
Fidante Partners income ¹	45.1	39.4	42.0	39.4	43.8	37.1	36.5
Performance fees	4.6	11.4	3.5	1.0	2.5	12.9	6.4
Net income	49.7	50.8	45.5	40.4	46.3	50.0	42.9
CIP Asset Management							
CIP income ²	31.6	29.6	32.2	34.3	28.9	29.2	29.1
Total net fee income	81.3	80.4	77.7	74.7	75.2	79.2	72.0
Personnel expenses	(29.2)	(32.2)	(31.7)	(32.9)	(31.9)	(32.4)	(29.9)
Other expenses	(16.8)	(18.4)	(18.1)	(17.0)	(17.2)	(16.0)	(15.0)
Total expenses	(46.0)	(50.6)	(49.8)	(49.9)	(49.1)	(48.4)	(44.9)
EBIT	35.3	29.8	27.9	24.8	26.1	30.8	27.1
Performance analysis							
Fidante Partners – income margin (bps) ³	15	17	15	14	16	18	16
CIP Asset Management – income margin (bps) ³	32	30	32	36	31	32	34
Cost to income ratio	56.6%	62.9%	64.1%	66.8%	65.3%	61.1%	62.4%
Net assets – average ⁴	251.4	242.9	232.5	221.8	212.3	201.6	194.9
ROE (pre-tax)	27.8%	24.7%	23.8%	22.6%	24.4%	30.8%	27.6%
Fidante Partners	71,826	62,393	62,693	58,912	56,330	59,630	56,031
CIP Asset Management	19,416	19,042	20,153	20,117	18,684	18,354	17,397
Closing FUM – total	91,242	81,435	82,846	79,029	75,014	77,984	73,428
Fidante Partners	66,127	60,866	60,887	58,173	58,621	57,559	54,120
CIP Asset Management	19,763	19,550	20,170	19,042	18,747	18,272	16,853
Average FUM – total⁴	85,890	80,416	81,057	77,215	77,368	75,831	70,973
FUM and net flows analysis							
Fidante Partners	5,764.3	1,854.4	1,943.4	(2,590.3)	(1,045.8)	1,375.3	2,497.0
CIP Asset Management	659.1	(1,193.1)	(63.8)	1,129.0	68.7	(8.4)	1,437.3
Net flows	6,423.4	661.3	1,879.6	(1,461.3)	(977.1)	1,366.9	3,934.3
Distributions	(857.4)	(297.5)	(464.7)	(353.0)	(441.7)	(318.6)	(339.1)
Market-linked movement	4,241.0	(1,774.3)	2,401.9	5,829.2	(1,550.7)	3,507.4	2,927.3
Total FUM movement	9,807.0	(1,410.5)	3,816.8	4,014.9	(2,969.5)	4,555.7	6,522.5

¹ Fidante Partners income includes equity-accounted profits, distribution fees, administration fees, and Fidante Partners Europe transaction fees.

² CIP income includes asset-based management fees and other income. Other income includes leasing fees, asset acquisition and disposal fees, development and placement fees.

³ Income margin represents net income divided by average FUM.

⁴ Calculated on a monthly basis.

Funds Management financial results

Funds Under Management and net flows

\$m	Q2 21	Q1 21	Q4 20	Q3 20	Q2 20	Q1 20
Funds Under Management						
Fidante Partners						
Equities	30,229	26,985	26,295	22,672	28,107	26,726
Fixed income	35,090	31,904	29,590	26,073	27,452	26,890
Alternatives	6,507	6,336	6,508	7,240	7,134	7,107
Total Fidante Partners	71,826	65,225	62,393	55,985	62,693	60,723
CIP Asset Management						
Fixed income	14,470	14,859	13,629	13,218	14,618	14,788
Property	4,946	5,147	5,413	5,576	5,535	5,448
Total CIP Asset Management	19,416	20,006	19,042	18,794	20,153	20,236
Total Funds Under Management	91,242	85,231	81,435	74,779	82,846	80,959
Average Fidante Partners	67,963	64,065	59,021	61,491	61,760	59,999
Average CIP Asset Management	20,190	19,397	18,799	20,112	20,247	20,110
Total average Funds Under Management¹	88,153	83,462	77,820	81,603	82,007	80,109
Analysis of flows						
Equities	5	335	(195)	587	836	22
Fixed income	3,327	2,107	2,955	(430)	628	659
Alternatives	86	(96)	(199)	(864)	-	(201)
Total Fidante Partners	3,418	2,346	2,561	(707)	1,464	480
CIP Asset Management	(571)	1,230	404	(1,597)	(21)	(43)
Net flows	2,847	3,576	2,965	(2,304)	1,443	437

¹ Average total Funds Under Management calculated on a monthly basis.

Reconciliation of total group assets and Funds Under Management

\$m	Q2 21	Q1 21	Q4 20	Q3 20	Q2 20	Q1 20
Funds Management Funds Under Management	91,242	85,231	81,435	74,779	82,846	80,959
Life investment assets	19,634	18,948	18,303	18,960	19,669	19,683
Adjustments to remove double counting of cross-holdings	(14,789)	(15,383)	(14,501)	(14,286)	(16,176)	(16,292)
Total Assets Under Management	96,087	88,796	85,237	79,453	86,339	84,350

Funds Management financial results

Funds Management focuses on building savings for retirement by providing specialist investment strategies that seek to deliver superior investment returns. Funds Management is one of Australia's largest active investment managers¹ and the fastest growing².

Funds Management funds under management (FUM) of \$91bn at 31 December 2020 has increased from \$22bn ten years ago. Growth in FUM can be attributed to the strength of Challenger's retail and institutional distribution platform, a market-leading business model focused on investor alignment and strong long-term investment performance.

Funds Management invests across a broad range of asset classes including fixed income, commercial property, Australian and global equities and alternatives.

Funds Management comprises Fidante Partners and CIP Asset Management and has operations in Australia, Europe and Japan.

Fidante Partners is a multi-boutique platform and forms long-term alliances with investment teams to create, support and grow specialist asset management businesses. Fidante Partners' deep experience in asset management, extensive investor distribution networks and operational infrastructure enable investment teams to focus on managing investment portfolios.

Fidante Partners has been successful in attracting new investment managers, adding new investment strategies and building its manager and distribution footprint. Fidante Partners also continues to expand its distribution channels and has recently entered the actively managed exchange-traded funds (ETFs) market.

Recognising Fidante Partner's distribution capability, in 2020 it won distributor of the year at the Zenith Fund Awards.

CIP Asset Management has transitioned from an internally focused to an externally focused asset manager and Challenger is committed to growing the business and building on its 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 also has operations in both Japan and Europe and is developing its distribution and product opportunities in both regions.

EBIT and ROE

Funds Management EBIT was \$35m and increased by \$7m (26%) on 1H20. The increase in Funds Management EBIT was due to higher fee income (up \$3m) and lower expenses (down \$4m).

Funds Management ROE was 27.8% and increased by 400 bps from 23.8% in 1H20. ROE benefited from higher EBIT (up 26%) with only an 8% increase in average net assets.

Total net fee income

1H21 total net income was \$81m and increased by \$3m (up 5%). Net fee income increased as a result of higher FUM based management fees due to higher FUM (up \$8m) and higher

performance fees (up \$1m), partially offset by lower Fidante Partners UK transaction fees (down \$5m) and lower CIP Asset Management transaction fees (down \$1m).

Expenses

1H21 Funds Management expenses were \$46m and decreased by \$4m (8%) on 1H20. Personnel costs reduced by \$3m and other expenses reduced by \$1m.

The 1H21 cost to income ratio was 56.6% and improved by 750 bps from 64.1% in 1H20.

Fidante Partners' net income

Fidante Partners' net fee income includes distribution and administration fees, transaction fees from Fidante Partners Europe, performance fees and a share in the equity-accounted profits of boutique investment managers.

Fidante Partners' net income was \$50m in 1H21, up \$4m (9%) on 1H20. Fidante Partners' net income benefited from higher FUM-based income (up \$8m) and higher performance fees (up \$1m), partially offset by lower Fidante Partners Europe transaction fees (down \$5m).

Fidante Partners' income margin (net income to average FUM) was 15 bps in 1H21, unchanged on 1H20. Fidante Partners' income margin was stable with the impact of an increase in higher margin retail business offset by lower Fidante Partners Europe transaction fees.

Fidante Partners' FUM and net flows

Fidante Partners' FUM at 31 December 2020 was \$71.8bn and increased by \$9.4bn (15%) for the half year and included:

- net flows of \$5.8bn, including \$3.9bn of institutional flows and \$1.9bn of retail flows;
- positive impact from investment markets of \$4.5bn; and
- net distributions of \$0.9bn.

Fidante Partners' 31 December 2020 FUM is invested in the following asset classes:

- 42% in equities (FY20 42%);
- 49% in fixed income (FY20 47%); and
- 9% in alternatives (FY20 11%).

Fidante Partners Europe

Fidante Partners includes a European distribution platform with interests in a number of specialist boutique fund managers.

Fidante Partners Europe is an important part of Funds Management's international distribution and product expansion. It provides an established and scalable platform to expand global investment capability and distribution. Fidante Partners Europe FUM was \$6.4bn at 31 December 2020.

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

² Measured as Australian listed fund manager net flows over the past 12 months divided by FUM 12 months ago. Peers include AMP Capital, Janus Henderson, Magellen, Perpetual, Pental, Pinnacle Investment Management, Platinum Investment Management. Data based on most recent ASX disclosures.

CIP Asset Management

CIP Asset Management’s net income was \$32m in 1H21 and decreased by \$1m (2%) on 1H20. Lower net income was a result of lower transaction fees (down \$1m) driven by lower property and fixed income transaction fees.

CIP Asset Management’s income margin (net income to average FUM) was 32 bps in 1H21 and was stable on 1H20.

CIP Asset Management FUM and net flows

CIP Asset Management’s FUM at 31 December 2020 was \$19.4bn and increased by \$0.4bn for the half year and included:

- net flows of \$0.6bn, predominantly from Challenger Life and Australian institutional clients; partially offset by
- negative market movement of \$0.2bn including foreign currency translation movements.

CIP Asset Management’s 31 December 2020 FUM is invested in the following asset classes:

- 75% in fixed income (FY20 72%); and
- 25% in property (FY20 28%).

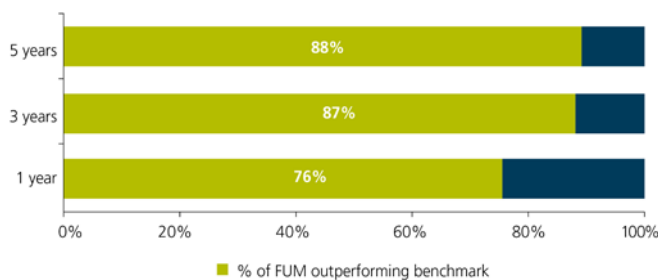
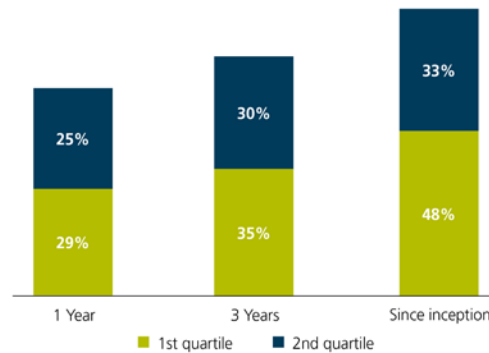
25% of CIP Asset Management’s FUM is from third-party clients with the balance managed on behalf of Challenger Life.

Funds Management investment performance

Investment performance represents the percentage of FUM meeting, or exceeding performance benchmarks, with performance weighted by FUM.

Long-term performance for Fidante Partners Australian boutiques remains strong with 88% of FUM outperforming benchmark over five years. Over one year, 76% of FUM outperformed benchmark¹.

For Fidante Partners, 54% of funds achieved first or second quartile performance over one year and 81% of funds have achieved either first or second quartile investment performance since inception².



¹ As at 31 December 2020. Percentage of Fidante Partners Australian boutiques meeting or exceeding performance benchmark.

² Mercer as at December 2020.

Corporate financial results

\$m	1H21	2H20	1H20	2H19	1H19	2H18	1H18
Other income	0.0	0.2	0.2	0.5	0.5	0.5	0.5
Personnel expenses	(16.8)	(14.4)	(18.1)	(19.6)	(19.0)	(21.7)	(20.1)
Other expenses	(7.0)	(18.5)	(9.8)	(4.8)	(5.5)	(4.6)	(5.8)
Total expenses (excluding LTI)	(23.8)	(32.9)	(27.9)	(24.4)	(24.5)	(26.3)	(25.9)
Long-term incentives (LTI)	(5.8)	(4.1)	(4.9)	(5.9)	(7.1)	(8.8)	(7.2)
Total expenses	(29.6)	(37.0)	(32.8)	(30.3)	(31.6)	(35.1)	(33.1)
Normalised EBIT	(29.6)	(36.8)	(32.6)	(29.8)	(31.1)	(34.6)	(32.6)
Interest and borrowing costs	(2.3)	(4.0)	(2.5)	(2.4)	(2.9)	(3.2)	(2.9)
Normalised loss before tax	(31.9)	(40.8)	(35.1)	(32.2)	(34.0)	(37.8)	(35.5)

The Corporate division comprises central functions such as Group executives, finance, treasury, legal, human resources, risk management and strategy.

Corporate also includes interest received on Group cash balances and any interest and borrowing costs associated with Group debt facilities.

Normalised EBIT

Corporate normalised EBIT was a loss of \$30m in 1H21, an improvement of \$3m on 1H20 as a result of lower expenses.

Other income

1H21 other income represents interest received on Group cash and was nil in 1H21, due to lower interest income offset by transaction costs.

Group cash at 31 December 2020 was \$137m, down \$10m in 1H21.

Total expenses

1H21 Corporate expenses were \$30m and decreased by \$3m on 1H20.

Corporate expenses include:

- Personnel costs of \$17m, decreased by \$1m as a result of lower variable reward costs;
- Other expenses of \$7m, decreased by \$3m due to lower professional fees; and
- Long-term incentive costs of \$6m, increased by \$1m. Long-term incentive (LTI) costs relate to the non-cash amortisation of equity grants.

Interest and borrowing costs

Interest and borrowing costs relate to debt facility fees on the Group's \$400m banking facility.

During 2H20, the \$400m facility was fully drawn in order to provide additional financial flexibility during the COVID-19 pandemic market sell-off. Once the market stabilised in late 2H20, \$350m of the \$400m was repaid and the remaining \$50m was outstanding at 31 December 2020.

1H21 interest and borrowing costs were \$2m and was unchanged on 1H20, reflecting the partial drawdown of the Group debt facility offset by lower facility fees.

Normalised Cash Operating Earnings framework

Life normalised Cash Operating Earnings (COE) is Challenger's preferred profitability measure for the Life business, as it aims to reflect the underlying performance trends of the Life business.

The Life normalised COE framework was introduced in June 2008 and has been applied consistently since.

The framework removes the impact of market and economic variables, which are generally non-cash and the result of external market factors. The normalised profit framework is subject to a review performed by Ernst & Young each half year.

Life normalised COE includes cash earnings plus normalised capital growth and excludes investment experience (refer below).



Cash earnings

Cash earnings represents investment yield and other income, less interest expenses and distribution expenses.

Investment yield

Represents the investment return on assets held to match annuities and the return on shareholder investment assets.

Investment yield includes net rental income, dividend income, infrastructure distributions, accrued interest on fixed income and cash, and discounts/premiums on fixed income assets amortised on a straight-line basis.

Interest expense

Represents interest accrued at contracted rates to annuitants and Life subordinated debt holders and other debt holders.

Distribution expense

Represents payments made for the acquisition and management of Life's products, including annuities.

Other income

Other income includes revenue from Accurium and profits on Life Risk wholesale longevity and mortality transactions (refer to page 25).



Normalised capital growth

Normalised capital growth represents the expected capital growth for each asset class through the investment cycle and is based on Challenger's long-term expected investment returns for each asset class. Normalised capital growth assumptions have been set with reference to long-term market growth rates and are reviewed regularly to ensure consistency with prevailing medium to long-term market returns.

Normalised capital growth can be determined by multiplying the normalised capital growth assumption (see below) by the average investment assets for the period.

Commencing in FY21 (from 1 July 2020), Life's investment portfolio categories were amended to more accurately reflect Life's investment portfolio following changes in portfolio composition in 2H20.

From 1 July 2020, the equities and infrastructure categories have been combined. Absolute return fund investments and insurance related investments have been reclassified from equities to alternatives as both are relatively uncorrelated to equity market returns.

Normalised growth assumptions have been updated for both the category changes and to ensure they reflect both the nature of the underlying investments and long-term expected investment returns.

Normalised capital growth assumptions for FY20 and FY21 are as follows:

\$m	FY20	FY21
Fixed income and cash (representing allowance for credit defaults)	-35 bps	-35 bps
Property	2.0%	2.0%
Infrastructure	4.0%	n/a
Equity and other	3.5%	n/a
Equity and infrastructure	n/a	4.0%
Alternatives	n/a	0.0%



Investment experience

Challenger Life is required by accounting standards and prudential standards to value all assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on assets and policy liabilities being recognised in the profit and loss, particularly during periods of market volatility. As Challenger is generally a long-term holder of assets, due to them being held to match the term of life liabilities, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements.

Investment experience removes the volatility arising from asset and liability valuation movements so as to more accurately reflect the underlying performance of the Life business.

Investment experience includes both asset and liability experience and net new business strain.

Asset and liability experience

Challenger Life is required by accounting standards and prudential standards to value all assets and liabilities supporting the Life business at fair value. Asset and liability experience is calculated as the difference between actual investment gains/losses (both realised and unrealised and based on fair value) and the normalised capital growth in relation to assets plus any economic and actuarial assumption changes in relation to policy liabilities for the period.

Changes in macroeconomic variables impact the value of Life's assets and liabilities. Macroeconomic variables and actuarial assumption changes include changes to bond yields, inflation factors, expense assumptions, and other factors applied in the valuation of life contract liabilities.

New business strain

In accordance with Australian Accounting Standards, Challenger Life values term annuities at fair value and lifetime annuities using a risk-free discount rate, both of which are based on the Australian Government bond curve plus an illiquidity premium.

Life tends to offer annuity rates that are higher than these rates. As a result, on writing new annuity business, a non-cash loss is recognised when issuing the annuity contract due to a lower discount rate used to value the liability. In addition, maintenance expense allowances over the expected future term of new business are also included in the policy liability valuation.

New business strain is a non-cash item and subsequently reverses over the future period of the contract. The new business strain reported in the period represents the non-cash loss on new sales net of the reversal of the new business strain of prior period sales.

Glossary of terms

Terms	Definitions
Additional Tier 1 regulatory capital	High-quality capital that provides a permanent and unrestricted commitment and is freely available to absorb losses, however does not satisfy all the criteria to be included in Common Equity Tier 1 regulatory capital.
Capital intensity ratio	CLC Prescribed Capital Amount (PCA) divided by Life investment assets.
Cash earnings (Life)	Investment yield and other income less interest and distribution expenses.
CET1 ratio	Common Equity Tier 1 regulatory capital divided by Prescribed Capital Amount.
Challenger Index Plus	Institutional product providing guaranteed excess return above a chosen index. Index Plus is available on traditional indices and customised indices.
CIP income	CIP Asset Management income includes asset-based management fees, and other income such as leasing fees, acquisition and disposal fees, development and placement fees.
Common Equity Tier 1 regulatory capital	The highest quality capital comprising items such as paid-up ordinary shares and retained earnings. Common Equity Tier 1 capital is subject to certain regulatory adjustments in respect of intangibles and adjusting policy liabilities.
Cost to income ratio	Total expenses divided by Normalised Cash Operating Earnings (Life) or Total net fee income (FM).
Distribution expenses (Life)	Payments made for the acquisition and management of annuities and other Life products.
Earnings per share (EPS)	Net profit after tax divided by weighted average number of shares in the period.
Fidante Partners' Income	Distribution and administration fees; Fidante Partners' share of boutique manager profits; and other income from boutique investment managers.
Funds Under Management (FUM)	Total value of listed and unlisted funds/mandates managed by the Funds Management business.
Group assets under management (AUM)	Total value of Life's investment assets and Funds Management FUM.
Group cash	Cash available to Group, excluding cash held by Challenger Life Company Limited.
Interest and borrowing costs (Corporate)	Interest and borrowing costs associated with group debt and group debt facilities.
Interest expenses (Life)	Interest accrued and paid to annuitants, subordinated debt and other debt providers (including Challenger Capital Notes and Challenger Capital Notes 2).
Investment experience (Life)	Represents fair value movements on Life's assets and policy liabilities and net new business strain. Refer to page 56 for more detail.
Investment yield (Life)	Net rental income, dividends received and accrued interest and discounts/premiums on fixed income securities amortised on a straight-line basis.
Investment yield – shareholders' funds (Life)	Represents the return on shareholder capital held by the Life business.
Life annuity book growth	Net annuity policy capital receipts over the period divided by opening policy liabilities (Life annuity book).
Life book growth	Net annuity and other policy capital receipts over the period divided by the opening policy liabilities (Life annuity book and Challenger Index Plus liabilities).
Life investment assets	Total value of investment assets that are managed by the Life business.
MyLife MyFinance	MyLifeMyFinance Limited ABN 54 087 651 750.
Net annuity policy receipts	Life retail annuity sales less annuity capital payments.
Net assets – average	Average net assets over the period (excluding non-controlling interests) calculated on a monthly basis.
Net fee income (FM)	Fidante Partners' income and performance fees (FM) and Challenger Investment Partners' income and performance fees.
Net Interest Margin (NIM)	Net Interest Margin on term-funded prime mortgages and included as part of Life's investment assets.
Net management fees (FM)	Management fees for managing investments.

Glossary of terms

Terms	Definitions
Net tangible assets	Consolidated net assets less goodwill and intangibles.
New business tenor	Represents the maximum product maturity of new business sales. These products may amortise over this period.
Normalised capital growth	Long-term expected capital growth based on long-term return assumptions calculated as long-term capital growth assumption multiplied by average investment assets.
Normalised Cash Operating Earnings (NCOE) (Life)	Cash earnings plus normalised capital growth.
Normalised cost to income ratio	Total expenses divided by total net income.
Normalised dividend payout ratio	Dividend per share divided by normalised earnings per share (basic).
Normalised EBIT (FM)	Net income less total expenses.
Normalised EBIT (Life)	Normalised Cash Operating Earnings less total Life expenses.
Normalised net profit after tax (NPAT)	Statutory net profit after tax, excluding investment experience and net new business strain; and significant items (refer to page 56 for more detail on investment experience).
Normalised net profit before tax (NPBT)	Statutory net profit after tax, excluding normalised tax; investment experience and net new business strain; and significant items (refer to page 56 for more detail on investment experience).
Normalised Return On Equity (ROE) – pre-tax	Normalised Life EBIT, FM EBIT, and/or Normalised NPBT (Group) divided by average net assets.
Normalised Return On Equity (ROE) – post-tax	Group's normalised NPAT divided by average net assets.
Normalised tax rate	Normalised tax divided by normalised profit before tax.
Other expenses	Non-employee expenses, including external professional services, occupancy costs, marketing and advertising, travel, technology and communications costs.
Other income (Corporate)	Includes interest received on Group cash balances.
Other income (Life)	Relates to Accurium revenue and Life Risk. Refer to page 25 for more detail.
PCA ratio	The ratio of the total CLC Tier 1 and Tier 2 regulatory capital base divided by the Prescribed Capital Amount.
Performance fees (FM)	Fees earned for outperforming benchmarks.
Personnel expenses	Includes fixed and short-term variable incentive components of remuneration structures. The amortisation of long-term incentive plans is reported separately within the Corporate results.
Prescribed Capital Amount (PCA)	Amount of capital that a life company must hold which is intended to be sufficient to withstand a 1-in-200-year shock and still meet adjusted policy liabilities and other liabilities. For further details, refer to APRA's LPS110 <i>Capital Adequacy</i> .
Product cash margin (Life)	Represents the return on assets backing annuities and other income, less interest and distribution expenses.
Significant items	Non-recurring or abnormal income or expense items.
Statutory Return On Equity (ROE) – post-tax	Statutory NPAT divided by average net assets.
Tier 1 regulatory capital	Tier 1 regulatory capital comprises Common Equity Tier 1 regulatory capital and Additional Tier 1 regulatory capital.
Tier 2 regulatory capital	Tier 2 regulatory capital contributes to the overall strength of the Life Company and its capacity to absorb losses, however does not satisfy all the criteria to be included as Tier 1 regulatory capital.
Total expenses	Personnel expenses plus other expenses.
Total net income	Normalised Cash Operating Earnings (Life) plus net fee income (FM) plus other income (Corporate).

Key dates

Challenger Limited (ASX:CGF)

2021 Third quarter performance update	15 April 2021
2021 Investor Day	17 June 2021
2021 Full-year financial results	10 August 2021
2022 First quarter performance update	13 October 2021
2021 Annual General Meeting	28 October 2021

Challenger 2021 interim dividend

Ex-dividend date	23 February 2021
Record date	24 February 2021
DRP election date	25 February 2021
Payment date	23 March 2021

Challenger 2021 final dividend

Ex-dividend date	30 August 2021
Record date	31 August 2021
DRP election date	1 September 2021
Payment date	22 September 2021