2021 Analyst Pack

Providing our customers with financial security for a better retirement

challenger.com.au
Challenger Limited ACN 106 842 371

challenger

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2021 Annual Report
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Important note

Information presented in the FY21 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 (Cth)*.

The 2021 Annual Report is available from Challenger's shareholder centre at:

› **www.challenger.com.au/shareholder**

The FY21 Analyst Pack is not audited. The statutory net profit after tax as disclosed in the consolidated profit and loss (page 16) 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 16), 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 Annual Report.

The 2021 Annual 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.

FY21 financial highlights[1]

Group	Normalised net profit before tax $396m, down 22% Normalised net profit after tax $279m, down 19% Statutory net profit after tax $592m, up $1.0bn Normalised EPS[2] 41.5 cents per share, down 27% Statutory EPS[2] 88.2 cents per share, up 156.6 cents per share Net income $682m, down 14% Expenses $281m, down 1% Normalised cost to income ratio 41.2%, up 5.5 percentage points Group assets under management $110.0bn, up 29% Normalised Return On Equity (pre-tax) 11.2%, down 360 bps Statutory Return On Equity (post-tax) 16.8% Full-year dividend 20.0 cents per share (fully franked), up 2.5 cents per share Normalised dividend payout ratio 48.2%
Life	Normalised Cash Operating Earnings (COE) $513m, down 20% COE margin 2.60%, down 72 bps Expenses $114m, unchanged Normalised EBIT[3] $399m, down 24% Total Life sales $6.9bn, up 35% Annuity sales $4.6bn, up 46% Total Life book growth $2.2bn, or 14.4% of opening liabilities Annuity net book growth $1.1bn, or 8.6% of opening liabilities Average investment assets $19.7bn, up 3% Investment assets $21.6bn, up 18% Normalised Return On Equity (pre-tax) 12.4%, down 420 bps Prescribed Capital Amount (PCA) ratio 1.63 times, down from 1.81 times Common Equity Tier 1 (CET1) ratio 1.14 times, down from 1.20 times Capital intensity 12.1%, up from 10.7%
Funds Management	Net income $169m, up 7% Expenses $98m, down 2% EBIT[3] $71m, up 23% Net flows $16.1bn, up from $2.5bn Funds Under Management (FUM) $105.8bn, up 30% Return On Equity (pre-tax) 27.7%, up 340 bps

[1] All percentage movements compare FY21 to the prior corresponding period (FY20) unless otherwise stated.
[2] Earnings per share (EPS).
[3] Earnings before interest and tax (EBIT).

Business and market overview

Challenger's purpose is to provide customers with financial security for a better retirement. To fulfil this purpose, Challenger will leverage capabilities across its Life, Funds Management, and recently acquired Bank businesses.

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

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

Critical features driving the growth of Australia's superannuation system include government-mandated and increasing contributions, tax incentives to encourage retirement savings and an efficient and competitive institutional model.

Australia's superannuation system is forecast to grow from approximately $3 trillion today[2] to almost $7 trillion[3] over the next 15 years.

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

Life

Life focuses on the retirement spending phase of superannuation, providing products that help customers convert retirement savings into safe and secure income in retirement.

As Australia's superannuation system grows, the retirement phase of superannuation is expected to increase significantly. As Australia's leading provider of annuities[4] Challenger Life is expected to benefit from this growth. The number of Australians over the age of 65, which is Life's target market, is expected to increase by 50% over the next 20 years[5]. Reflecting these demographic changes, and growth in the superannuation system, the annual transfer from the retirement savings phase of superannuation to the retirement phase was estimated to be approximately $70bn[6] in 2020.

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 seeking retirement income products that convert savings into regular and secure income, helping to provide financial security in retirement.

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 (refer to page 34 for more detail).

These reforms provide an opportunity to increase the proportion of savings invested in products that deliver stable, regular and reliable retirement income. Annuities currently represent only a small part of the retirement phase, with lifetime annuities representing less than 2% of the annual transfer to the retirement phase.

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 13 years and remains the dominant retirement income brand in Australia.

An important distribution channel for Life's products is third-party financial advisers. Life's products are included on all major advice hubs' Approved Product Lists (APLs) and are available on the leading administration platforms.

Challenger is also focused on building institutional partnerships with large superannuation funds. As their members transition to retirement, major superannuation funds are increasing their focus on providing more comprehensive retirement solutions to their members. As the retirement system develops, the profit-for-member sector provides a significant growth opportunity for Challenger.

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

Under a reinsurance arrangement with MS Primary, which commenced in July 2019, MS Primary provides Challenger an annual amount of reinsurance, across both Australian and US dollar annuities, of at least ¥50bn (equivalent to ~A$600m[7]) per year[8]. This is subject to review in the event of a material adverse change for either MS Primary or Challenger Life.

At 30 June 2021, 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 33 for more detail on the MS Primary and MS&AD relationship.

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

1 Thinking Ahead Institute - Global Pension Assets Study 2021.
2 APRA, as at March 2021.
3 Rice Warner Superannuation Market Projections Report 2020
4 Plan for Life – March 2021 – based on annuities under administration.
5 2020 – 2040 comparison based on Australian Bureau of Statistics, Population Projections Series B, cat no. 3222.0.
6 Based on Taxation Statistics 2018-19 from Australian Taxation Office.
7 Based on the exchange rate as at 30 June 2021.
8 Reinsurance across both Australian and US dollar annuities, of at least ¥50bn per year for a minimum of five years.

Funds Management

Funds Management focuses on building savings for retirement. As people work and save for retirement, the business supports them to build their wealth and savings by providing investment strategies that seek to deliver superior investment returns.

Funds Management is one of Australia's fastest growing[1] and third largest active fund manager[2] and is diversifying globally with operations in Europe, Japan and Singapore.

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 alignment with clients and high quality managers with 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 funds management firms, with Challenger providing distribution, administration and business support, leaving investment managers to focus entirely 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, while maintaining strong investment performance. Over the last three years, long-term performance for Fidante Partners Australian boutiques remains strong with 92% of funds and mandates outperforming their respective benchmarks.

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

Funds Management has extensive client relationships, for example 45 of Australia's top 50 superannuation funds are clients of Fidante Partners.

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.

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

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

Bank acquisition

Challenger is diversifying its product offering and extending its customer reach.

In December 2020, Challenger announced the acquisition of MyLifeMyFinance Limited (MyLife MyFinance), an Australian-based customer digital bank, for $35 million[3].

The acquisition received formal approval from the Treasurer of the Commonwealth of Australia and was completed in July 2021.

MyLife MyFinance is an Australian-based authorised deposit-taking institution (ADI) and digital bank, offering a range of simple savings and lending products. MyLife MyFinance has an ADI licence with an existing term deposit offering.

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

Adding an 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 purpose: to provide customers with financial security for a better retirement.

The Bank 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.

Initially, Challenger will offer government guaranteed retail term deposits, which are familiar banking products and represent a significant portion of both retiree and pre-retiree wealth.

The Bank 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 will accelerate Challenger's direct to customer capability. To ensure speed to market, term deposits will initially be marketed under the MyLife MyFinance brand and will transition to the Challenger brand during FY22.

The asset and lending strategy for the Bank will centre on broadening the lending capability and embedding a strong risk management approach in order to deliver the Group's return on equity target once the business scales.

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

Integration is well progressed, with integration costs expected to be between $5 million and $8 million incurred over FY21 and FY22, which will be reported as a significant item.

[1] Plan For Life Wholesale Trust Data, September 2020, December 2020 and March 2021.

[2] Consolidated FUM for Australian Fund Managers – Rainmaker Roundup, March 2021.

[3] Acquisition price subject to completion adjustments.

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 and again in July 2021. Challenger continues to comply with national and state public health orders.

Challenger has also been supporting its customers and business partners throughout the pandemic, including 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 repositioned its investment portfolio to more defensive settings, which will be maintained.

As a result of this repositioning, Life was holding over $3bn of cash and liquid investments at the start of FY21. Excess cash and liquids instruments have been progressively redeployed over the course of the year predominantly into higher yielding fixed income investments.

Challenger has enhanced its capital settings to more closely align with its brand and purpose of providing financial security for a better retirement. From FY22, Challenger is extending its target capital ratios and intends to operate toward the top of its target range providing increased flexibility for investment market volatility and reducing the risk of realising negative investment experience during significant market shocks. Refer to page 48 for additional detail on Challenger Life's excess capital position and target capital ratios.

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 markets participants;
- demand for and competition with Challenger products, including annuities and managed funds; and
- operational risk.

Purpose and corporate strategy

In June 2021, Challenger announced a refreshed corporate strategy that builds on the foundations of the core strategic pillars that have been in place for many years.

The refreshed corporate strategy will make Challenger stronger and more relevant for the future as we seek to further expand our offerings for retirees.

Providing customers with financial security for a better retirement remains Challenger's purpose, which will be served by providing both guaranteed income products such lifetime annuities and bank term deposits[1], as well as non-guaranteed funds management products that help people save for retirement.

Challenger has introduced explicit vision statements for each key stakeholder group: customers; shareholders; employees and the community to help clarify Challenger's objectives and long-term ambitions.

Our **purpose** is to provide our customers with financial security for a better retirement

Vision statements

Customers
By 2030 we will provide 1 in 5 Australian retirees with improved financial outcomes as consumers of Challenger products, and be the partner of choice for institutions and advisers.

Community
Champion financial security for retirement, providing financial help and education, advocating for constructive public policies and leading by example with responsible business practices.

Employees
Bring together a diverse group of top talent, inspired by our purpose, with strong culture and capabilities to deliver shared success.

Shareholders
Build resilient long-term shareholder value, leveraging the capabilities of the group to achieve compelling returns above our cost of capital.

Strategic priorities

- **Broaden customer access across multiple channels**
- **Expand the range of financial products and services for a better retirement**
- **Leverage the combined capabilities of the group**
- **Strengthen resilience and sustainability of Challenger**

I ACT values

- **Act with integrity**
- **Aim high**
- **Collaborate**
- **Think customer**

Reflecting Challenger's commitment to a more customer-centric business, the customer vision is ambitious: to provide one in five Australian retirees with improved financial outcomes as consumers of Challenger by 2030. At the end of this decade Challenger's goal is to help support the retirement of 20% of middle Australian retiree households. Challenger's strategy will continue to evolve to move Challenger toward achieving this vision.

At the same time, Challenger will remain focused on the impact on other stakeholders and has a clear vision for ensuring it makes a positive contribution across all key stakeholder groups.

For the community, Challenger will champion financial security for retirement, providing financial help and education, advocating for constructive public policies and leading by example with responsible business practices.

For its employees, Challenger will bring together a diverse group of top talent, inspired by its purpose, with strong culture and capabilities to deliver shared success.

And for its shareholders, Challenger will build resilient long-term shareholder value, leveraging capabilities across the group to achieve compelling returns.

These vision statements will be achieved through the execution of four strategic priorities.

1. Broaden the ways customers can access products across multiple channels;
2. Expand the range of products and services offered to support a better retirement;
3. Leverage the combined capabilities of the Group; and
4. Continue to strengthen the resilience and sustainability of Challenger.

[1] Bank term deposits are guaranteed under the Financial Claims Scheme.

FY21 strategic progress

Strategic progress over FY21 has been measured against the core strategic pillars that have been in place for many years.

Increase the use of secure retirement income streams

Challenger is focused on growing the allocation of Australian retirement savings to secure and stable incomes.

FY21 progress:

Strategy to diversify sales delivering – Life sales up 35% to $6.9bn

Challenger is building more resilient sales by diversifying across a range of retail and institutional products and clients.

In FY21, sales increased across all key Life product categories, including domestic retail annuities (up 19%), institutional annuities and Index Plus (up 53%) and Japanese annuities (up 6%).

Total Life sales increased by 35% and are benefiting from Challenger's diversification strategy, which includes:

- Increasing focus on institutional sales (refer to page 7 for more detail);
- Working with a wider range of independent financial advice networks following structural change in the domestic financial advice market; and
- Expansion of the annuity relationship with MS Primary in Japan and expanding the relationship to include the reinsurance of US dollar-denominated annuities (refer to page 33 for more detail).

Stabilisation of structural change to Australian financial advice market

Life has traditionally relied upon third-party financial advisers, both independent and part of major advice hubs, to distribute its products. The Australian wealth management and financial adviser markets have been significantly disrupted following 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 impacted Challenger's annuity sales, particularly term annuity sales, which had been well supported by advisers aligned to the wealth management operations of major banks.

With adviser movement from major banks to Independent Financial Adviser (IFA) networks and advisers exiting the industry stabilising over the last 12 months, the scope for further impact on Challenger's domestic retail term sales has reduced.

The contribution to Challenger term annuity sales by major banks has stabilised and accounted for ~9% of FY21 domestic fixed term annuity sales, which was consistent with the contribution in FY20 (~12%).

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. Despite this, retail lifetime annuity sales increased by 6% in FY21.

The COVID-19 pandemic has also delayed retirees entering aged care. Despite this, CarePlus sales were up 11% on FY20.

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 digital bank, for $35 million[1]. The acquisition received formal approval from the Treasurer of the Commonwealth of Australia and completed in July 2021.

The acquisition is highly strategic and provides Challenger the opportunity to expand its secure retirement income offering, including entering Australia's term deposit market.

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

Adding an Authorised Deposit-Taking Institution capability to sit alongside the Life and Funds Management businesses will broaden both Challenger's product and distribution reach and help fulfil Challenger's vision to provide customers with financial security for a better retirement.

Term deposits are Government guaranteed[1] and a familiar product amongst both retirees and those approaching retirement, and they form a significant portion of their wealth allocation.

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.

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 has deep expertise in retirement income, including knowledge of the regulatory landscape and significant experience and track record in managing the financial risks that retirees face.

Challenger is the market leader in annuities with 80%[2] market share.

FY21 progress:

Annuity provider of the year

Life is a market leader in Australian retirement incomes and won the Association of Financial Advisers Overall Annuity Provider of the Year and Long Term Income Stream of the Year. Life was also the winner of Plan For Life's Overall Longevity Cover Excellence Award for 2020, which recognises Australian life insurance companies and fund managers who design products to assist retirees in meeting the challenges of rising longevity.

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 catering to the needs of superannuation funds, insurance companies and multi-managers.

Challenger's institutional offering provides institutional clients with access to Challenger Life's capabilities, including:

- investment and structuring skills;
- asset and liability management; and
- intellectual property and thought leadership, especially around retirement income.

Challenger's institutional approach is solutions led and an enabler providing components to client solutions, helping them build more comprehensive retirement solutions.

Challenger Life's institutional business (annuities and other institutional products) continues to grow strongly and increased by 81% in FY21 (and has increased by 32% Compound Annual Growth Rate (CAGR) over the past four years).

Sales are benefiting from an expansion in the institutional product offering, including introducing institutional term annuities, and an increase in the institutional client base. The number of institutional clients has more than doubled over the past five years, and covers profit-for-member funds, insurance companies and multi-managers.

With the low interest rate environment, Challenger's institutional clients are focused on diversifying their investment returns. Significant growth in institutional term annuity sales was achieved in FY21, which accounted for 36% of annuity sales, up from 19% in FY20.

Total institutional sales (annuities and other institutional products) was $4.0 billion in FY21, representing 58% of total Life sales.

The focus on more comprehensive solutions, including using guaranteed income products, by profit-for-member funds represents a significant growth opportunity for Challenger.

[1] The Financial Claims Scheme provides protection to depositors of up to $250,000 per account holder per authorised deposit-taking institution (ADI).
[2] Plan for Life – March 2021 – based on annuities under administration at 31 March 2021.

Superannuation fund clients are increasing their focus on providing retirement income solutions for their members and are engaging with Challenger on the support it can provide to help them build more comprehensive retirement solutions for their members. The Retirement Income Covenant (refer to page 34 for more detail) is also increasing superannuation funds' focus on providing their members with products that provide longevity risk protection.

Enhanced customer digital engagement through Challenger Investor Online

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

In FY21, Challenger's online customer portal was enhanced to provide an improved customer experience and increased security.

The enhancements also drive efficiencies by transitioning customers from paper processes to digital engagement, and provide a range of new features, including online self-service. The enhancements also increased security, including introducing two-factor authentication.

Leading adviser ratings

Despite structural changes in the Australian financial advice market and new competitors entering the retirement incomes 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.

Excellent customer experience

Challenger has a reputation for excellent customer experience demonstrated by Challenger's Net Promoter Score of 35%[2], up from 22% in FY20. Overall client satisfaction was 91%, with 67% of customers very satisfied and 24% somewhat satisfied. Customer satisfaction scores were broadly consistent across all product types and distribution channels (advised vs non-advised).

When surveying customer experience with Challenger compared to other financial institutions, 60% rated it better and 38% rated it the same as other companies[2].

The Customer Satisfaction and Advocacy research[2] also shows 90% of customers agree that Challenger products provide them with confidence in retirement and 87% agree that Challenger is a trustworthy company.

Retirement Essentials Age Pension Concierge Service pilot

Challenger trialled a Retirement Essentials Age Pension Concierge Service, aimed at helping to simplify the process of applying for the age pension. Retirement Essentials is a specialist provider of age pension eligibility and entitlements tools, which were made available to advisers to help cut Centrelink red tape and improve the client experience.

The objective for Challenger was to drive increased adviser engagement and sales of lifetime annuities through its retirement income leadership position. The pilot resulted in an increase in lifetime sales and engagement with advisers focused on retirement issues, including accessing the age pension for clients.

Enhanced online origination process

Challenger has enhanced its online origination process to improve the digital experience for its customers. A range of manual and paper-based processes have been replaced with editable PDFs, digital signatures and other automated processes. The enhanced online origination process led to:

- 69% improvement in turnaround time from quote to application;
- 100% improvement in the take-up of online ID and verification; and
- 25% reduction in rework on eSignature applications.

[1] Marketing Pulse Adviser Study, December 2020.
[2] Fifth Quadrant, February 2021.

Adviser referral program

Changes in the advice landscape continue to impact customers, who are looking for a closer relationship with Challenger as a retirement expert. Customers want information about changes that impact retirees and are concerned about how to find a new adviser. Challenger has implemented an Adviser Referral program, referring new and existing customers who do not have a financial adviser, to an external panel of advisers who have experience in retirement planning and income advice. This program has assisted customers with a referral to an accredited Financial Planner.

Provide customers with excellent funds management solutions

Challenger is focused on providing excellent funds management solutions in order to help people build their wealth and savings for retirement.

FY21 progress:

Distributor of the year

In FY21, Funds Management is one of the fastest growing Australian active investment managers[1], attracting net inflows of $16 billion, representing 20% of opening period FUM.

FUM growth is benefiting from a diverse range of boutique managers covering key asset classes and high-quality retail and institutional sales teams. In FY21, FUM increased in all but one of Fidante Partners' boutiques. Four boutiques finished FY21 with FUM exceeding $10 billion, up from one boutique in FY20.

Fidante Partners' distribution capability continues to be externally recognised and in FY21 won Distributor of the Year at the annual Zenith Investment Partners (Zenith) Fund Awards. Zenith recognised Fidante Partners' sales teams and broad distribution footprint.

Top ranking wholesale trust for inflows

Fidante ranked as the top Australian active manager for retail net flows in 2020/21 with the highest net flows among 117 active managers[1]. Fidante Partners also ranked number one for retail flows in both fixed income and equities.

The Ardea Real Outcome Fund achieved the highest inflows of any wholesale investment trust in the entire Australian market for the second consecutive year[2] and is the fastest growing Active Exchange Traded Fund (ETF) in Australia[3]. The Ardea Real Outcome Fund also received its 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 developing new investment strategies for existing managers, adding new boutiques and forming partnerships with best-in-class investment managers.

New products for existing managers

Ardea Investment Management launched the Ardea Global Alpha Fund, a relative value fixed income fund investing in a global portfolio of high-quality government bonds and related derivatives. The fund is an Undertakings for the Collective Investment in Transferable Securities (UCITS) compliant version of the Ardea Real Outcome Fund which is one of the fastest growing fixed income strategies in Australia and provides a platform for offshore investors to access a strategy that has been very popular with Australian investors. The fund will be distributed across the United Kingdom and select European markets and will be among a number of products available for Southeast Asian distribution.

In November 2020, Ares Australia Management launched its second product - the Ares Diversified Credit Fund (ADCF), which offers investors direct access to global private credit markets not readily accessible by Australian wholesale investors. In May 2021, the Ares Global Credit Income Fund received a recommended rating from Zenith Investment Partners.

Alphinity Investment Management launched a new Global Sustainable Equity Fund. The fund aims to invest in quality global companies that are supporting a transition to a more sustainable future and are also identified as undervalued and within an earnings upgrade cycle. A Sustainable

[1] Plan For Life Wholesale Trust Data, September 2020, December 2020 and March 2021.
[2] Plan For Life Wholesale Trust Data, September 2020.
[3] ASX Investment Products monthly update July 2020 to June 2021, inflow/outflows.

Advisory Compliance Committee, including two recognised independent ESG experts, will provide specialist insights and ensure the Fund remains 'true to label' and aligned with the fund's Charter.

New boutiques

Fidante Partners has an active program of seeking and screening potential new boutique managers. In FY21, Fidante Partners announced the launch of a new emerging market boutique manager, Ox Capital Management.

Ox Capital Management brings together a team of highly experienced portfolio managers and analysts with extensive experience investing in Asia and other dynamic emerging markets. Ox Capital Management will launch a long-only and a long-short emerging market equity fund in FY22.

New partnerships

In April 2021, Fidante Partners and global specialist asset manager Impax Asset Management Limited entered into a new partnership agreement, with Fidante Partners becoming Impax's exclusive distribution partner in Australia and New Zealand. Impax Asset Management Group is a global leader dedicated to investing in the transition to a more sustainable global economy.

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

Funds Management also entered into a distribution partnership agreement with the number one Japanese investment trust manager, Nomura Asset Management. Fidante Partners has been selected to distribute the Nomura Global Dynamic Bond Fund and Nomura Global Multi-Theme Equity Fund products in Australia and New Zealand on behalf of Nomura Asset Management.

CIP Asset Management fixed income product expansion

Challenger is Australia's largest fixed income manager, with Fidante Partners managing $41 billion and CIP Asset Management (CIPAM) fixed income franchise managing over $16 billion across multiple strategies, comprising both public and private credit investments.

CIPAM was formed over 20 years ago, with the business evolving from providing investment management for Challenger Life to managing money for institutional clients. Over the past four years, the business has expanded its offering to a wider group of investors, which include retail and high net worth clients. In 2020, it rebranded to CIP Asset Management as it increased its focus on retail investors.

Following this rebrand, CIPAM launched a retail version of the CIP Asset Management Credit Income Fund in October 2020, which is a floating rate, multi-sector credit strategy investing in public and private debt markets. 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. The fund also received its first retail research ratings, a Recommend rating from both Zenith Investment Partners and Lonsec.

In December 2020, CIPAM launched its third income-oriented fund and attracted 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.

In May 2021, CIPAM launched a new wholesale share class of its flagship Multi Sector Private Lending Fund, providing the opportunity for wholesale/sophisticated individual investors to access the offering. The fund was launched in February 2020 and is a multi-sector credit strategy investing in Australian and New Zealand private securitised, corporate and real estate lending.

In addition to a range of institutional client mandates, CIPAM now has three income focused credit funds that provide investors with a range of return and risk options, ranging from cash plus three percent (credit income fund) per annum, cash plus five percent (multi asset fund) per annum and cash plus eight percent (private lending opportunities fund) per annum.

Diversifying globally

Funds Management continues to see significant growth opportunities in Australia and recognises the opportunity to diversify globally. Distribution efforts over the past few years are now showing great momentum and are expected to support future net flows.

Funds Management has been selectively expanding offshore and is focusing on markets where it has the right product, there is the right market structure and where it can build the right sales capability. After selectively expanding into the European and Japanese markets through our presence in London and Tokyo, Challenger opened an office in Singapore in May 2021. The Singapore office will provide a distribution hub to access investors across Asia.

In Europe, Fidante Partners FY21 sales remained robust despite the disruption from the pandemic on European sales activity. A range of investment strategies have been successful and are attracting new customers. More recently, Fidante Partners won its first major multi-geography (Australia and UK) mandate win of over A$1 billion, which will be funded in FY22.

In Japan, CIPAM won its first mandate to manage Japanese real estate for a third-party client, investing in a diverse portfolio of real estate assets across Japan.

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 very strong with 92% of FUM outperforming benchmark over three years and 96% over five years[1]. Since fund inception, 84% of Fidante Partners' funds have achieved either first or second quartile investment performance [2].

Award-winning investment strategies

Fidante Partners' investment managers continue to be externally recognised. During FY21, 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);
- Eiger Australian Small Companies Fund – Money Management 2021 FMOTY Awards – Emerging Manager;
- Greencape Broadcap Fund – Financial Standard Investment Leadership Awards – Australian Equities Active Core (2021);
- Ardea Investment Management – Zenith Fund Awards - Global and Diversified Fixed Interest (2020); and
- Alphinity Sustainable Share Fund, Greencape Broadcap Fund, Greencape High Conviction Fund – Canstar 2021 Managed Fund Star Ratings and Awards Australian Shares Large Cap (funds that invest in domestic stocks which are in the top 70% of the stock market by value).

In addition to these investment manager awards, Fidante Partners was awarded the Zenith Distributor of the Year award 2020. This award recognises the quality of investment managers as well as the operating and distribution platform which supports them.

Highly rated retail investment products

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

- 35% 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
- 80% of ratings are a 'buy' rating compared to an average of approximately 73% across the Australian funds management industry.

The quality and performance of Fidante Partners' investment managers and funds continue to receive strong independent validation. At 30 June 2021, Zenith rated 20 out of the 24 ratings awarded to Fidante Partners' funds as either Recommended or Highly Recommended.

[1] As at 30 June 2021. Percentage of Fidante Partners Australian boutiques meeting or exceeding performance benchmark.
[2] Mercer as at June 2021.

In addition to the retention of a number of ratings, there were a number funds that received rating upgrades from primary research houses. These included two 'Highly Recommended' (from 'Recommended') by Lonsec, one 'Highly Recommended' (from 'Recommended') by Zenith and one to Bronze by Morningstar[1]. There were also eight first time ratings, of which six were 'buys' across ActiveX, Alphinity, Ares Australia Management, CIPAM and Whitehelm managers.

Embedding ESG across the Funds Management platform

Principles for Responsible Investment (UNPRI) is a United Nations-supported international network of investors working together to implement its six aspirational principles. Its goal is to understand the implications of sustainability for investors and support signatories to facilitate incorporating these issues into their investment decision-making and ownership practices.

Reflecting Challenger's commitment to sustainable investing, Funds Management established a Responsible Investment Committee during the year. In the Principles for Responsible Investment Assessment Report 2020, Challenger received an "A" rating.

In FY21, Challenger continued to develop its ESG practices and supported Fidante Partners to embed ESG practices within their boutique fund managers. All boutiques have developed their own standalone ESG policies and are now signatories to the UNPRI.

Within Fidante Partner's boutiques, Alphinity launched a Global Sustainable Share Fund, and Whitehelm Listed Core Infrastructure Fund rebranded as Low Carbon Infrastructure Fund to better represent their ESG approach.

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.

FY21 progress:

High employee engagement and strong risk culture

Employee engagement measures the strength of the relationship between an organisation and its employees. Challenger believes having a highly engaged team that is inspired by its business purpose and its values will lead to superior customer and shareholder outcomes.

Challenger's employee engagement survey conducted by Willis Towers Watson in April 2021 showed that despite the COVID-19 pandemic and shift to work from home, Challenger has maintained high employee engagement achieving an overall sustainable engagement score of 85%. This was 1% higher than Challenger's 2019 result and in line with the global high performing norm.

Challenger has a strong risk culture, which was reflected in a risk culture score of 86% in the latest employee engagement score. The score was four points above the Global High Performing Norm, and 10% higher than the Australian National Norm. The consistently high-risk culture result confirms risk culture is embedded right across the business.

Diversity and inclusion

Challenger believes that a diverse and inclusive workplace delivers better outcomes for employees, the business and the community.

Challenger continued to make progress implementing its Diversity and Inclusion strategy and achieved a Diversity and Inclusion score of 94% in the annual employee engagement survey. This was 11 points above the Australian National Norm and 12 points above the Global High Performing Norm. In addition:

- 98% of employees believe gender-based harassment and sexual harassment is not tolerated;
- 95% of employees believe we have a working environment that is accepting of differences in personal identity; and
- 94% of employees have the flexibility they need to manage their work and other commitments.

[1] Ardea Real Outcome Fund and Lennox Microcap Fund both upgraded to Highly Recommended by Lonsec and Lennox Small Companies Fund upgraded to Bronze by Morningstar.

During FY21, Challenger continued to be recognised as an employer of choice for women, and was included in:

- Workplace Gender Equality Agency (WGEA) Employer of Choice for Gender Equality;
- Equileap Global Top 100 employer for gender equality; and
- The Bloomberg Global Gender Equality Index.

Challenger also joined the Pride in Diversity network – a leading not-for-profit support program providing inclusion strategies for LGBTQI+ persons and submitted responses to the Australian Workplace Equality Index's annual questionnaire on how supported LGBTQI+ persons feel at work.

Refreshing approach to sustainability

Challenger evolved its sustainability strategy in FY21 to reflect Challenger's most material environmental, social and governance opportunities and align it to its purpose.

With focus on responsible investment across stakeholder groups increasing, Challenger's updated sustainability strategy reflects a strengthened focus on responsible investing.

Challenger's sustainability strategy focuses on:

- Financially resilient customers and communities;
- Constructive public policy settings;
- Doing things right; and
- Responsible investment.

To support the implementation of Challenger's sustainability strategy, a group-wide ESG steering committee has been established. The committee includes representatives from across the business that meet regularly to assess and progress ESG related initiatives. The committee also provide updates and recommendations to the Challenger Board.

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. Prior to the COVID-19 pandemic, Challenger had strong flexible work foundations. During the pandemic this was accelerated with almost 100% of employees moving to remote work. Business continuity has been maintained throughout the pandemic.

Challenger recognises that the way employees work has changed forever, and organisations need to adapt to leverage the benefits. Challenger is promoting and supporting a hybrid work model that supports employee engagement and delivers on Challenger's organisational strategy. Challenger is supporting leaders and employees to introduce new ways of working that balance the needs of the team, organisation and individuals, providing an opportunity to build an even more diverse and inclusive workplace.

To support hybrid work, Challenger has adopted cloud-based collaboration tools and rolled out new laptops to employees. A Future of Work Group has been formed to work with employees to constantly evolve Challenger's work practices.

Community partnership with the Council on the Ageing NSW (COTA)

Challenger's partnership with COTA New South Wales, was established in 2019 to deliver a program of research, advice and practical support to address the underemployment of people over 50. The program aims to encourage people to talk about ways to tackle perceptions and misconceptions around older workers. This includes giving employers the tools to attract and retain older employees.

Enabling people to work for as long as they wish provides a range of benefits for individuals and the economy and aligns strongly with Challenger's purpose of helping provide financial security for a better retirement.

In FY21, working alongside both COTA NSW and Newgate Research, Challenger published its first piece of research on understanding the needs of older workers and how businesses can enhance their workplaces for older Australians.

Based on insights of this research, a program and toolkit are being designed, covering:

- Education and advice for hiring managers;
- Support for auditing existing programs and policies, and building new ones to promote age diversity;
- Advice on fostering connections between age diverse groups at work; and
- Developing training programs to deliver equal access to upskilling and training opportunities.

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:

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

Commitment to effective climate change management

Challenger recognises 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.

Challenger is committed to supporting progress in transitioning to a low carbon economy. This year, Challenger published its first climate change statement outlining its overall approach to climate change and how it considers climate-related risks and opportunities. This includes working with internal and external stakeholders to find ways to reduce risk and create a more resilient economy.

Challenger's strong governance supports the resilience of its business, with the Board having oversight of climate-related risks and opportunities. A newly established ESG Steering Committee that provides quarterly reporting to the Group Risk Committee, will enhance this process in FY22.

Became a signatory to the Investors Against Slavery and Trafficking initiative

Investors Against Slavery and Trafficking (IAST) Asia-Pacific 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 S&P/ASX100 companies setting out investor expectations on how these issues are considered in their practices.

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

	FY21	FY20	FY19	2H21	1H21	2H20	1H20	2H19	1H19
Earnings									
Normalised NPBT ($m)	395.8	506.5	548.3	199.6	196.2	227.9	278.6	278.3	270.0
Normalised NPAT ($m)	278.5	343.7	396.1	141.7	136.8	152.3	191.4	196.3	199.8
Statutory NPAT ($m)	592.3	(416.0)	307.8	369.5	222.8	(636.4)	220.4	301.7	6.1
Underlying operating cash flow ($m)	156.8	194.7	236.9	37.3	119.5	54.7	140.0	133.2	103.7
EBIT margin (%)	58.8%	64.3%	67.4%	56.7%	61.0%	61.9%	66.5%	67.5%	67.3%
Normalised cost to income ratio (%)	41.2%	35.7%	32.6%	43.3%	39.0%	38.1%	33.5%	32.5%	32.7%
Normalised effective tax rate (%)	29.6%	32.1%	27.8%	29.0%	30.3%	33.2%	31.3%	29.5%	26.0%
Earnings per share (cents)									
Basic – normalised	41.5	56.5	65.5	21.1	20.4	25.0	31.5	32.4	33.1
Basic – statutory	88.2	(68.4)	50.9	54.9	33.2	(104.4)	36.3	49.8	1.0
Diluted – normalised	33.8	46.9	56.0	17.8	17.5	21.1	27.7	27.8	30.1
Diluted – statutory	68.0	(68.4)	44.8	43.4	27.3	(104.4)	31.5	41.2	1.0
Return On Equity (%)									
Normalised ROE – pre-tax	11.2%	14.8%	15.8%	11.1%	11.5%	14.0%	15.2%	16.2%	15.6%
Normalised ROE – post-tax	7.9%	10.0%	11.4%	7.8%	8.0%	9.4%	10.4%	11.4%	11.5%
Statutory ROE – post-tax	16.8%	(12.1%)	8.9%	20.5%	13.0%	(39.2%)	12.0%	17.5%	0.3%
Capital management									
Net assets – average[1] ($m)	3,519	3,424	3,462	3,641	3,396	3,257	3,634	3,469	3,443
Net assets – closing ($m)	3,826	3,250	3,600	3,826	3,513	3,250	3,716	3,600	3,388
Net assets per basic share ($)	5.69	4.90	5.94	5.69	5.23	4.90	6.12	5.94	5.60
Net tangible assets ($m)	3,202	2,619	3,019	3,202	2,877	2,619	3,079	3,019	2,793
Net tangible assets per basic share ($)	4.76	3.95	4.98	4.76	4.28	3.95	5.07	4.98	4.61
Dividend (cps)	20.0	17.5	35.5	10.5	9.5	-	17.5	18.0	17.5
Dividend franking (%)	100.0	100.0	100.0	100.0	100.0	-	100.0	100.0	100.0
Normalised dividend payout ratio (%)	48.2%	31.0%	54.2%	49.8%	46.6%	-	55.5%	55.6%	52.9%
CLC PCA ratio (times)	1.63	1.81	1.53	1.63	1.63	1.81	1.54	1.53	1.54
CLC CET1 ratio (times)	1.14	1.20	1.06	1.14	1.09	1.20	1.07	1.06	1.04
Sales, net flows and assets under management									
Life annuity sales ($m)	4,566.0	3,127.4	3,543.1	2,375.0	2,191.0	1,170.5	1,956.9	1,402.6	2,140.5
Other Life sales ($m)	2,362.1	2,024.0	1,006.9	1,115.6	1,246.5	841.8	1,182.2	407.1	599.8
Total Life sales ($m)	6,928.1	5,151.4	4,550.0	3,490.6	3,437.5	2,012.3	3,139.1	1,809.7	2,740.3
Life annuity net flows ($m)	1,079.8	(251.1)	685.8	922.2	157.6	(344.7)	93.6	192.3	493.5
Life annuity book ($m)	13,670	12,581	12,870	13,670	12,770	12,581	12,845	12,870	12,324
Life annuity book growth (%)	8.6%	(2.0%)	5.8%	7.3%	1.3%	(2.7%)	0.7%	1.6%	4.2%
Total Life net flows ($m)	2,163.8	315.8	474.8	1,455.1	708.7	(607.8)	923.6	(108.9)	583.7
Total Life book[2] ($m)	17,302	14,997	14,836	17,302	15,801	14,997	15,551	14,836	14,496
Total Life book growth (%)	14.4%	2.1%	3.4%	9.7%	4.7%	(4.1%)	6.2%	(0.8%)	4.2%
Funds Management – net flows ($m)	16,111.5	2,540.9	(2,438.4)	9,688.1	6,423.4	661.3	1,879.6	(1,461.3)	(977.1)
Total Group AUM ($m)	109,960	85,237	81,770	109,960	96,087	85,237	86,339	81,770	78,386
Other									
Headcount – closing FTEs[3]	738	735	687	738	709	735	717	687	675
Weighted average number of basic shares on issue (m)	671.6	608.3	605	672.3	670.8	609.6	607.1	605.7	604.4
Number of basic shares on issue (m)	672.6	663.1	605.8	672.6	672.2	663.1	607.6	605.8	605.4
Share price closing ($)	5.41	4.41	6.64	5.41	6.44	4.41	8.09	6.64	9.49

[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	FY21	FY20	FY19	2H21	1H21	2H20	1H20	2H19	1H19
Cash earnings	478.7	518.7	515.0	251.0	227.7	244.5	274.2	263.5	251.5
Normalised capital growth	34.1	120.2	155.1	17.8	16.3	49.6	70.6	77.0	78.1
Normalised Cash Operating Earnings (COE)	**512.8**	**638.9**	**670.1**	**268.8**	**244.0**	**294.1**	**344.8**	**340.5**	**329.6**
Net fee income	169.3	158.1	149.9	88.0	81.3	80.4	77.7	74.7	75.2
Other income	-	0.4	1.0	(0.0)	0.0	0.2	0.2	0.5	0.5
Total net income	**682.1**	**797.4**	**821.0**	**356.8**	**325.3**	**374.7**	**422.7**	**415.7**	**405.3**
Personnel expenses	(179.9)	(174.0)	(185.3)	(93.7)	(86.2)	(82.7)	(91.3)	(93.2)	(92.1)
Other expenses	(101.4)	(110.4)	(82.1)	(60.8)	(40.6)	(60.1)	(50.3)	(41.8)	(40.3)
Total expenses	**(281.3)**	**(284.4)**	**(267.4)**	**(154.5)**	**(126.8)**	**(142.8)**	**(141.6)**	**(135.0)**	**(132.4)**
Normalised EBIT	**400.8**	**513.0**	**553.6**	**202.3**	**198.5**	**231.9**	**281.1**	**280.7**	**272.9**
Interest and borrowing costs	(5.0)	(6.5)	(5.3)	(2.7)	(2.3)	(4.0)	(2.5)	(2.4)	(2.9)
Normalised profit before tax	**395.8**	**506.5**	**548.3**	**199.6**	**196.2**	**227.9**	**278.6**	**278.3**	**270.0**
Normalised tax	(117.3)	(162.8)	(152.2)	(57.9)	(59.4)	(75.6)	(87.2)	(82.0)	(70.2)
Normalised profit after tax	**278.5**	**343.7**	**396.1**	**141.7**	**136.8**	**152.3**	**191.4**	**196.3**	**199.8**
Investment experience after tax	318.6	(750.3)	(88.3)	231.5	87.1	(788.7)	38.4	105.4	(193.7)
Significant items after tax[1]	(4.8)	(9.4)	-	(3.7)	(1.1)	-	(9.4)	-	-
Statutory net profit after tax	**592.3**	**(416.0)**	**307.8**	**369.5**	**222.8**	**(636.4)**	**220.4**	**301.7**	**6.1**
Performance analysis									
Normalised EPS – basic (cents)	41.5	56.5	65.5	21.1	20.4	25.0	31.5	32.4	33.1
Shares for basic EPS calculation (m)	671.6	608.3	605.0	672.3	670.8	609.6	607.1	605.7	604.4
Normalised cost to income ratio (%)	41.2%	35.7%	32.6%	43.3%	39.0%	38.1%	33.5%	32.5%	32.7%
Normalised tax rate (%)	29.6%	32.1%	27.8%	29.0%	30.3%	33.2%	31.3%	29.5%	26.0%
Total net income analysis (%)									
Cash earnings (Life)	70.2%	65.0%	62.7%	70.3%	70.0%	65.2%	64.9%	63.4%	62.1%
Normalised capital growth (Life)	5.0%	15.1%	18.9%	5.0%	5.0%	13.2%	16.7%	18.5%	19.3%
Net fee income (Funds Management)	24.8%	19.8%	18.3%	24.7%	25.0%	21.5%	18.4%	18.0%	18.5%
Other income (Corporate)	0.0%	0.1%	0.1%	0.0%	0.0%	0.1%	0.0%	0.1%	0.1%
Normalised EBIT by division ($m)									
Life	398.9	524.7	563.6	206.1	192.8	238.9	285.8	285.7	277.9
Funds Management	71.0	57.7	50.9	35.7	35.3	29.8	27.9	24.8	26.1
Corporate	(69.1)	(69.4)	(60.9)	(39.5)	(29.6)	(36.8)	(32.6)	(29.8)	(31.1)
Normalised EBIT	**400.8**	**513.0**	**553.6**	**202.3**	**198.5**	**231.9**	**281.1**	**280.7**	**272.9**

[1] FY21 significant items (after-tax) of $5m represents the write-off of Challenger's investment in Avenir Capital, a boutique investment manager, following its closure and transaction costs associated with the MyLife MyFinance bank acquisition (refer to page 3 for more detail). 1H20 significant items (after-tax) of $9m represent the write-off of a Fidante Partners boutique intangible asset and costs associated with the closure of the FME Asset Management boutique investment manager.

Consolidated profit and loss (continued)

Normalised profit after tax

FY21 normalised profit after tax was $279m and decreased by $65m (19%) from $344m in FY20. The decrease reflects lower normalised profit before tax (down $111m), partially offset by lower normalised tax (down $46m).

Normalised earnings per share (EPS)

Normalised EPS decreased by 27% on FY20 to 41.5cps. The decrease reflects lower normalised profit after tax (down 19%) and a higher average number of basic shares on issue (up 10%).

The weighted average number of basic shares on issue in FY21 was 672m shares, up 63m shares on FY20. The weighted average number of basic shares increased predominantly as a result of the institutional placement and share purchase plan announced in June 2020.

Net income

FY21 net income was $682m and decreased by $115m (down 14%) on FY20, with:

- Life Normalised Cash Operating Earnings (COE) of $513m was down $126m (20%), as a result of repositioning the investment portfolio to more defensive settings during the COVID-19 pandemic market sell-off; and
- Funds Management fee income of $169m was up $11m (7%), from higher FUM-based revenue, partially offset by lower performance fees.

Expenses

FY21 total expenses were $281m and decreased by $3m (down 1%) on FY20. Personnel expenses increased by $6m from higher variable reward costs and other expenses reduced by $9m as a result of lower marketing, travel and entertainment, and occupancy costs.

The FY21 normalised cost to income ratio was 41.2% and increased by 5.5 percentage points on FY20. The increase in the cost to income ratio was driven by lower net income (down 14%), partially offset by lower expenses (down 1%).

Normalised EBIT

FY21 normalised EBIT was $401m, down $112m (22%) on FY20. Lower Life EBIT (down $126m) was partially offset by higher Funds Management EBIT (up $13m).

Life EBIT decreased by $126m (down 24%) to $399m and reflected lower normalised COE (down $126m).

Funds Management EBIT increased by $13m (up 23%) to $71m, from higher FUM-based management fees (up $16m), and lower expenses (down $2m), partially offset by lower non-FUM based income (down $6m).

Corporate EBIT was -$69m and unchanged on FY20.

Normalised Return On Equity (ROE)

FY21 normalised ROE (pre-tax) was 11.2% and decreased by 360 bps on FY20. Lower normalised ROE reflects lower normalised profit before tax (down 22%) and higher average Group net assets. Group net assets were 3% higher than FY20 reflecting higher retained earnings.

Normalised tax

Normalised tax was $117m in FY21 and decreased by $46m (28%) on FY20. Lower normalised tax reflects lower normalised net profit before tax and a lower normalised effective tax rate.

The normalised effective tax rate in FY21 was 29.6%, down from 32.1% in FY20. 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 61 for more detail).

FY21 investment experience was a gain of $319m (after-tax) reflecting the reversal of unrealised pandemic related investment market losses incurred in 2H20.

Refer to page 29 for more detail, including investment experience by asset class.

Significant items

FY21 significant items were $5m (after-tax) and represent transaction costs associated with the MyLife MyFinance acquisition ($1m) (refer to page 3 for more detail) and the write-off of Challenger's investment in Avenir Capital ($4m).

Avenir Capital is a Fidante Partners boutique, which was closed following a review of its business and determination that it had not achieved significant operating scale.

Statutory net profit after tax

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

FY21 statutory profit after tax was $592m, increased by $1.0bn on FY20, and includes:

- Normalised net profit after tax of +$279m;
- Life investment experience of +$319m (refer to page 29 for more detail); and
- Significant items of -$5m.

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, in order to maintain a strong capital position, the Challenger Board did not declare a final FY20 dividend.

With an improved economic outlook and more stable investment market conditions, the Challenger Board recommenced paying shareholder dividends in FY21.

FY21 Dividend

The Challenger Board has declared a fully franked final FY21 dividend of 10.5 cps, bringing the full year dividend to 20.0 cps (fully franked), compared to 17.5 cps (fully franked) in FY20.

Dates for the final FY21 dividend are as follows:

- ex-date: 30 August 2021;
- record date: 31 August 2021;
- Dividend Reinvestment Plan (DRP) election date: 1 September 2021; and
- payment date: 22 September 2021.

The FY21 dividend payout ratio was 48.2%, which is within Challenger's normalised dividend payout ratio target of between 45% and 50% of normalised profit after tax. Challenger operates a DRP (refer below) which has the effect of reducing the cash dividend paid.

Challenger's franking account balance at 30 June 2021 was $119m. 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.

For the interim FY21 dividend, the DRP had the effect of reducing the effective cash dividend payout ratio by approximately 4.5%.

FY22 outlook

Normalised net profit before tax guidance

Challenger's FY22 normalised net profit before tax guidance is a range of between $430m and $480m. The mid-point of the guidance range ($455m) represents Challenger's best estimate and would result in Challenger achieving its Normalised ROE pre-tax target (refer below). The mid-point of the guidance range is expected to result in:

- a Life COE margin of approximately 2.5%;
- a Life PCA ratio of around 1.60x with the more defensive investment portfolio settings maintained; and
- no material contribution from the recently acquired Bank.

Normalised Return On Equity (ROE) target

Commencing from FY22, Challenger's Normalised ROE (pre-tax) target has been revised from the Reserve Bank of Australia (RBA) cash rate plus a margin of 14% to the cash rate plus a margin of 12%.

The reduction in the ROE target reflects Challenger's decision to enhance its risk settings and hold higher levels of excess capital.

From FY22, Challenger is extending its target PCA ratio to 1.30 times to 1.70 times (from 1.30 times to 1.60 times) and is targeting to operate around 1.60 times (refer to page 49 for more detail).

The Normalised ROE target of RBA cash rate plus a margin of 14% was set based on the mid-point of the PCA range of 1.30 times to 1.60 times (i.e. set at 1.45 times).

As a result of increasing the targeted excess capital operating level, up from 1.45 times to 1.60 times, the Normalised ROE target reduces by 2% from FY22 to the RBA cash rate plus a margin of 12%.

There has been no change to how the target is applied in business decision-making, including capital allocation, annuity pricing and business case assessment.

In FY21, the average RBA cash rate was 15 bps, resulting in Challenger's Normalised ROE target being 14.15% for FY21.

Normalised effective tax rate

The FY21 normalised effective tax rate was 29.6% and is broadly in line with Australia's 30% corporate tax rate.

Over the medium and long 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.

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 sheet[1]

$m	FY21	1H21	FY20	1H20	FY19	1H19
Assets						
Life investment assets						
Fixed income and cash[2]	16,418.2	14,821.1	13,970.6	12,956.7	12,459.8	12,014.5
Property[2]	3,467.5	3,316.2	3,292.1	3,337.8	3,382.0	3,739.4
Equity and infrastructure[2,3]	623.2	604.2	393.4	2,035.9	2,042.3	1,778.3
Alternatives[3]	1,054.3	892.5	647.2	1,338.8	1,126.3	1,092.1
Life investment assets	**21,563.2**	**19,634.0**	**18,303.3**	**19,669.3**	**19,010.4**	**18,624.3**
Cash and cash equivalents (Group cash)	223.0	136.6	146.1	141.2	91.5	87.7
Receivables	115.9	127.7	163.0	121.2	182.7	167.7
Derivative assets	641.9	450.1	522.9	403.3	331.2	158.7
Investment in associates	83.2	63.3	63.0	56.1	58.1	53.4
Other assets	63.1	61.4	65.8	60.3	76.6	57.0
Fixed assets	28.2	25.1	25.9	27.3	28.3	29.7
Right-of-use lease assets[4]	34.7	37.9	32.4	34.4	-	-
Tax assets	-	-	43.1	-	-	-
Goodwill and intangibles	589.1	597.5	598.0	602.0	581.2	594.9
Less Group/Life eliminations[5]	(31.3)	(36.3)	(41.0)	(44.8)	(62.4)	(63.5)
Total assets	**23,311.0**	**21,097.3**	**19,922.5**	**21,070.3**	**20,297.6**	**19,709.9**
Liabilities						
Payables	196.9	162.4	191.4	189.6	256.1	306.5
Tax liabilities	104.8	39.7	-	204.8	158.2	31.8
Derivative liabilities	507.6	143.7	136.2	118.8	227.0	276.3
Subordinated debt	404.5	401.7	395.7	404.9	403.9	400.6
Challenger Capital Notes	863.3	881.6	799.5	798.3	796.5	794.7
Group debt	-	50.0	50.0	-	-	-
Lease liabilities[4]	70.3	72.4	67.6	70.2	-	-
Provisions	35.7	31.8	35.5	17.0	19.2	16.1
Life annuity liabilities	13,669.9	12,769.7	12,581.2	12,845.3	12,870.2	12,323.7
Challenger Index Plus Fund liabilities	3,632.2	3,031.5	2,415.8	2,705.6	1,966.2	2,172.3
Total liabilities	**19,485.2**	**17,584.5**	**16,672.9**	**17,354.5**	**16,697.3**	**16,322.0**
Group net assets	**3,825.8**	**3,512.8**	**3,249.6**	**3,715.8**	**3,600.3**	**3,387.9**
Equity						
Contributed equity	2,425.5	2,422.6	2,377.6	2,110.8	2,093.7	2,090.2
Reserves	(50.9)	(55.5)	(50.9)	(61.0)	(52.4)	(66.0)
Retained earnings	1,451.2	1,145.7	922.9	1,666.0	1,559.0	1,363.7
Total equity	**3,825.8**	**3,512.8**	**3,249.6**	**3,715.8**	**3,600.3**	**3,387.9**

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	FY21	1H21	FY20	1H20	FY19	1H19
Opening net assets	**3,512.8**	**3,249.6**	**3,715.8**	**3,600.3**	**3,387.9**	**3,485.4**
Statutory net profit after tax	369.5	222.8	(636.4)	220.4	301.7	6.1
Dividends paid	(64.0)	-	(106.7)	(109.7)	(106.4)	(109.4)
New share issue	2.9	34.8	266.8	2.6	3.4	3.4
Reserve movements	4.6	(4.6)	10.1	(8.6)	13.7	(32.7)
CPP[1] Trust movements	-	10.2	-	14.5	-	35.1
Transition of new leasing standard[2]	-	-	-	(3.7)	-	-
Closing net assets	**3,825.8**	**3,512.8**	**3,249.6**	**3,715.8**	**3,600.3**	**3,387.9**

1 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

	FY21	FY20	FY19	2H20	1H21	2H20	1H20	2H19	1H19
Earnings per share (cents)									
Basic – normalised	41.5	56.5	65.5	21.1	20.4	25.0	31.5	32.4	33.1
Basic – statutory	88.2	(68.4)	50.9	54.9	33.2	(104.4)	36.3	49.8	1.0
Diluted – normalised	33.8	46.9	56.0	17.8	17.5	21.1	27.7	27.8	30.1
Diluted – statutory	68.0	(68.4)	44.8	43.4	27.3	(104.4)	31.5	41.2	1.0
Number of shares (m)									
Basic share count	672.6	663.1	605.8	672.6	672.2	663.1	607.6	605.8	605.4
CPP[1] Trust treasury shares	3.4	4.4	5.8	3.4	3.4	4.4	4.4	5.8	5.8
Total issued shares	676.0	667.5	611.6	676.0	675.6	667.5	612.0	611.6	611.2
Movement in basic share count									
Opening	663.1	605.8	601.7	672.2	663.1	607.6	605.8	605.4	601.7
CPP[1] Trust deferred share purchase	-	-	(0.8)	-	-	-	-	-	(0.8)
Net Treasury shares (acquired)/released	1.0	1.4	4.2	(0.0)	1.0	-	1.4	-	4.2
New share issues	8.5	55.9	0.7	0.4	8.1	55.5	0.4	0.4	0.3
Closing	672.6	663.1	605.8	672.6	672.2	663.1	607.6	605.8	605.4
Movement in CPP Trust Treasury shares									
Opening	4.4	5.8	9.2	3.4	4.4	4.4	5.8	5.8	9.2
Shares vested to participants	(1.0)	(1.4)	(4.2)	0.0	(1.0)	-	(1.4)	-	(4.2)
CPP[1] Trust deferred share purchase	-	-	0.8	-	-	-	-	-	0.8
Shares bought into CPP Trust	-	-	-	-	-	-	-	-	-
Closing	3.4	4.4	5.8	3.4	3.4	4.4	4.4	5.8	5.8
Weighted average number of shares (m)									
Basic EPS shares									
Total issued shares	675.2	612.8	611.2	675.9	674.6	614.0	611.8	611.4	611.0
Less CPP[1] Trust Treasury shares	(3.6)	(4.5)	(6.2)	(3.6)	(3.8)	(4.4)	(4.7)	(5.7)	(6.6)
Shares for basic EPS calculation	671.6	608.3	605.0	672.3	670.8	609.6	607.1	605.7	604.4
Diluted shares for normalised EPS									
Shares for basic EPS calculation	671.6	608.3	605.0	672.3	670.8	609.6	607.1	605.7	604.4
Add dilutive impact of unvested equity awards	8.7	4.2	4.5	2.4	5.9	4.2	4.3	2.9	7.1
Add dilutive impact of Capital Notes	178.3	145.5	117.8	155.0	136.3	145.5	99.5	117.8	85.1
Add dilutive impact of subordinated notes	59.1	59.1	58.5	59.1	59.1	59.1	49.5	58.5	42.3
Shares for diluted normalised EPS calculation	917.7	817.1	785.8	888.8	872.1	818.4	760.4	784.9	738.9
Diluted shares for statutory EPS									
Shares for basic EPS calculation	671.6	608.3	605.0	672.3	670.8	609.6	607.1	605.7	604.4
Add dilutive impact of unvested equity awards	8.7	-	4.5	2.4	5.9	-	4.3	2.9	7.1
Add dilutive impact of Capital Notes	178.3	-	117.8	155.0	136.3	-	99.5	117.8	-
Add dilutive impact of subordinated notes	59.1	-	58.5	59.1	59.1	-	49.5	58.5	-
Shares for diluted statutory EPS calculation	917.7	608.3	785.8	888.8	872.1	609.6	760.4	784.9	611.5
Summary of shares rights (m)									
Hurdled Performance Share Rights									
Opening	9.8	7.2	8.2	16.1	9.8	10.2	7.2	7.4	8.2
New grants	7.5	3.9	2.2	0.1	7.4	-	3.9	-	2.2
Vesting/forfeiture	(2.6)	(1.3)	(3.2)	(1.5)	(1.1)	(0.4)	(0.9)	(0.2)	(3.0)
Closing	14.7	9.8	7.2	14.7	16.1	9.8	10.2	7.2	7.4
Deferred Performance Share Rights									
Opening	2.1	2.5	2.8	2.9	2.1	2.1	2.5	2.6	2.8
New grants	1.8	1.1	1.4	-	1.8	-	1.1	-	1.4
Vesting/forfeiture	(1.0)	(1.5)	(1.7)	(0.0)	(1.0)	-	(1.5)	(0.1)	(1.6)
Closing	2.9	2.1	2.5	2.9	2.9	2.1	2.1	2.5	2.6

[1] 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 30 June 2021 was 676m shares. The number of shares on issue increased by 9m shares in FY21, predominantly due to 8m new shares issued under Challenger's Share Purchase Plan (SPP), which was completed in July 2020.

The SPP raised $35 million and followed an institutional placement that 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 22 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 hurdled 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 63m shares (up 10%) in FY21 to 672m shares.

The increase reflects the weighted impact of 63m new shares issued following the institutional placement and SPP announced in June 2020.

The weighted average number of shares used to determine normalised diluted EPS increased by 101m shares (up 12%) in FY21 to 918m shares. The increase primarily reflects a higher basic weighted average number of shares on issue (63m shares - refer above), the issue of Challenger Capital Notes 3 in November 2020 net of the repurchase of Challenger Capital Notes 1 (refer to pages 46 and 47) and a lower dilutive impact from Challenger debt instruments as a result of the increase in the Challenger's share price used to calculate potential dilution (refer to page 22).

The weighted average number of shares used to determine statutory diluted EPS increased by 309m shares (up 51%) in FY21 to 918m shares. In FY20, the weighted average number of shares used to determine the statutory diluted EPS was the same as the statutory basic EPS given Challenger recorded a statutory loss for the year. The dilutive impact of issuing more shares results in the loss incurred being spread over a higher share count, which would have resulted in a lower loss per share. In these circumstances, the dilutive EPS cannot be lower than the basic EPS.

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 effective sources of funding for Challenger.

Each of 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:

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

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 30 June 2021 was $5.41.

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 price
Challenger Capital Notes 1	9 Oct 2014	$28m	$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		**$1,273m**	

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 30 June 2021 ($5.41). Therefore, the VWAP floor price is used at 30 June 2021 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 dilutive impact for Challenger Capital Notes and Challenger Capital Notes 3.

Earnings per share

Normalised diluted EPS

The normalised basic EPS for FY21 of 41.5 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 FY21.

The weighted average number of shares used to determine the normalised diluted EPS increased by 101m shares in FY21.

The increase is due to:

- increase in weighted average number of basic shares on issue to reflect the institutional placement and Share Purchase Plan, which raised $305m of new shareholder equity (63m increase in basis share count);
- a $68m increase in face value of debt following the issuance of Challenger Capital Notes 3 and partial repurchases of Capital Notes 1 (refer to pages 46 and 47 for more detail); partially offset by
- a reduction in the dilutive impact of the remaining Challenger Capital Notes 1 and Challenger Capital Notes 3 as a result of an increase in Challenger's weighted average share price over the last 20 days of FY21. The volume weighted average share price was $5.41, 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 $32m 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	FY21	FY20	FY19	2H21	1H21	2H20	1H20	2H19	1H19
Receipts from customers	675.2	683.3	700.9	351.4	323.8	348.8	334.5	364.6	336.3
Dividends received	65.0	66.0	101.7	31.4	33.6	20.3	45.7	34.1	67.6
Interest received	604.7	711.9	780.4	294.4	310.3	327.0	384.9	367.0	413.4
Interest paid	(492.0)	(686.2)	(729.2)	(257.7)	(234.3)	(415.6)	(270.6)	(362.7)	(366.5)
Payments to suppliers and employees	(605.2)	(564.5)	(561.5)	(300.3)	(304.9)	(258.9)	(305.6)	(258.0)	(303.5)
Income tax (paid) / refunded	(90.9)	(15.8)	(55.4)	(81.9)	(9.0)	33.1	(48.9)	(11.8)	(43.6)
Underlying operating cash flow	**156.8**	**194.7**	**236.9**	**37.3**	**119.5**	**54.7**	**140.0**	**133.2**	**103.7**
Net annuity policy capital receipts/(payments)	1,079.8	(251.1)	685.8	922.2	157.6	(344.7)	93.6	192.1	493.7
Net other Life capital receipts/(payments)	1,084.0	566.9	(211.0)	532.9	551.1	(263.1)	830.0	(301.2)	90.2
(Purchase)/Proceeds of investments	(596.8)	(1,467.7)	(904.8)	(238.2)	(358.6)	(568.5)	(899.2)	333.8	(1,238.6)
Capital expenditures	(12.9)	(9.3)	(59.9)	(9.5)	(3.4)	(3.3)	(6.0)	(18.5)	(41.4)
Net equity placement proceeds	34.6	264.1	-	(0.2)	34.8	264.1	-	-	-
Net (repayments)/proceeds from borrowings	(1,355.7)	820.0	506.3	(967.8)	(387.9)	825.7	(5.7)	35.6	470.7
Receipts/(Payments) for Treasury shares	0.7	(8.3)	(47.5)	(1.7)	2.4	(4.5)	(3.8)	(7.8)	(39.7)
Net dividends paid	(61.1)	(211.0)	(209.0)	(61.1)	-	(103.9)	(107.1)	(103.0)	(106.0)
Net non-operating cashflows SPV's	(1.9)	(28.3)	(43.9)	1.6	(3.5)	(19.8)	(8.5)	(22.0)	(21.9)
Other cash flow	**170.7**	**(324.7)**	**(284.0)**	**178.2**	**(7.5)**	**(218.0)**	**(106.7)**	**109.0**	**(393.0)**
Net increase/(decrease) in cash and cash equivalents	**327.5**	**(130.0)**	**(47.1)**	**215.5**	**112.0**	**(163.3)**	**33.3**	**242.2**	**(289.3)**

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.

FY21 underlying operating cash flow was $157m, down $38m on FY20. The decrease in underlying operating cash flow reflects higher tax payments (up $75m), higher payments to suppliers (up $41m) and lower receipts from customers (down $8m), partially offset by higher interest and dividends received net of interest paid to customers (up $86m).

FY21 underlying operating cash flow ($157m) was $122m lower than normalised net profit after tax ($279m) mainly due to:

- non-cash normalised capital growth (-$34m);
- timing differences in relation to Fidante Partners boutique equity accounted profits and variable reward timing differences ($17m); and
- Challenger Index Plus distributions (-$135m) which relate to index distributions paid to clients in relation to the Challenger Index Plus product. The Challenger Guaranteed Index products pays a margin above an agreed index, which is hedged by Challenger. The cash settlement of the index to the client is recognised in the Financial Report as an operating cash flow, as required by Australian accounting standards. However, the hedges are either marked-to-market on the balance sheet or have cash settlement reflected through investing cash flows, as opposed to operating cashflow. There is no impact on total cashflows or normalised net profit after tax from this item.

Net annuity policy capital receipts

FY21 net annuity policy capital receipts were +$1.1bn and comprised:

- annuity sales of $4,566m; less
- annuity capital payments of $3,486m.

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

FY21 annuity net flows (+$1.1bn) represents annuity book growth of +8.6% for the year and is calculated as FY21 annuity total net flows divided by the opening period annuity liability of $12,581m.

FY21 annuity net flows benefited from an increase in sales (up 46% on FY20), partially offset by a slightly higher maturity rate. The maturity rate in FY21 was 27.7%.

Net other Life capital receipts

FY21 net other Life capital receipts were +$1.1bn and comprised:

- other Life sales of $2,362m; less
- other Life capital payments of $1,278m.

FY21 other Life net flows benefited from higher sales (up 17% on FY20) and lower maturities, which were 12% lower than FY20.

Other Life sales represent Institutional Guaranteed Index Plus. Total Institutional Guaranteed Index Plus maturities for the year were $1,278m, of which 91% were reinvested.

FY21 total Life book growth was +14.4% (FY20 +2.1%) and can be calculated as total FY21 net flows (+$2,164m) divided by the sum of the opening period liabilities of $14,997m (Life annuity liabilities and Challenger Index Plus Fund liabilities – refer to page 25 for more detail).

Life financial results

$m	FY21	FY20	FY19	2H21	1H21	2H20	1H20	2H19	1H19
Investment yield - policyholders' funds	752.4	840.5	871.3	377.1	375.3	398.4	442.1	438.8	432.5
Interest expense	(396.3)	(473.6)	(515.4)	(192.1)	(204.2)	(227.8)	(245.8)	(255.3)	(260.1)
Distribution expense	(9.4)	(10.5)	(18.3)	(4.6)	(4.8)	(4.8)	(5.7)	(7.3)	(11.0)
Other income[1]	40.0	47.2	33.6	20.6	19.4	31.2	16.0	15.3	18.3
Product cash margin	**386.7**	**403.6**	**371.2**	**201.0**	**185.7**	**197.0**	**206.6**	**191.5**	**179.7**
Investment yield – shareholders' funds	92.0	115.1	143.8	50.0	42.0	47.5	67.6	72.0	71.8
Cash earnings	**478.7**	**518.7**	**515.0**	**251.0**	**227.7**	**244.5**	**274.2**	**263.5**	**251.5**
Normalised capital growth	34.1	120.2	155.1	17.8	16.3	49.6	70.6	77.0	78.1
Normalised Cash Operating Earnings	**512.8**	**638.9**	**670.1**	**268.8**	**244.0**	**294.1**	**344.8**	**340.5**	**329.6**
Personnel expenses	(72.7)	(68.6)	(68.9)	(38.3)	(34.4)	(32.0)	(36.6)	(34.8)	(34.1)
Other expenses	(41.2)	(45.6)	(37.6)	(24.4)	(16.8)	(23.2)	(22.4)	(20.0)	(17.6)
Total expenses	**(113.9)**	**(114.2)**	**(106.5)**	**(62.7)**	**(51.2)**	**(55.2)**	**(59.0)**	**(54.8)**	**(51.7)**
Normalised EBIT	**398.9**	**524.7**	**563.6**	**206.1**	**192.8**	**238.9**	**285.8**	**285.7**	**277.9**
Asset and liability experience[2]	466.0	(1,102.4)	(70.2)	345.4	120.6	(1,157.3)	54.9	164.1	(234.3)
New business strain[2]	(10.9)	31.9	(33.3)	(14.8)	3.9	30.9	1.0	2.6	(35.9)
Total investment experience	**455.1**	**(1,070.5)**	**(103.5)**	**330.6**	**124.5**	**(1,126.4)**	**55.9**	**166.7**	**(270.2)**
Net profit after investment experience before tax	**854.0**	**(545.8)**	**460.1**	**536.7**	**317.3**	**(887.5)**	**341.7**	**452.4**	**7.7**
Reconciliation of investment experience to capital growth									
Asset and liability experience	466.0	(1,102.4)	(70.2)	345.4	120.6	(1,157.3)	54.9	164.1	(234.3)
Normalised capital growth	34.1	120.2	155.1	17.8	16.3	49.6	70.6	77.0	78.1
Asset and liability capital growth	**500.1**	**(982.2)**	**84.9**	**363.2**	**136.9**	**(1,107.7)**	**125.5**	**241.1**	**(156.2)**
Performance analysis									
Cost to income ratio[3] (%)	22.2%	17.9%	15.9%	23.3%	21.0%	18.8%	17.1%	16.1%	15.7%
Net assets – average[4] ($m)	3,220	3,163	3,164	3,365	3,065	2,982	3,388	3,164	3,151
Normalised ROE (pre-tax) (%)	12.4%	16.6%	17.8%	12.4%	12.5%	16.1%	16.8%	18.2%	17.5%

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 61 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	FY21	FY20	FY19	2H21	1H21	2H20	1H20	2H19	1H19
Sales									
Retail fixed term sales	1,689.1	1,369.4	2,121.7	778.9	910.2	594.0	775.3	747.5	1,374.2
Institutional fixed term sales	1,510.9	600.0	300.0	1,120.1	390.8	100.0	500.0	150.0	150.0
Japan sales	790.4	743.4	268.1	247.0	543.4	272.8	470.7	93.4	174.7
Fixed term sales	3,990.4	2,712.8	2,689.8	2,146.0	1,844.4	966.8	1,746.0	990.9	1,698.9
Lifetime sales	575.6	414.6	853.3	229.0	346.6	203.7	210.9	411.7	441.6
Life annuity sales	**4,566.0**	**3,127.4**	**3,543.1**	**2,375.0**	**2,191.0**	**1,170.5**	**1,956.9**	**1,402.6**	**2,140.5**
Maturities and repayments	(3,486.2)	(3,378.5)	(2,857.3)	(1,452.8)	(2,033.4)	(1,515.2)	(1,863.3)	(1,210.3)	(1,647.0)
Life annuity flows	**1,079.8**	**(251.1)**	**685.8**	**922.2**	**157.6**	**(344.7)**	**93.6**	**192.3**	**493.5**
Closing Life annuity book	13,669.9	12,581.2	12,870.2	13,669.9	12,769.7	12,581.2	12,845.3	12,870.2	12,323.7
Annuity book growth[1]	**8.6%**	**(2.0%)**	**5.8%**	**7.3%**	**1.3%**	**(2.7%)**	**0.7%**	**1.6%**	**4.2%**
Other Life sales	2,362.1	2,024.0	1,006.9	1,115.6	1,246.5	841.8	1,182.2	407.1	599.8
Other maturities and repayments	(1,278.1)	(1,457.1)	(1,217.9)	(582.7)	(695.4)	(1,104.9)	(352.2)	(708.3)	(509.6)
Other Life flows	**1,084.0**	**566.9**	**(211.0)**	**532.9**	**551.1**	**(263.1)**	**830.0**	**(301.2)**	**90.2**
Closing Challenger Index Plus Fund liabilities	3,632.2	2,415.8	1,966.2	3,632.2	3,031.5	2,415.8	2,705.6	1,966.2	2,172.3
Other Life net book growth	**44.9%**	**28.8%**	**(9.9%)**	**22.1%**	**22.8%**	**(13.4%)**	**42.2%**	**(14.1%)**	**4.2%**
Total Life sales	6,928.1	5,151.4	4,550.0	3,490.6	3,437.5	2,012.3	3,139.1	1,809.7	2,740.3
Total maturities and repayments	(4,764.3)	(4,835.6)	(4,075.2)	(2,035.5)	(2,728.8)	(2,620.1)	(2,215.5)	(1,918.6)	(2,156.6)
Total Life net flows	**2,163.8**	**315.8**	**474.8**	**1,455.1**	**708.7**	**(607.8)**	**923.6**	**(108.9)**	**583.7**
Closing total Life book[3]	17,302.1	14,997.0	14,836.4	17,302.1	15,801.2	14,997.0	15,550.9	14,836.4	14,496.0
Total Life book growth[1]	**14.4%**	**2.1%**	**3.4%**	**9.7%**	**4.7%**	**(4.1%)**	**6.2%**	**(0.8%)**	**4.2%**
Assets									
Closing investment assets	**21,563**	**18,303**	**19,010**	**21,563**	**19,634**	**18,303**	**19,669**	**19,010**	**18,624**
Fixed income and cash	14,961	13,287	12,022	15,574	14,328	13,691	12,836	12,241	11,802
Property	3,316	3,321	3,588	3,333	3,299	3,308	3,336	3,535	3,661
Equity and infrastructure[2]	509	1,521	1,805	595	437	1,089	2,027	1,817	1,789
Alternatives[2]	933	1,093	1,079	947	914	977	1,244	1,122	1,040
Average investment assets[4]	**19,719**	**19,222**	**18,494**	**20,449**	**18,978**	**19,065**	**19,443**	**18,715**	**18,292**
Liabilities									
Closing liabilities	**18,579**	**16,198**	**16,045**	**18,579**	**17,095**	**16,198**	**16,761**	**16,045**	**15,702**
Annuities and Challenger Index Plus Fund	15,885	15,410	14,414	16,433	15,324	15,499	15,341	14,646	14,194
Capital Notes	856	805	805	887	830	805	805	805	805
Subordinated debt	402	402	405	404	401	400	406	405	405
Average liabilities[4]	**17,143**	**16,617**	**15,624**	**17,724**	**16,555**	**16,704**	**16,552**	**15,856**	**15,404**
Margins[5]									
Investment yield – policyholders' funds	3.82%	4.37%	4.71%	3.72%	3.92%	4.20%	4.52%	4.73%	4.69%
Interest expense	(2.01%)	(2.46%)	(2.79%)	(1.89%)	(2.13%)	(2.40%)	(2.51%)	(2.75%)	(2.82%)
Distribution expense	(0.05%)	(0.06%)	(0.10%)	(0.05%)	(0.05%)	(0.05%)	(0.06%)	(0.08%)	(0.12%)
Other income	0.20%	0.25%	0.19%	0.20%	0.20%	0.33%	0.16%	0.16%	0.20%
Product cash margin	**1.96%**	**2.10%**	**2.01%**	**1.98%**	**1.94%**	**2.08%**	**2.11%**	**2.06%**	**1.95%**
Investment yield – shareholders' funds	0.47%	0.60%	0.77%	0.49%	0.44%	0.50%	0.70%	0.78%	0.78%
Cash earnings	**2.43%**	**2.70%**	**2.78%**	**2.47%**	**2.38%**	**2.58%**	**2.81%**	**2.84%**	**2.73%**
Normalised capital growth	0.17%	0.62%	0.84%	0.18%	0.17%	0.52%	0.72%	0.83%	0.84%
Normalised Cash Operating Earnings (COE)	**2.60%**	**3.32%**	**3.62%**	**2.65%**	**2.55%**	**3.10%**	**3.53%**	**3.67%**	**3.57%**

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

2 Commencing 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.

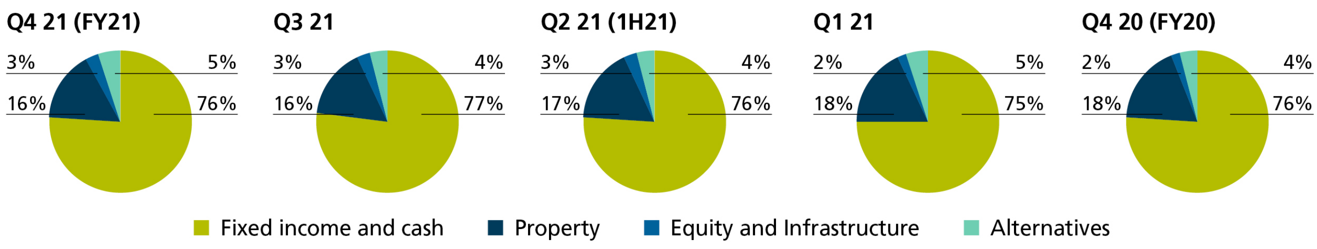
Life financial results

Life quarterly sales and investment assets

$m	Q4 21	Q3 21	Q2 21	Q1 21	Q4 20
Life sales					
Retail fixed term sales	463	316	426	484	367
Institutional fixed term sales	50	1,070	240	151	50
Japan sales	168	79	153	390	63
Fixed term sales	681	1,465	819	1,025	480
Lifetime sales[1]	122	107	139	208	98
Life annuity sales	**803**	**1,572**	**958**	**1,233**	**578**
Maturities and repayments	(760)	(693)	(900)	(1,133)	(926)
Life annuity flows	**43**	**879**	**58**	**100**	**(348)**
Annuity book growth[2]	**0.3%**	**7.0%**	**0.5%**	**0.8%**	**(2.7%)**
Other Life sales	268	847	903	344	486
Other maturities and repayments	(233)	(349)	(366)	(330)	(783)
Other Life flows	**35**	**498**	**537**	**14**	**(297)**
Other Life net book growth	**1.5%**	**20.6%**	**22.2%**	**0.6%**	**(15.2%)**
Total Life sales	1,071	2,419	1,861	1,577	1,064
Total maturities and repayments	(993)	(1,042)	(1,266)	(1,463)	(1,709)
Total Life net flows	**78**	**1,377**	**595**	**114**	**(645)**
Total Life book growth[2]	**0.5%**	**9.2%**	**3.9%**	**0.8%**	**(4.3%)**
Life					
Fixed income and cash[3]	16,418	15,996	14,821	14,260	13,971
Property[3]	3,468	3,309	3,316	3,303	3,292
Equity and infrastructure[3,4]	623	569	604	398	393
Alternatives[4]	1,054	922	893	987	647
Total Life investment assets	**21,563**	**20,796**	**19,634**	**18,948**	**18,303**
Average Life investment assets[5]	**21,062**	**19,924**	**19,323**	**18,625**	**18,393**

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 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, providing products that help customers convert retirement savings into safe and secure income in retirement.

Life's annuity products appeal to retirees as they provide security and certainty of guaranteed[1] 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 for Challenger to fund the retirement incomes paid to customers.

Life is a market leader in Australian retirement incomes, with a 80%[2] annuity market share, and has won the Association of Financial Advisers 'Annuity Provider of the Year' for the last 13 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's products are distributed in Australia via both independent financial advisers and financial adviser administrative platforms. Life's products are available on leading independent investment and administration platforms.

Life is also expanding its relationships with institutional clients, including the profit-for-member sector of Australia's superannuation system. As superannuation fund members transition to retirement, funds are increasing their focus on providing more comprehensive retirement solutions. As the retirement system develops, the institutional superannuation sector provides a significant growth opportunity for Challenger.

In Japan, Life has an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary) to provide Australian dollar and US dollar annuities. MS Primary is a leading provider of annuity products in Japan and is part of the MS&AD Insurance Group Holdings Inc. (MS&AD Group). Refer to page 33 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 29 for more detail).

Challenger Life Company (CLC) undertakes Challenger's guaranteed annuity business and is an APRA-regulated entity. CLC's financial strength is rated by Standard & Poor's with an 'A' rating and stable outlook. CLC's capital strength is outlined on pages 48 to 50.

Normalised EBIT and ROE

Life's normalised EBIT was $399m in FY21 and decreased by $126m (24%) on FY20. The decrease in EBIT reflects a $126m reduction in normalised cash operating earnings (COE) and stable expenses.

Life's normalised ROE (pre-tax) was 12.4% in FY21 and decreased by 420 bps on FY20, driven by lower normalised COE as a result of moving to more defensive investment portfolio settings during the COVID-19 pandemic and slightly higher retained earnings.

Life is committed to maintaining a strong capital position and more defensive investment portfolio settings to strengthen the resilience and sustainability of the business.

Life has a strong regulatory capital position, with $1.6bn of excess regulatory capital above APRA's minimum requirement at 30 June 2021, resulting in a PCA ratio of 1.63 times, which is within Life's internal capital targets. Refer to pages 48 to 50 for more details on CLC's excess capital position.

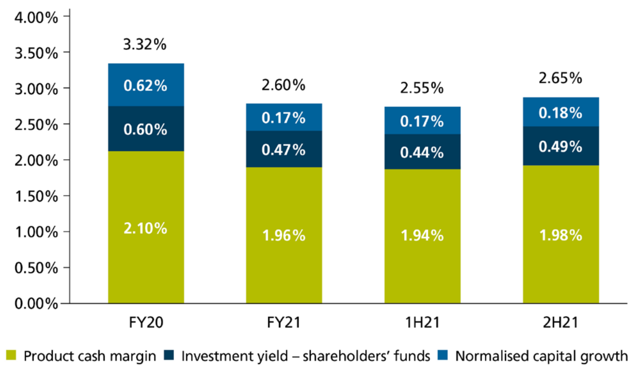
Commencing from FY22, Life is enhancing its risk settings to provide a more stable investor experience and alignment with its brand and purpose, including extending its internal target capital levels and introducing a target to operate at a PCA ratio of around 1.60 times (refer to page 49 for more detail).

Normalised Cash Operating Earnings (COE) and COE margin

FY21 normalised COE was $513m and decreased by $126m (20%) on FY20. Normalised COE reflects:

- higher average investment assets, which increased by 3% on FY20; offset by
- lower COE margin of 2.60%, which reduced by 72 bps on FY20. The lower COE margin largely reflects the impact of moving to more defensive investment portfolio settings during the COVID-19 pandemic.

Life COE margin composition



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

[2] Plan for Life – March 2021 – based on annuities under administration at 31 March 2021.

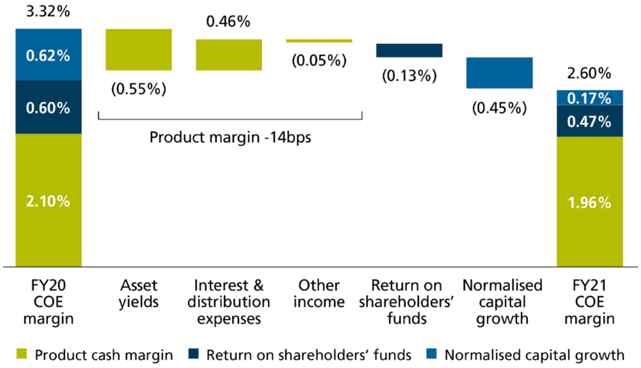
[3] Market Pulse Adviser Study, December 2020.

FY21 to FY20 COE margin

Life's FY21 COE margin was 2.60% and decreased by 72 bps on FY20 as a result of:

- Lower normalised capital growth (-45 bps): The lower normalised growth reflects moving to more defensive investment portfolio settings during 2H20 and a reduction in the alternatives normalised growth assumption commencing from FY21 (reduced from 3.5% to 0%).

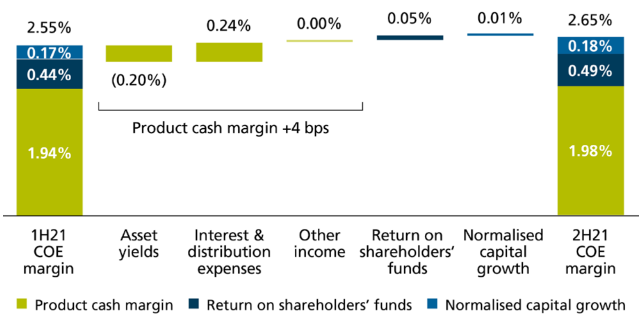
  As part of moving to more defensive portfolio settings, the proportion of fixed income investments was on average 7 percentage points higher in FY21 than in FY20. This change in portfolio mix reduced normalised capital growth as fixed income has a growth assumption of -35 bps, representing an allowance for credit defaults.
- Lower return on shareholder capital (-13 bps): Reflects lower interest rates, with shareholder capital not hedged for movements in interest rates. For example, the average 3-month bank bill rate reduced from 70 bps in FY20 to 5 bps in FY21.
- Lower product cash margin (-14 bps): The product cash margin represents the investment return on annuities and institutional products, less associated interest and direct distribution costs. The product cash margin also includes other income, including Life Risk revenue (refer to page 29). The product cash margin fell 14 bps from FY20 due to:
  - Lower investment yield on policyholder funds (-55 bps): Reflects the impact from repositioning the investment portfolio to more defensive settings in 2H20 and higher levels of cash held through the pandemic. For example, in FY21, cash and investment grade fixed income investments represented 64% of average investment assets for the year, up from 53% in FY20. The lower investment yield on policyholder funds also includes the impact of tighter fixed income credit spreads;
  - Lower interest and distribution expense (+46 bps): Reflect lower annuity and institutional rates paid to customers as a result of the lower interest rate environment and annuity repricing initiatives implemented over the year; and
  - Lower other income (-5 bps): Reflects lower Life Risk revenue with FY20 including the one-off recognition of a $10m (5 bps) fee in relation to the termination of a contract.



2H21 to 1H21 COE margin

Life's 2H21 COE margin was 2.65% and increased by 10 bps on 1H21 as a result of:

- Higher product cash margin (+4 bps): The product cash margin represents the investment return on annuities and institutional products, less associated interest and direct distribution costs. The product cash margin also includes other income, including Life Risk revenue (refer to page 29). The product cash margin increased by 4 bps in 2H21 due to:
  - Lower investment yield on policyholder funds (-20 bps): Reflects the impact of lower interest rates and tighter credit spreads reducing the return on fixed income investments. 2H21 also benefited from the early repayment ($12m) of an asset backed security, which increased the investment yield by 12 bps in 2H21;
  - Lower interest and distribution expense (+24 bps): Reflects lower annuity and institutional rates paid to customers as a result of the lower interest rate environment and annuity repricing initiatives implemented over the half; and
  - Stable other income: Reflects stable Accurium and Life Risk income in 2H21.
- Normalised capital growth (+1bps): Reflects a slightly higher allocation to equities and infrastructure in 2H21.
- Higher return on shareholder capital (+5 bps): Reflects higher shareholder capital and the benefit of deploying cash and liquids into higher returning investments.



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.

FY21 Life normalised COE includes $33m of income from Life Risk transactions, representing the release of profit and expense margins, down from $41m in FY20. FY20 Life Risk included 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. Excluding the one-off fee, Life Risk revenue was stable on FY20.

There were no additional wholesale longevity and mortality transactions written during the year, however there was a release of capital (refer to page 49 for more detail).

The present value of future profits arising from the Life Risk portfolio was $1,041m at 30 June 2021, up 26% from $829m at 30 June 2020. The increase in present value of future profits follows a review of mortality rates, with mortality higher than expected. The increase in the present value of future profits will support growth in future Life Risk revenue.

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 an 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 FY21 revenue was $7m, up $1m on FY20 and is included in other income within Life's normalised COE.

Expenses

FY21 Life expenses were $114m and were stable on FY20.

Personnel expenses were $73m and increased by $4m, reflecting a change in variable reward mix, with higher cash and lower deferred equity payments, and an increase in employees.

Other expenses were $41m and decreased by $4m, as a result of lower marketing and advertising costs.

Expenses in 2H21 were $63m and increased by $12m or 22% on 1H21. The increase related to timing differences with 1H21 reflecting lower business activity due to the pandemic. 2H21 also includes the full year impact of the change in variable reward mix ($3m) and $3m of distribution and marketing initiatives and other one-off costs which are not expected to be recurring.

With the Normalised Cash Operating Earnings (down 20%) and stable expenses, Life's cost to income ratio increased 230 bps to 23.3%.

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.

FY21 investment experience was a gain of $455m (pre-tax), comprising a $466m asset and policy liability gain and a $11m loss in relation to new business strain.

($m)	Actual capital growth	Normalised capital growth	Investment experience
Fixed income	331	52	**383**
Property	121	(66)	**55**
Equity and infrastructure	77	(20)	**57**
Alternatives	47	-	**47**
Policy liability	(76)	-	**(76)**
Assets and policy liability experience	**500**	**(34)**	**466**
New business strain	(11)	-	**(11)**
Total investment experience (pre-tax)	**489**	**(34)**	**455**

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 a gain of $466m in FY21, comprising:

- Fixed income (+$383m): Represents positive revaluation gains of $312m, the write back of $19m of prior period credit defaults, and normalised capital growth of $52m. The fixed income normalised capital growth represents an allowance for credit defaults in Life's Cash Operating Earnings.

The actual capital growth of $312m reflects the contraction in global credit spreads. In 2H20 during the height of the pandemic, credit spreads expanded significantly and resulted in $331m of unrealised losses. Over FY21, the unrealised fixed income losses recognised in 2H20 reversed as credit spreads retraced to pre-pandemic levels.

- Property (+$55m): Reflects the revaluation of Life's property portfolio, with revaluation gains of $121m partially offset by normalised capital growth ($66m).

  All properties were independently valued in June 2021. Revaluation gains include domestic office +5.9%; domestic retail -0.2%; domestic industrial 6.1%; and Japan +0.9%.
- Equity and infrastructure (+$57m): Reflects revaluation gains of $77m following the rally in domestic and international equity markets and exceeded equities normalised capital growth ($20m). The normalised capital growth assumption for equities and infrastructure is 4% per annum.
- Alternatives ($47m): Predominately relates to revaluation gains on Challenger's absolute return portfolio, which was in excess of Challenger's normalised growth assumption of 0% per annum for alternatives.
- Policy liability (-$76m): Includes -$183m in relation to the illiquidity premium adjustment, partially offset by a $107m 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. The policy liability gain was significant in FY21, reflecting the significant relative movements in yields on inflation instruments and semi-government securities held for hedging purposes.

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 FY21 net new business strain was a loss of $11m (FY20 $32m gain) reflecting the new business strain on FY21 annuity sales less the unwind from prior period sales.

Life sales and AUM

Total Life sales

Challenger is focused on diversifying its sales channels to build more resilient sales across a range of retail and institutional products and clients.

Total Life sales were a record $6.9bn and increased by 35% on FY20. Sales increased in all key product categories, with sales benefiting from Challenger's diversification strategy, with a focus on:

- increasing institutional sales (refer to page 7 for more detail);
- working with a wider range of independent financial advice networks following structural change in the domestic financial advice market; and
- leveraging its annuity relationship with MS Primary in Japan to include the reinsurance of US dollar denominated annuities (refer to page 33 for more detail).

Annuity sales

Total annuity sales were $4.6bn in FY20 and increased by $1.4bn or 46% on FY20. Annuity sales comprised:

- Domestic retail sales of $2.1bn, up $343m or 19%;
- Domestic institutional sales of $1.6m, up $1.0bn; and
- Japan sales of $0.8bn, up $47m or 6%

Domestic retail annuity sales

Domestic retail annuity sales were $2,127m and increased by 19% on FY20. Retail annuity sales are benefiting from stabilisation of the retail financial advice market, and increased sales from independent financial advisers (IFA's).

The Australian wealth management and financial adviser markets have been significantly disrupted following 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 major banks.

With adviser movement from major banks to IFA networks and advisers exiting the industry stabilising, the impact of this disruption on Challenger's domestic annuity sales has started to stabilise.

The impact of adviser movement across the bank-aligned and independent advice market is showing signs it has stabilised, with major banks accounting for 9% of FY21 domestic fixed term annuity sales, which was broadly consistent with the contribution in FY20 (12%).

Domestic retail annuity sales comprised:

- term annuity sales of $1,689m, which increased by $320m or 23% on FY20; and
- lifetime annuity sales of $438m, which increased by $24m or 6%.

Lifetime annuity sales comprise Liquid Lifetime sales of $279m (FY20 $272m) and CarePlus sales of $159m (FY20 $143m).

CarePlus is a lifetime annuity specifically designed for aged care.

Domestic institutional sales

Domestic institutional sales were $4,010m, up $1,386m or 53%, and comprised:

- Institutional term annuity sales of $1,511m, up $911m;
- Institutional lifetime annuity sales of $138m; and
- Institutional Guaranteed Index Plus sales of $2,362m, up $338m or 17%.

Institutional term annuity sales represent a relatively new distribution channel for Challenger, with sales growth benefiting from the institutional team focusing on new client opportunities. Term annuities are a viable alternative to term deposits and other short-term fixed income instruments. These investments are usually shorter duration, particularly for an initial investment; however, clients typically roll the investment multiple times, extending the effective duration. The average duration of FY21 institutional term annuity sales was 1.5 years.

Term annuities are a simple product for investors and are an effective way for Challenger to build institutional clients. They also provide a solid foundation for Challenger to develop broader relationships, including the exploration of retirement solution partnerships, with the profit-for-member superannuation sector.

Profit-for-member funds accounted for 66% of FY21 institutional term annuity sales.

Institutional lifetime annuity sales were $138m and represent reinsurance of its closed lifetime annuity portfolio (1H21 $114m) and the buy-out of a closed defined benefit fund ($24m). This success reflects recent efforts to target Australia's large closed defined benefit pension and closed lifetime annuity markets.

Institutional Guaranteed Index Plus range provides clients contractual alpha above a pre-agreed benchmark with flexibility in relation to the term and underlying index return, with the security of an A-rated[1] counterparty and zero fees.

Sales are benefiting from a refresh and relaunch of the Index Plus product, providing a more attractive client proposition and an increase in the underlying indexes available. Superannuation funds also have an intense focus and pressure on both fees and performance because of range of superannuation reforms which is also aiding sales (refer to page 34 for more detail).

Institutional Guaranteed Index Plus sales were $2,362m in FY21, with $500m of flows from new clients, $568m of flows from existing clients, $135m of distributions reinvested by existing clients, and $1,159m being the rollover of maturities from existing clients. Profit-for-member funds accounted for all new clients in FY21.

[1] Standard & Poor's Global Ratings (S&P) Challenger Life Company 'A' rating with a stable outlook.

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 33 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 $790m in FY21, up 6% from $743m in FY20. MS Primary annuity sales represent the reinsurance of both Australian dollar and US dollar denominated annuities.

MS Primary sales represented 17% of Challenger's FY21 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$600m[1]) 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.

1H21 sales were $543m and after the strong start to year, the reinsurance quota share was reduced; however, FY21 sales exceeded the agreed minimum amount by 18%.

Focus on long-term annuity sales

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

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.

Lifetime and long-term MS Primary annuities accounted for just over 54% of total annuities in force at 30 June 2021, up from 27% five years ago (FY16).

New business tenor

The tenor on new business annuity sales was 5.9 years in FY21, down from 9.9 years in FY20. The reduction in Life's new business tenor is a result of:

- A change in the mix of MS Primary sales, shifting to shorter average durations; and
- Increased proportion of institutional term annuity sales, which represented 38% of total FY21 term annuity sales (FY20 22%), which tend to have shorter durations. For example, the average duration of institutional term annuity sales in FY21 was 1.5 years.

The new business tenor of domestic retail sales was stable at 7 years in FY21.

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 28% in FY21, up from 26% in FY20.

Following significant growth in institutional term annuity sales in FY21, which tend to have shorter durations, the maturity rate for annuities is expected to be approximately 27% in FY22.

Total maturities in FY22 are expected to be $3.7bn (FY21 $3.5bn) and include $1.0bn of institutional term annuity business. Excluding the institutional term annuity maturities, the retail maturity rate is expected to be 20%, down from 28%, reflecting Challenger's focus on longer duration retail business.

Net book growth

Life annuity book growth

FY21 Life annuity net flows (i.e. annuity sales less capital repayments) were +$1,080m, up from net outflows of $251m in FY20.

Based on the opening Life annuity book liability ($12,581m), FY21 annuity book growth was +8.6%, up from -2.0% in FY20.

Annuity net book growth was higher than the prior period due to higher sales more than offsetting higher maturity levels.

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 FY21, Other Life net flows were +$1,084m, up from $567m in FY20, and drove a 50% increase in Index Plus Fund liabilities.

Across both annuity and institutional Index Plus business, FY21 net flows were +$2,164m for the year and represented total book growth of 14.4%[2] for the year.

Average AUM

Life's average investment assets were $19.7bn in FY21 and increased by 3% ($0.5bn) on FY20. The increase in average investment assets reflects Life higher net flows and positive investment experience (refer to page 29 for more detail).

[1] Based on the exchange rate as at 30 June 2021.

[2] Based on total Life net flows of $2,164m 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$600m[1]) 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 was $790m up 6% on FY20 and represented ~17% of Challenger Life's FY21 total annuity sales (~24% in FY20).

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 30 June 2021, 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 30 June 2021.

Retirement income regulatory reforms

In November 2020, the Government released the Retirement Income Review. The review concluded that Australians want a secure retirement, and that the retirement income system is a major influence in determining whether retirees will have the income they need to achieve that goal. The review also noted that there has been insufficient attention on assisting people to optimise their retirement income**,** and that more efficient use of savings in retirement can have a big impact on improving retirement outcomes.

In response to the review and as part of the 2021/2022 Federal Budget, the Government is progressing a range of reforms to enhance the retirement phase of the superannuation system.

These reforms include:

- Legislating a Retirement Income Covenant;
- Repealing the work test for voluntary non-concessional and salary sacrificed superannuation contributions for those aged 67 to 74;
- Improving and making the Pension Loans Scheme more flexible;
- Lowering the minimum age of access for the Downsizer Contribution Scheme; and
- Giving older Australians a 2-year amnesty to convert certain legacy retirement products, without some of the negative consequences that would ordinarily result from this.

These reforms are aimed at giving retirees the confidence to spend in retirement and therefore improve outcomes in retirement.

In addition, to ensure Australians have access to high quality and affordable advice, in 2022 the Government will undertake a Quality of Advice Review. The review will be conducted by Treasury and will consider the full breadth of issues impacting on both the quality and affordability of all forms of financial advice.

Retirement Income Covenant

In response to the Retirement Income Review, the Government has reaffirmed its commitment to legislate the Retirement Income Covenant, for commencement by 1 July 2022. To facilitate this, on 19 July 2021, the Government released a position paper on the covenant, for a three-week public consultation to 6 August 2021.

The covenant will create a new obligation on trustees to formulate, review regularly, and give effect to a retirement income strategy. The strategy will set out the trustee's plan to assist its members to achieve and balance three objectives:

- Maximise retirement income;
- Manage risks to the sustainability and stability of retirement income; and
- Allow some flexible access to retirement savings.

Draft legislation to implement the covenant is expected to be introduced into the parliament after consultation on the position paper closes.

Repealing the Work Test

The Government will amend the work test rules to allow retirees aged between 67 and 74, who have not had the benefit of compulsory superannuation throughout their working lives, to make non-concessional and salary sacrificed contributions without meeting the work test.

Improving the Pension Loans Scheme

The Government is making the Pension Loans Scheme more flexible and appealing for older Australians by introducing a "No Negative Equity Guarantee" and allowing retirees to access a capped, lump-sum advance payment.

The guarantee will mean that, in the rare circumstance where a debt under the scheme exceeds the property value, borrowers or their beneficiaries will not be exposed to liability beyond the market value of the property.

Changes to the scheme will also allow immediate access for eligible people to lump sums, payable as up to two instalments per year, of up to 50% of the maximum age pension.

The changes will take effect from 1 July 2022.

Broadening access to the Downsizer Contribution Scheme

The Government will lower the minimum age for the downsizer contribution scheme, from 65 to 60, to allow Australians nearing retirement to make a one-off after-tax contribution to superannuation of up to $300,000 per person when they sell their family home. A downsizer contribution can be made after the sale of a person's principal place of residence where the residence was held for a minimum of 10 years. This change will take effect from 1 July 2022.

Broadening access to the downsizer contribution scheme is expected to increase retiree superannuation savings, which in turn may allow retirees to direct more of their savings into income stream products, including annuities.

Amnesty on converting legacy retirement products

The Government will provide a temporary option to commute legacy retirement products into more flexible and contemporary retirement products. A two-year period will be provided for commutation of market-linked, life-expectancy and lifetime pension and annuity products (commenced before September 2007), allowing the holders of these products to exit them and transfer any underlying capital and reserves into an accumulation superannuation account.

Challenger has a modest book of legacy products that are within scope of this measure and the commercial impact on Challenger's business is expected to be insignificant.

Your Future, Your Super

In June 2021, the Your Future, Your Super Budget package passed the parliament. The reforms introduce a new annual underperformance test that will apply initially to MySuper products.

The underperformance test may increase demand for Challenger's high performing funds management business, which has a strong history of delivering above benchmark returns through quality active management strategies.

Life balance sheet

$m	FY21	1H21	FY20	1H20	FY19	1H19
Assets						
Life investment assets						
Cash and equivalents	1,396.6	2,083.3	3,002.7	760.0	361.0	1,518.3
Asset-backed securities	8,246.2	6,964.8	6,385.1	6,289.3	5,293.3	5,062.2
Corporate credit	6,775.4	5,773.0	4,582.8	5,907.4	6,805.5	5,434.0
Fixed income and cash (net)	**16,418.2**	**14,821.1**	**13,970.6**	**12,956.7**	**12,459.8**	**12,014.5**
Australian – Office	2,081.8	1,947.9	1,912.7	1,919.4	1,833.9	2,097.1
Australian – Retail	722.9	709.1	709.3	751.2	883.3	954.1
Australian – Industrial	199.3	189.5	187.5	193.3	185.2	180.4
Japanese	357.7	366.8	390.1	359.5	325.6	314.6
Other	105.8	102.9	92.5	114.4	154.0	193.2
Property (net)	**3,467.5**	**3,316.2**	**3,292.1**	**3,337.8**	**3,382.0**	**3,739.4**
Equity and infrastructure[1]	623.2	604.2	393.4	2,035.9	2,042.3	1,778.3
Alternatives[1]	1,054.3	892.5	647.2	1,338.8	1,126.3	1,092.1
Life investment assets	**21,563.2**	**19,634.0**	**18,303.3**	**19,669.3**	**19,010.4**	**18,624.3**
Other assets (including intangibles)	773.9	896.0	1,178.4	915.9	702.3	560.9
Total assets	**22,337.1**	**20,530.0**	**19,481.7**	**20,585.2**	**19,712.7**	**19,185.2**
Liabilities						
Life annuity book	13,669.9	12,769.7	12,581.2	12,845.3	12,870.2	12,323.7
Challenger Index Plus Fund liabilities	3,632.2	3,031.5	2,415.8	2,705.6	1,966.2	2,172.3
Subordinated debt	404.5	401.7	395.7	404.9	403.9	400.6
Challenger Capital Notes	872.7	892.5	805.0	805.0	805.0	805.0
Other liabilities	210.7	269.8	345.6	350.6	348.5	412.9
Total liabilities	**18,790.0**	**17,365.2**	**16,543.3**	**17,111.4**	**16,393.8**	**16,114.5**
Net assets	**3,547.1**	**3,164.8**	**2,938.4**	**3,473.8**	**3,318.9**	**3,070.7**

[1] Commencing 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.

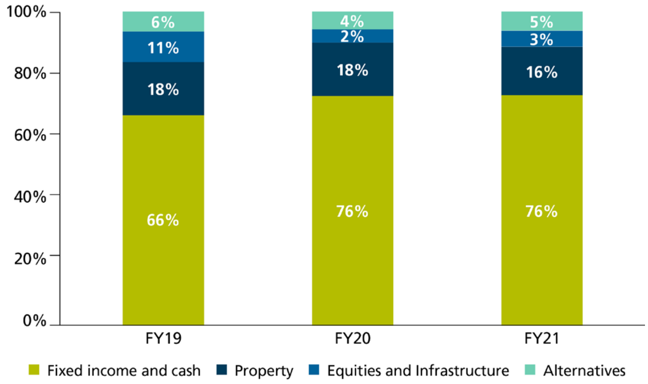
Life investment portfolio overview

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	30 June 2021	30 June 2020
Fixed income and cash	76%	76%
Property	16%	18%
Equity and infrastructure	3%	2%
Alternatives	5%	4%



Life investment portfolio repositioned

During the early stages of the COVID-19 pandemic (2H20), Life actively managed its investment portfolio and repositioned its portfolio to more defensive settings. These actions reduced capital intensity and increased Life's excess regulatory 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 30 June 2021 was approximately $1.4bn, down from $3.0bn at 30 June 2020. The reduction in cash and liquids represents the deployment into higher returning investments over the year, predominantly into fixed income. The closing FY21 balance ($1.4bn) includes annuity sales in June, which were deployed in July 2021.

Fixed income portfolio overview

Life's fixed income and cash portfolio was $16.4bn at 30 June 2021 and increased by 18% from $14.0bn at 30 June 2020.

The fixed income and cash portfolio represented 76% of Life's total investment assets at 30 June 2021, with the mix of investment assets remaining stable across the year. The fixed income portfolio comprises approximately 1,400 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 30 June 2021, 79% of the fixed income portfolio was investment grade, down from 85% at 30 June 2020, partly reflecting the deployment of excess cash and liquids balance into higher returning investments.

A total of 86% 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 67% of the fixed income portfolio invested in Australian-based securities.

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 FY21, the credit default loss recognised in investment experience was positive 13 bps (+$19m), representing the write back of prior period defaults following the recovery post the height of the pandemic.

Over the past five financial years, the average credit default loss experience recognised in investment experience has been -14 bps per annum.

Detailed disclosure of Life's fixed income portfolio is included on pages 37 to 40. 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

30 June 2021		$m	% portfolio	
Liquids		1,397	9%	Includes cash and equivalents and Government Bonds (net of repurchase agreements)
Asset-Backed Securities (ABS)	Residential Mortgage-Backed Securities (RMBS)	4,428	27%	RMBS expertise developed when Challenger was Australia's largest non-bank securitiser of RMBS (via Mortgage Management business sold in 2009)
	Other ABS	2,617	16%	Financing secured against underlying assets. Asset security includes motor vehicle, equipment and consumer finance
	Senior Secured Loans	921	5%	Senior debt secured by collateral and typically originated by Challenger
	Aviation Finance	144	1%	Secured commercial aircraft financing
	CMBS	136	1%	Commercial mortgage-backed securities (CMBS)
Corporate Credit	Banks and Financials	1,345	8%	Corporate loans to banks, insurance companies and fund managers
	Infrastructure	1,614	10%	Long-dated inflation-linked bonds issued by Public Private Partnership projects and loans to infrastructure companies
	Senior Secured Loans	299	2%	Senior debt secured by collateral
	Non-Financial Corporates	2,527	15%	Traded commercial loans to non-financial corporates (includes exposures to retail, construction, hotels, media, mining and health care).
	Commercial Real Estate	990	6%	Loans secured against commercial real estate assets and typically originated by Challenger.
Total		**16,418**	**100%**	

Table 2: Fixed income portfolio by credit rating

30 June 2021 ($m)	Investment grade Liquids	AAA	AA	A	BBB	Total	Non-investment grade BB	B or lower	Total	Total $m
Liquids										
Government bonds[1]	530	-	-	-	-	**530**	-	-	**-**	**530**
Covered bonds	52	-	-	-	-	**52**	-	-	**-**	**52**
Cash & Equivalents	815	-	-	-	-	**815**	-	-	**-**	**815**
Asset-Backed Securities										
RMBS	-	2,798	645	522	282	**4,247**	118	63	**181**	**4,428**
Other ABS	-	1,157	366	202	165	**1,890**	545	182	**727**	**2,617**
Senior Secured Bank Loans	-	429	119	58	182	**788**	121	12	**133**	**921**
Aviation Finance	-	-	-	48	60	**108**	17	19	**36**	**144**
CMBS	-	20	-	55	56	**131**	2	3	**5**	**136**
Corporate Credit										
Banks and Financials	-	-	57	334	818	**1,209**	87	49	**136**	**1,345**
Infrastructure	-	-	135	448	731	**1,314**	206	94	**300**	**1,614**
Senior Secured Loans	-	-	-	-	2	**2**	17	280	**297**	**299**
Non-Financial Corporates	-	7	16	161	891	**1,075**	542	910	**1,452**	**2,527**
Commercial Real Estate	-	41	4	369	460	**874**	94	22	**116**	**990**
Total	**1,397**	**4,452**	**1,342**	**2,197**	**3,647**	**13,035**	**1,749**	**1,634**	**3,383**	**16,418**
Fixed income portfolio (%)	9%	27%	8%	13%	22%	**79%**	11%	10%	21%	**100%**
Average duration (years)	-	1.9	2.5	3.8	3.9	**2.9**	3.2	3.7	3.4	**3.1**

30 June 2021 (%)	Investment grade Liquids	AAA	AA	A	BBB	Total	Non-investment grade BB	B or lower	Total	Total %
Liquids										
Government bonds[1]	100%	-	-	-	-	**100%**	-	-	-	**100%**
Covered bonds	100%	-	-	-	-	**100%**	-	-	-	**100%**
Cash & Equivalents	100%	-	-	-	-	**100%**	-	-	-	**100%**
Asset-Backed Securities										
RMBS	-	63%	15%	12%	6%	**96%**	3%	1%	4%	**100%**
Other ABS	-	44%	14%	8%	6%	**72%**	21%	7%	28%	**100%**
Senior Secured Bank Loans	-	47%	13%	6%	20%	**86%**	13%	1%	14%	**100%**
Aviation Finance	-	-	-	33%	42%	**75%**	12%	13%	25%	**100%**
CMBS	-	15%	-	40%	41%	**96%**	2%	2%	4%	**100%**
Corporate Credit										
Banks and Financials	-	-	4%	25%	61%	**90%**	6%	4%	10%	**100%**
Infrastructure	-	-	8%	28%	45%	**81%**	13%	6%	19%	**100%**
Senior Secured Loans	-	-	-	-	1%	**1%**	6%	93%	99%	**100%**
Non-Financial Corporates	-	-	1%	6%	36%	**43%**	21%	36%	57%	**100%**
Commercial Real Estate	-	4%	-	37%	47%	**88%**	10%	2%	12%	**100%**
Total	**9%**	**27%**	**8%**	**13%**	**22%**	79%	**11%**	**10%**	**21%**	100%

[1] Gross Government Bonds are shown net of $1,854m of Australian Government Bonds and $2,257m 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 46 for more detail.

Table 3: Fixed income portfolio by rating type

30 June 2021 ($m)	Investment grade						Non-investment grade			Total
	Liquids	AAA	AA	A	BBB	Total	BB	B or lower	Total	$m
Liquids										
Externally rated	1,397	-	-	-	-	**1,397**	-	-	-	**1,397**
Internally rated	-	-	-	-	-	**-**	-	-	-	**-**
Asset-Backed Securities										
Externally rated	-	4,317	1,096	667	341	**6,421**	312	112	424	**6,845**
Internally rated	-	87	34	219	403	**743**	491	167	658	**1,401**
Corporate Credit										
Externally rated	-	47	206	1,274	2,767	**4,294**	677	898	1,575	**5,869**
Internally rated	-	1	6	37	136	**180**	269	457	726	**906**
Total	**1,397**	**4,452**	**1,342**	**2,197**	**3,647**	**13,035**	**1,749**	**1,634**	**3,383**	**16,418**
Externally rated	100%	98%	97%	88%	85%	**93%**	57%	62%	59%	**86%**
Internally rated	0%	2%	3%	12%	15%	**7%**	43%	38%	41%	**14%**

30 June 2021 (%)	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	-	63%	16%	10%	5%	**94%**	4%	2%	6%	**100%**
Internally rated	-	6%	2%	16%	29%	**53%**	35%	12%	47%	**100%**
Corporate Credit										
Externally rated	-	1%	4%	22%	46%	**73%**	12%	15%	27%	**100%**
Internally rated	-	-	1%	4%	15%	**20%**	30%	50%	80%	**100%**
Total	**9%**	**27%**	**8%**	**13%**	**22%**	**79%**	**11%**	**10%**	**21%**	**100%**

Table 4: Fixed income portfolio by industry sector

	Investment grade						Non-investment grade			Total
30 June 2021 ($m)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**$m**
Industrials and consumers	-	1,745	526	491	1,288	**4,050**	1,135	1,335	**2,470**	**6,520**
Residential property	-	2,646	614	506	330	**4,096**	125	68	**193**	**4,289**
Banks, financials & insurance	867	-	64	334	831	**2,096**	96	68	**164**	**2,260**
Government	530	-	-	-	-	**530**	-	-	**-**	**530**
Commercial property	-	61	3	418	465	**947**	91	19	**110**	**1,057**
Infrastructure and utilities	-	-	135	448	733	**1,316**	207	94	**301**	**1,617**
Other	-	-	-	-	-	**-**	95	50	**145**	**145**
Total	1,397	4,452	1,342	2,197	3,647	**13,035**	1,749	1,634	**3,383**	**16,418**

	Investment grade						Non-investment grade			Total
30 June 2021 (%)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**%**
Industrials and consumers	-	26%	8%	8%	20%	**62%**	17%	21%	**38%**	**100%**
Residential property	-	62%	14%	12%	8%	**96%**	2%	2%	**4%**	**100%**
Banks, financials & insurance	38%	-	3%	15%	37%	**93%**	4%	3%	**7%**	**100%**
Government	100%	-	-	-	-	**100%**	-	-	**-**	**100%**
Commercial property	-	6%	-	40%	44%	**90%**	8%	2%	**10%**	**100%**
Infrastructure and utilities	-	-	8%	28%	45%	**81%**	13%	6%	**19%**	**100%**
Other	-	-	-	-	-	**-**	66%	34%	**100%**	**100%**
Total	**9%**	**27%**	**8%**	**13%**	**22%**	**79%**	**11%**	**10%**	**21%**	**100%**

Table 5: Fixed income portfolio by geography and credit rating

	Investment grade						Non-investment grade			Total
30 June 2021 ($m)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**$m**
Australia	1,291	3,548	839	1,459	2,134	**9,271**	902	841	**1,743**	**11,014**
United States	72	332	76	323	831	**1,634**	679	725	**1,404**	**3,038**
United Kingdom	-	256	143	108	271	**778**	6	2	**8**	**786**
Europe	2	129	206	176	355	**868**	92	19	**111**	**979**
New Zealand	-	186	63	118	42	**409**	63	40	**103**	**512**
Rest of world	32	1	15	13	14	**75**	7	7	**14**	**89**
Total	**1,397**	**4,452**	**1,342**	**2,197**	**3,647**	**13,035**	**1,749**	**1,634**	**3,383**	**16,418**

	Investment grade						Non-investment grade			Total
30 June 2021 (%)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**%**
Australia	12%	32%	8%	13%	19%	**84%**	8%	8%	**16%**	**100%**
United States	2%	11%	3%	11%	27%	**54%**	22%	24%	**46%**	**100%**
United Kingdom	-	33%	18%	14%	34%	**99%**	1%	-	**1%**	**100%**
Europe	-	13%	21%	18%	37%	**89%**	9%	2%	**11%**	**100%**
New Zealand	-	37%	12%	23%	8%	**80%**	12%	8%	**20%**	**100%**
Rest of the world	35%	1%	17%	15%	16%	**84%**	8%	8%	**16%**	**100%**
Total	**9%**	**27%**	**8%**	**13%**	**22%**	**79%**	**11%**	**10%**	**21%**	**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 $3.5bn (net of debt) at 30 June 2021 and increased by 5% from 30 June 2020 as a result of property revaluation gains. There were no property purchases or disposal during the year.

Property represented 16% of Life's investment portfolio at 30 June 2021, down from 18% at 30 June 2020. The decrease in investment asset mix reflects higher revaluation gains on other asset classes.

Life's property portfolio is mainly focused on domestic properties that provide long-term income streams. Australian properties accounted for 90% of the portfolio, and Australian office 60%.

Challenger Life has a policy that all directly owned properties are independently valued each year. In recognition of the continuing impact of the COVID-19 pandemic, all properties were independently valued in June 2020 (FY20), December 2020 (1H21) and 30 June 2021 (2H21).

For FY21, the valuation of properties increased as follows:

- Australian office +5.9%;
- Australian retail -0.2%;
- Australian industrial +6.1%; and
- Japanese portfolio +0.9%.

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 60% of the portfolio, with the Australian Government as a major tenant, accounting for ~31% of FY21 gross rental income[1].

Australian direct retail assets account for 21% 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 retail portfolio valuations were reduced by approximately 8% during 2H20 as a result of the COVID-19 pandemic and decreased slightly (-0.2%) in FY21.

The weighted average cap rate on Life's Australian direct portfolio[2] was 5.64% at 30 June 2021, down 25 bps for the year.

Property includes a net $358m exposure to Japanese property (10% 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 valuation of the Japanese portfolio increased by 0.9% in FY21.

The property portfolio generates long-term cash flows to match long-term liabilities, with a weighted average lease expiry of 5.7 years and 47% of leasing area having contracted leases expiring in FY26 and beyond. The portfolio had an occupancy rate of 92% at 30 June 2021, which was stable on the prior year.

Approximately 68% of contracted leases have either annual fixed increases or inbuilt increases based on inflation or market outcomes (e.g. CPI).

During the COVID-19 pandemic, Life has been supporting its commercial property tenants. For FY21, rental abatements and rent deferrals were provided to tenants in line with the regulated framework in each State or Territory.

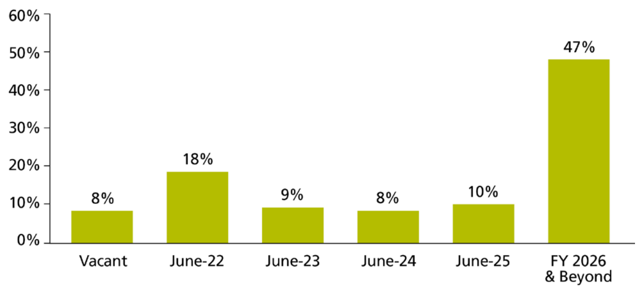
Given the ongoing nature of the COVID-19 pandemic and evolving restrictions and economic impacts, Life will continue to work with its tenants to support them, recognising any industry led initiatives and in line with Government guidelines. However, it has reduced its rental expectation for FY22, which has been fully reflected in Challenger's FY22 normalised net profit before tax guidance (refer to page 18 for detail).

Full details of Life's property portfolio are listed on pages 42 to 44.

Property portfolio summary

% of total portfolio	FY21	FY20
Australian office	60%	58%
Australian retail	21%	22%
Australian industrial	6%	6%
Other	3%	2%
Australian total	**90%**	**88%**
Japanese retail	10%	12%
Other (including offshore)	0%	0%
Total	**100%**	**100%**

Portfolio lease expiry overview[3]



[1] Represents total gross passing Government income relative to direct property portfolio.

[2] Excluding the Victorian County Court.

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

Direct property portfolio overview[1]

30 June 2021		Office	Retail	Industrial	Total
Total rent (%)[2]		51%	43%	6%	100%
WALE[3] (years)		5.7	6.3	2.7	5.7
Tenant credit ratings					
	AAA	19%	0%	0%	19%
	AA	15%	1%	0%	16%
	A	1%	1%	0%	2%
	BBB	2%	10%	2%	14%
	BB	6%	13%	3%	22%
	B or below	2%	7%	0%	9%
	Not rated	1%	9%	0%	10%
	Vacant	5%	2%	1%	8%
	Total	**51%**	**43%**	**6%**	**100%**
% of total gross net	Investment grade	37%	12%	2%	51%
	Non-investment grade	9%	29%	3%	41%
	Vacant	5%	2%	1%	8%

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

30 June 2021		Acquisition date[1]	Total cost ($m)[2]	Carrying value ($m)	Cap rate FY21 (%)[3]	Last external valuation date
Australia						
Office						
	6 Chan Street (formerly DIBP Building), ACT	01 Dec 01	127.5	261.0	4.88	30 Jun 21
	14 Childers Street, ACT	01 Dec 17	98.8	85.5	6.50	30 Jun 21
	35 Clarence Street, NSW	15 Jan 15	154.0	229.0	5.13	30 Jun 21
	45 Benjamin Way (formerly ABS Building), ACT	01 Jan 00	150.2	251.0	5.38	30 Jun 21
	82 Northbourne Avenue, ACT	01 Jun 17	62.3	51.8	5.75	30 Jun 21
	215 Adelaide Street, QLD	31 Jul 15	256.7	225.0	6.00	30 Jun 21
	565 Bourke Street, VIC	28 Jan 15	109.1	148.0	5.00	30 Jun 21
	839 Collins Street, VIC	22 Dec 16	212.0	246.5	4.75	30 Jun 21
	County Court, VIC	30 Jun 00	219.1	388.0	n/a[4]	30 Jun 21
	Discovery House, ACT	28 Apr 98	104.6	164.0	5.13	30 Jun 21
	Executive Building, TAS	30 Mar 01	35.1	49.0	5.75	30 Jun 21
Retail						
	Bunbury Forum, WA	03 Oct 13	158.2	78.1	7.25	30 Jun 21
	Channel Court, TAS	21 Aug 15	87.8	80.0	7.25	30 Jun 21
	Gateway, NT	01 Jul 15	124.1	102.9	6.34	30 Jun 21
	Golden Grove, SA	31 Jul 14	159.9	148.0	6.25	30 Jun 21
	Karratha, WA	28 Jun 13	57.1	45.4	7.50	30 Jun 21
	Kings Langley, NSW	29 Jul 01	16.6	24.7	5.75	30 Jun 21
	Lennox, NSW	27 Jul 13	64.2	65.0	6.75	30 Jun 21
	North Rocks, NSW	18 Sep 15	187.0	179.0	6.00	30 Jun 21
Industrial						
	21 O'Sullivan Circuit, NT	27 Jan 16	47.8	31.4	7.75	30 Jun 21
	31 O'Sullivan Circuit, NT	27 Jan 16	29.4	28.5	7.25	30 Jun 21
	Cosgrave Industrial Park, Enfield, NSW	31 Dec 08	91.4	139.4	4.50	30 Jun 21
Total Australia			**2,552.9**	**3,021.2**	**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.

4 The carrying value has been determined by references to the proposed sale agreement rather than the capitalisation of net market income.

Direct property investments

30 June 2021		Acquisition date[1]	Total cost ($m)[2]	Carrying value ($m)	Cap rate FY21 (%)[3]	Last external valuation date
Japan						
Retail						
	Aeon Kushiro	31 Jan 10	30.5	34.2	5.40	30 Jun 21
	Carino Chitosedai	31 Jan 10	118.4	127.2	4.50	30 Jun 21
	Carino Tokiwadai	31 Jan 10	77.6	75.5	4.60	30 Jun 21
	DeoDeo Kure	31 Jan 10	32.2	31.2	5.50	30 Jun 21
	Fitta Natalie Hatsukaichi	28 Aug 15	11.7	13.4	5.90	30 Jun 21
	Izumiya Hakubaicho	31 Jan 10	69.6	71.4	4.80	30 Jun 21
	Kansai Super Saigo	31 Jan 10	13.3	13.2	5.50	30 Jun 21
	Kojima Nishiarai	31 Jan 10	12.2	14.6	4.10	30 Jun 21
	Kotesashi Towers	28 Nov 19	25.2	21.5	5.07	30 Jun 21
	Life Asakusa	31 Jan 10	27.9	35.1	4.20	30 Jun 21
	Life Higashi Nakano	31 Jan 10	32.9	36.7	4.30	30 Jun 21
	Life Nagata	31 Jan 10	25.2	27.7	4.90	30 Jun 21
	MaxValu Tarumi	28 Aug 15	17.0	18.2	5.70	30 Jun 21
	Seiyu Miyagino	31 Jan 10	9.8	10.6	5.20	30 Jun 21
	TR Mall Ryugasaki	30 Mar 18	86.7	90.5	5.50	30 Jun 21
	Valor Takinomizu	31 Jan 10	27.4	23.5	5.80	30 Jun 21
	Valor Toda	31 Jan 10	42.5	41.7	5.20	30 Jun 21
	Yaoko Sakato Chiyoda	31 Jan 10	19.8	20.9	4.70	30 Jun 21
	Yorktown Toride	05 Mar 20	31.9	25.9	5.10	30 Jun 21
Industrial						
	Aeon Matsusaka XD	26 Sep 19	14.7	13.7	5.60	30 Jun 21
Total Japan			**726.5**	**746.7**	**4.95**	
Europe						
Retail						
	Aulnay sous Bois, Avenue de Savigny, France	31 Dec 08	20.3	9.8	7.00	30 Jun 21
Total Europe			**20.3**	**9.8**	**7.00**	
Total Overseas			**746.8**	**756.5**	**4.98**	
Development						
	Maitland, NSW	06 Dec 06	5.7	8.0	n/a	30 Jun 21
Total development			**5.7**	**8.0**		
Total direct portfolio investments			**3,305.4**	**3,785.7**	**5.50**	

[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 was $0.6bn at 30 June 2021 and increased by 58% ($230m) from 30 June 2020.

The increase in equities and infrastructure in FY21 reflects equities purchased during the year, a reduction in infrastructure investments and revaluation gains.

Equity and infrastructure represented 3% of Life's total investment assets at 30 June 2021, up from 2% at 30 June 2020.

Challenger's equity investments comprise beta and low beta investments. For beta investments, returns are correlated to the MSCI World Net Daily Total Return Index. For low beta investments, over the long term, Life expects to participate in 40% of monthly equity market sell offs and participate in 60% of monthly equity market rallies, resulting in an equity market beta for the strategy of approximately 0.5 times.

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 70% of infrastructure investments with the remainder diversified across geographic regions and sectors.

Equity and infrastructure portfolio

30 June 2021	Domestic	Offshore	Total
Equity beta	38	102	**140**
Low beta	68	249	**317**
Infrastructure	117	49	**166**
Total equity & infrastructure	**223**	**400**	**623**

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 was $1.1bn at 30 June 2021 and increased by 63% ($407m) from 30 June 2020. The increase was driven by an increase in absolute return fund investments and valuation gains.

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

30 June 2021	Domestic	Offshore	Total
Absolute return funds	-	799	799
General insurance	-	155	155
Life insurance	-	100	100
Total alternatives	**-**	**1,054**	**1,054**

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	FY21	1H21	FY20	1H20	FY19	1H19
Repurchase agreements	4,111.1	4,966.3	5,393.4	4,460.0	4,448.5	4,397.4
Controlled property debt	394.5	420.4	458.0	455.0	466.6	476.9
Subordinated debt	404.5	401.7	395.7	404.9	403.9	400.6
Challenger Capital Notes	872.7	892.5	805.0	805.0	805.0	805.0
Infrastructure debt	179.3	182.6	185.8	189.0	192.0	194.7
Other finance	0.7	0.7	0.7	0.7	13.2	13.9
Total CLC debt facilities	**5,962.8**	**6,864.2**	**7,238.6**	**6,314.6**	**6,329.2**	**6,288.5**

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 $1.3bn during FY21 due to a decrease in repurchase agreements used to hedge interest rate movements (down $1.3bn) and a decrease in debt secured by property investments (down $63m), partially offset by an $68m 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 30 June 2021 were $4.1bn, 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 these debt instruments will convert into ordinary shares.

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 in the early stages 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 announced a new Challenger Capital Notes Offer (Challenger Capital Notes 3) with the proceeds 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.

In April 2021, Challenger announced an invitation to noteholders to repurchase the remaining $47m of Challenger Capital Notes 1 on issue, with participation by noteholders being optional. Following completion of the repurchase invitation, approximately $28m of Challenger Capital Notes 1 remained 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.

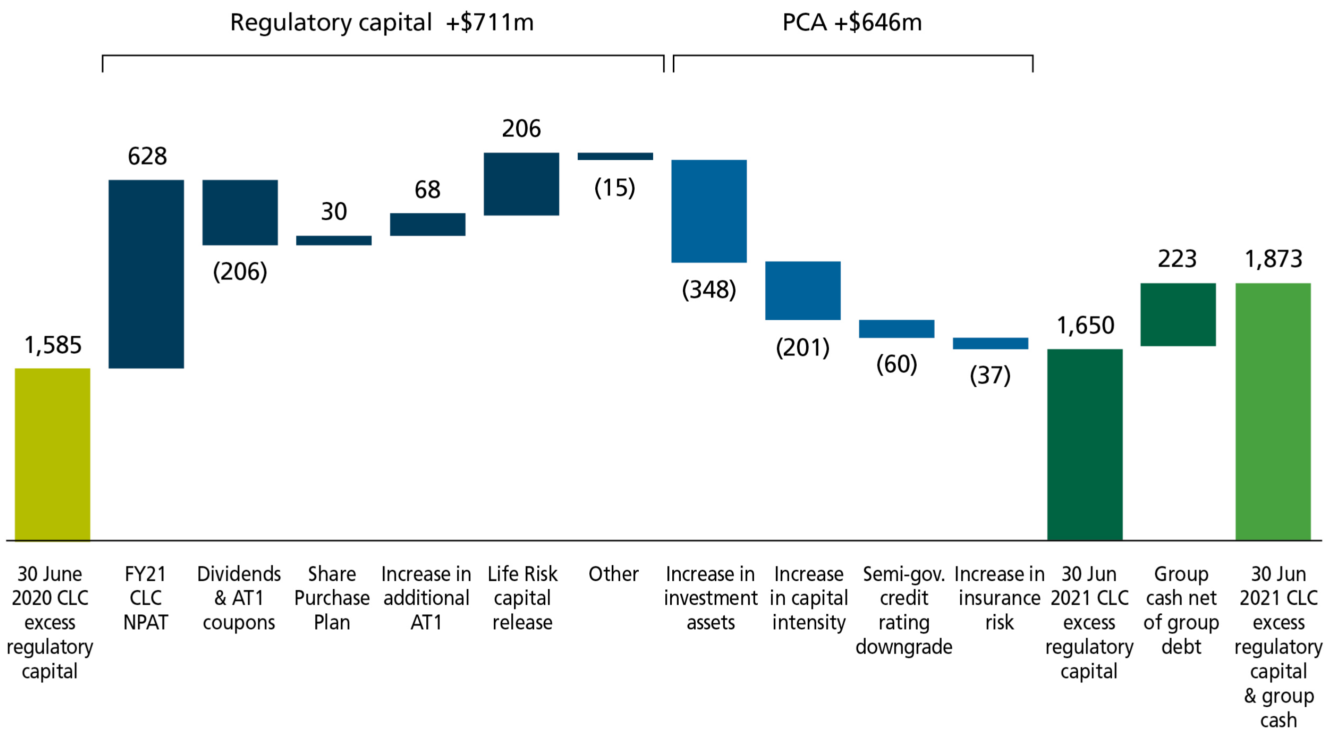
Challenger Life Company Limited (CLC) regulatory capital

$m	FY21	1H21	FY20	1H20	FY19	1H19
CLC regulatory capital						
Common Equity Tier 1 (CET1) regulatory capital	2,971.2	2,622.9	2,337.0	2,811.3	2,789.4	2,517.6
Additional Tier 1	872.7	892.5	805.0	805.0	805.0	805.0
Tier 2 regulatory capital – subordinated debt[1]	405.4	402.7	396.7	406.2	405.3	402.2
CLC total regulatory capital base	**4,249.3**	**3,918.1**	**3,538.7**	**4,022.5**	**3,999.7**	**3,724.8**
CLC Prescribed Capital Amount (PCA)						
Asset risk charge	2,481.8	2,290.2	1,842.8	2,523.6	2,539.5	2,355.2
Insurance risk charge	227.0	213.8	199.5	164.6	135.3	83.3
Operational risk charge	57.9	54.4	56.5	53.4	51.8	47.5
Aggregation benefit	(167.4)	(156.7)	(144.8)	(125.4)	(104.0)	(64.8)
CLC PCA	**2,599.3**	**2,401.7**	**1,954.0**	**2,616.2**	**2,622.6**	**2,421.2**
CLC excess over PCA	**1,650.0**	**1,516.4**	**1,584.7**	**1,406.3**	**1,377.1**	**1,303.6**
PCA ratio (times)	1.63	1.63	1.81	1.54	1.53	1.54
Tier 1 ratio (times)	1.48	1.46	1.61	1.38	1.37	1.37
CET1 ratio (times)	1.14	1.09	1.20	1.07	1.06	1.04
Capital intensity ratio (%)[2]	12.1%	12.2%	10.7%	13.3%	13.8%	13.0%

1 FY21 Tier 2 regulatory capital - subordinated debt ($405.4m) differs to the Group balance sheet ($404.5m) due to accrued interest and amortised costs ($0.9m).

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 30 June 2021 was $4.2bn and increased by $0.7bn in FY21. The increase reflects:

- CLC's statutory profit for the half year which includes investment experience gains ($628m);
- Proceeds from the Share Purchase Plan completed in July 2020 ($30m);
- An increase in Additional Tier 1 capital following the launch of Challenger Capital Notes 3 and substantial replacement of Challenger Capital Notes 1 ($68m – refer to pages 46 and 47 for more detail);
- Release of capital from Life Risk ($206m). During the period CLC undertook a restructure of two wholesale longevity transactions in its UK longevity reinsurance business. The restructure had the effect of a prepayment of future premiums and resulted in a $206m cash payment to CLC; and
- Dividend and coupon payments on Alternative Tier 1 instruments (-$206m). Dividends for the year include a one-off $100m distribution to fund the MyLife MyFinance bank acquisition and its initial growth (refer to page 3 for more detail).

CLC's Prescribed Capital Amount (PCA)

CLC's PCA at 30 June 2021 was $2.6bn and increased by $0.6bn in FY21, reflecting:

- growth in investment assets (+$348m);
- increase in capital intensity (+$201m) from an increase in capital intensity (refer below);
- higher capital intensity following a downgrade in credit ratings for the New South Wales and Victorian semi-governments debt exposures (+$60m); and
- increase in insurance risk charge (+$37m) predominantly due to the restructure of the UK longevity reinsurance transactions (-$49m).

Increase in capital intensity

CLC's capital intensity ratio, which is calculated as CLC PCA divided by Life's closing investment assets, increased from 10.7% at 30 June 2020 to 12.1% at 30 June 2021.

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 to more defensive settings, reducing capital intensity and increasing CLC's excess capital position.

As a result, Life's cash and liquids balance at 30 June 2020 was ~$3bn, which was progressively deployed into higher returning investments over the year, which increased CLC's capital intensity increased by 140 bps to 12.1% in FY21.

CLC's excess capital position

CLC's excess capital above PCA at 30 June 2021 was $1.6bn and increased by $65m in FY21, with the increase in CLC's regulatory capital base partly offset by an increase in capital requirement.

CLC's capital ratios at 30 June 2021 were as follows:

- PCA ratio 1.63 times – down 18 points from 30 June 2020;
- Common Equity Tier 1 (CET1) ratio 1.14 times – down 6 points from 30 June 2020; and
- Total Tier 1 ratio 1.48 times – down 13 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 (1.48 times) and CET1 capital ratio (1.14 times) are well in excess of APRA's minimum requirements.

Target surplus level of excess capital

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 for FY21 corresponded to a PCA ratio of between 1.3 times to 1.6 times.

From FY22, Challenger is extending its target capital ratios to a PCA ratio range of 1.3 times to 1.7 times, up from 1.3 times to 1.6 times. In assessing CLC's capital targets, the internal capital models consider various constraints, including statutory capital minimums set by APRA, a measure of economic capital, and ratings agency capital. As noted above, there are three levels at which APRA statutory capital minimums are assessed: total capital base (which is assessed by the PCA ratio), Tier 1 capital and CET1 minimum requirements. Based on risk appetite relative to each of the five measures (the three statutory capital measures, economic capital and ratings agency capital), CLC determines its capital position relative to target.

Given CLC's current mix of capital, the metric that generates the worst outcome relative to target, forms CLC's constraining target. At 30 June 2021, CLC's constraining target was CET1. The target surplus produced by the internal capital models currently corresponds to a CET1 ratio of between 0.8 times to 1.2 times. This ratio may change over time.

Increase in capital intensity

Challenger has enhanced its capital settings to align with its purpose of providing financial security for a better retirement. From FY22, Challenger is extending its target capital ratios to a PCA ratio range of 1.3 times to 1.7 times, up from 1.3 times to 1.6 times. Within this range, Challenger intends to operate around 1.6 times, which provides increased flexibility to accommodate investment market volatility during periods of significant market shocks.

Group capital targets

Challenger completed the acquisition of MyLife MyFinance, an Australian based savings and loans bank in July 2021, providing Challenger with access to the significant Australian term deposit market.

The purchase price for MyLife MyFinance and regulatory capital to support growth, has been funded by a $100m distribution made by CLC during FY21.

Challenger will be required to hold regulatory capital for MyLife MyFinance in accordance with the authorised deposit-taking institution capital standards.

While different capital rules apply to banks and life insurance companies, overall capital outcomes for assets backing term deposit and term annuity business of similar duration are expected to be broadly similar. This factors in asset mix, and banks not being required to hold additional capital for duration or liability new business strain.

Challenger will set target capital levels and target capital ratios for its banking operations and will report capital levels for each of CLC and the Bank. Some excess capital may be retained at Group level for flexibility of deployment across different regulated entities.

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 ($317m) used to redeem Challenger Capital Notes 1. As a result, CLC’s Additional Tier 1 increased by $68m in FY21.

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 are included on pages 46 and 47.

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 30 June 2021 was $223m and increased by $77m in FY21.

Challenger has additional financial flexibility, including a $400m Group banking facility, which was undrawn at 30 June 2021.

Profit and equity sensitivities

$m	Change in variable	Profit/(loss) after tax FY21	Change in equity FY21	Profit/(loss) after tax FY20	Change in equity FY20
Credit risk					
Fixed income assets (change in credit spreads)[1]	+50 bps	(146.9)	(146.9)	(102.9)	(102.9)
	-50 bps	146.9	146.9	102.9	102.9
Policy liabilities (illiquidity premium change in credit spreads)	+50 bps	81.8	81.8	77.8	77.8
	-50 bps	(81.8)	(81.8)	(77.8)	(77.8)
Property risk					
Direct and indirect properties	+1%	24.3	24.3	26.3	26.3
	-1%	(24.3)	(24.3)	(26.3)	(26.3)
Equity and infrastructure risk					
Equity and infrastructure investments	+10%	43.6	43.6	27.6	27.6
	-10%	(43.6)	(43.6)	(27.6)	(27.6)
Alternatives risk					
Alternatives investments	+10%	73.8	73.8	45.3	45.3
	-10%	(73.8)	(73.8)	(45.3)	(45.3)
Life Insurance risk					
Mortality, morbidity and longevity[2]					
Life insurance contract liabilities	+50%	(29.9)	(29.9)	(24.4)	(24.4)
	-50%	29.9	29.9	24.4	24.4
Interest rate risk					
Change in interest rates	+100 bps	1.5	1.5	0.5	0.5
	-100 bps	(1.5)	(1.5)	(0.5)	(0.5)
Foreign exchange risk					
British pound	+10%	-	-	0.4	0.4
	-10%	-	-	(0.4)	(0.4)
US dollar	+10%	0.4	0.4	2.2	2.2
	-10%	(0.4)	(0.4)	(2.2)	(2.2)
Euro	+10%	-	-	0.2	0.2
	-10%	-	-	(0.2)	(0.2)
Japanese yen	+10%	0.2	0.8	-	1.0
	-10%	(0.2)	(0.8)	-	(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 30 June 2021. If using these sensitivities as forward looking, an allowance for changes post-30 June 2021, 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 60 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

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.

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, foreign exchange 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.

Risk appetite

Challenger's risk appetite statement provides that, subject to acceptable economic returns and limits, it can retain exposure to credit risk, property risk, equity and life insurance risk.

Accept exposure (subject to appropriate returns)	**Minimise exposure**
✓ Credit 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
	× Regulatory and compliance 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 risk

Credit risk is the risk of loss due to a counterparty failing to discharge its contractual obligations when they fall due, a change in credit rating, movements in credit spreads, or movements in the basis between different valuation discount curves.

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 30 June 2021, a 50 bps increase/decrease in credit spreads would have resulted in an unrealised loss/gain of $147m (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 30 June 2021, a 50 bps increase/decrease in credit spreads would have resulted in an unrealised gain/loss of $82m (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 income and includes leasing and tenant default risk, which may impact the cash flows from these investments.

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 51 show the impact of a change in property valuations at balance date and are based on Life's gross property investments of $3.9bn (net investments of $3.5bn plus debt of $0.4bn). A 1% move in the direct and indirect property portfolio at 30 June 2021 would result in a $24m (after-tax) movement in property valuations.

Equity and infrastructure risk

Challenger is exposed to movements in the market value of listed equity investments, unlisted equity investments, and infrastructure investments. Challenger holds equities and infrastructure as part of its investment portfolio in order to provide diversification across the investment portfolio

Equity risk sensitivity

The equity and infrastructure risk sensitivities included on page 51 show a 10% move in the equity portfolio at 30 June 2021 would have resulted in a $44m (after-tax) movement in the valuation of equity 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 sensitivity

The alternatives risk sensitivity on page 46 assumes a 10% market move in the alternatives portfolio at 30 June 2021 would have impacted the valuation by $74m (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 takes longevity risk, which is the risk customers 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 risks on its wholesale mortality reinsurance business.

CLC is required under APRA prudential standards to maintain regulatory capital in relation to life insurance risks. CLC regularly reviews the portfolio for longevity experience to ensure longevity assumptions remain appropriate.

Mortality 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 and longevity sensitivities

The mortality sensitivities on page 51 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 51.

The sensitivities assume the change in variable occurs on 30 June 2021 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 30 June 2021.

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 is set out on page 51. 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	FY21	FY20	FY19	2H21	1H21	2H20	1H20	2H19	1H19
Fidante Partners									
Fidante Partners income[1]	97.4	81.4	83.2	52.3	45.1	39.4	42.0	39.4	43.8
Performance fees	10.1	14.9	3.5	5.5	4.6	11.4	3.5	1.0	2.5
Net income	**107.5**	**96.3**	**86.7**	**57.8**	**49.7**	**50.8**	**45.5**	**40.4**	**46.3**
CIP Asset Management									
CIP income[2]	61.8	61.8	63.2	30.2	31.6	29.6	32.2	34.3	28.9
Total net fee income	**169.3**	**158.1**	**149.9**	**88.0**	**81.3**	**80.4**	**77.7**	**74.7**	**75.2**
Personnel expenses	(63.2)	(63.9)	(64.8)	(34.0)	(29.2)	(32.2)	(31.7)	(32.9)	(31.9)
Other expenses	(35.1)	(36.5)	(34.2)	(18.3)	(16.8)	(18.4)	(18.1)	(17.0)	(17.2)
Total expenses	**(98.3)**	**(100.4)**	**(99.0)**	**(52.3)**	**(46.0)**	**(50.6)**	**(49.8)**	**(49.9)**	**(49.1)**
EBIT	**71.0**	**57.7**	**50.9**	**35.7**	**35.3**	**29.8**	**27.9**	**24.8**	**26.1**
Performance analysis									
Fidante Partners – income margin (bps)[3]	14.8	15.9	14.8	14.8	14.9	16.8	14.8	14.0	15.9
CIP Asset Management – income margin (bps)[3]	30.6	31.2	33.4	29.8	31.7	30.0	31.7	36.4	30.6
Funds Management – income margin (bps)[3]	18.3	19.6	19.4	17.9	18.8	20.2	19.0	19.5	19.3
Funds Management – FUM-based income margin (bps)[4]	16.3	16.1	15.7	16.2	16.6	16.6	15.5	15.6	15.8
Cost to income ratio	58.1%	63.5%	66.0%	59.4%	56.6%	62.9%	64.1%	66.8%	65.3%
Net assets – average[5]	256.0	237.8	216.7	260.3	251.4	242.9	232.5	221.8	212.3
ROE (pre-tax)	27.7%	24.3%	23.5%	27.7%	27.8%	24.7%	23.8%	22.6%	24.4%
Fidante Partners	84,943	62,393	58,912	84,943	71,826	62,393	62,693	58,912	56,330
CIP Asset Management	20,881	19,042	20,117	20,881	19,416	19,042	20,153	20,117	18,684
Closing FUM – total	**105,824**	**81,435**	**79,029**	**105,824**	**91,242**	**81,435**	**82,846**	**79,029**	**75,014**
Fidante Partners	72,488	60,737	58,556	78,754	66,127	60,866	60,887	58,173	58,621
CIP Asset Management	20,176	19,837	18,911	20,481	19,763	19,550	20,170	19,042	18,747
Average FUM – total[5]	**92,664**	**80,574**	**77,467**	**99,235**	**85,890**	**80,416**	**81,057**	**77,215**	**77,368**
FUM and net flows analysis									
Fidante Partners	14,346.5	3,797.8	(3,636.1)	8,582.2	5,764.3	1,854.4	1,943.4	(2,590.3)	(1,045.8)
CIP Asset Management	1,765.0	(1,256.9)	1,197.7	1,105.9	659.1	(1,193.1)	(63.8)	1,129.0	68.7
Net flows	16,111.5	2,540.9	(2,438.4)	9,688.1	6,423.4	661.3	1,879.6	(1,461.3)	(977.1)
Distributions	(1,332.2)	(762.2)	(794.7)	(474.8)	(857.4)	(297.5)	(464.7)	(353.0)	(441.7)
Market-linked movement	9,609.9	627.6	4,278.5	5,368.9	4,241.0	(1,774.3)	2,401.9	5,829.2	(1,550.7)
Total FUM movement	**24,389.2**	**2,406.3**	**1,045.4**	**14,582.2**	**9,807.0**	**(1,410.5)**	**3,816.8**	**4,014.9**	**(2,969.5)**

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

2 CIPAM 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 FUM-based income margin represents FUM-based income (net income excluding performance and transaction fees) divided by average FUM.

5 Calculated on a monthly basis.

Funds Management financial results

Funds Under Management and net flows

$m	Q4 21	Q3 21	Q2 21	Q1 21	Q4 20
Funds Under Management					
Fidante Partners					
Equities	37,428	33,820	30,229	26,985	26,295
Fixed income	40,609	38,378	35,090	31,904	29,590
Alternatives	6,906	6,566	6,507	6,336	6,508
Total Fidante Partners	84,943	78,764	71,826	65,225	62,393
CIP Asset Management					
Fixed income	16,278	16,020	14,470	14,859	13,629
Property	4,603	4,910	4,946	5,147	5,413
Total CIP Asset Management	20,881	20,930	19,416	20,006	19,042
Total Funds Under Management	**105,824**	**99,694**	**91,242**	**85,231**	**81,435**
Average Fidante Partners	82,206	75,305	67,963	64,065	59,021
Average CIP Asset Management	21,042	20,032	20,190	19,397	18,799
Total average Funds Under Management[1]	**103,248**	**95,337**	**88,153**	**83,462**	**77,820**
Analysis of flows					
Equities	641	2,071	5	335	(195)
Fixed income	2,147	3,420	3,327	2,107	2,955
Alternatives	254	50	86	(96)	(199)
Total Fidante Partners	**3,042**	**5,541**	**3,418**	**2,346**	**2,561**
CIP Asset Management	(383)	1,489	(571)	1,230	404
Net flows	**2,659**	**7,030**	**2,847**	**3,576**	**2,965**

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

Reconciliation of total group assets and Funds Under Management

$m	Q4 21	Q3 21	Q2 21	Q1 21	Q4 20
Funds Management Funds Under Management	105,824	99,694	91,242	85,231	81,435
Life investment assets	21,563	20,796	19,634	18,948	18,303
Adjustments to remove double counting of cross-holdings	(17,427)	(16,332)	(14,789)	(15,383)	(14,501)
Total Assets Under Management	**109,960**	**104,158**	**96,087**	**88,796**	**85,237**

Funds Management financial results

Funds Management focuses on building savings for retirement. As people work and save for retirement, the business supports them building their wealth and savings by providing investment strategies that seek to deliver superior investment returns.

Funds Management is one of Australia's fastest growing[1] and third largest active fund manager[2]. It is diversifying globally and developing its global distribution capability, with operations in Europe, Japan and Singapore.

Funds Management funds under management (FUM) was $106 billon at 30 June 2021 and has increased from $24 billion 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 alignment with clients 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 alternative investments.

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

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 and building successful active equity, active fixed income and alternative investment managers, while maintaining strong investment performance. Recognising Fidante Partners' distribution capability, in 2020 it won Distributor of the Year at the annual Zenith Fund Awards.

Fidante Partners includes a European, Japanese and Singaporean distribution platform with interests in a number of specialist boutique fund managers and is an important part of Funds Management's international distribution and product expansion.

CIPAM continued its transition to becoming a more externally focused asset manager. Challenger is committed to growing the business and building on its breadth of investment expertise. CIPAM principally originates and manages fixed income and commercial real estate, along with providing investment solutions for leading global and Australian institutions, including Challenger Life.

EBIT and ROE

Funds Management EBIT was $71m and increased by $13m (23%) on FY20. The increase in EBIT was due to higher fee income (up $16m) and lower expenses (down $2m), partially offset by performance fees (down $5m).

Funds Management ROE was 27.7% and increased by 340 bps from 24.3% in FY20. ROE benefited from the 23% increase in EBIT.

Total net fee income

FY21 total net income was $169m and comprised FUM-based fees of $151m (FY20 $130m), transaction fees of $8m (FY20 $13m) and performance fees of $10m (FY20 $15m).

Expenses

FY21 Funds Management expenses were $98m and decreased by $2m (2%) on FY20. Personnel costs reduced by $1m and other expenses reduced by $1m.

2H21 Funds Management expenses were $52m and increased by $6m (14%) on 1H21. The increase relates to timing differences with 1H21 reflecting lower business activity due to the COVID-19 pandemic and higher personnel costs in 2H21. 2H21 included the full year impact of a change in variable reward mix, with higher cash rather than deferred equity payments ($4m) increasing personnel costs.

The FY21 cost to income ratio was 58.1% and improved by 540 bps from 63.5% in FY20.

Fidante Partners' net income

Fidante Partners' net fee income includes FUM-based 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 $107m in FY21 and increased by $11m (12%) on FY20. Fidante Partners' net income comprised:

- FUM-based income of $97m and increased by $20m (26%) on FY20 as a result of the FUM-based margin expanding (refer below) and an 19% increase in average FUM;
- Performance fees of $10m reduced by $5m on FY20; and
- Transactions fees of nil, which reduced by $4m on FY20. Lower Fidante Partners transaction fees reflect market conditions.

Fidante Partners' income margin (net income to average FUM) was 14.8 bps and fell 110 bps from FY20. The reduction in income margin was due to lower performance and transaction fees. Fidante Partners FUM-based margin expanded as a result of a higher proportion of retail business and higher equity accounted profits derived from a larger equity stake in Ardea Investment Management.

In 2H21, Fidante Partners increased its equity stake in Ardea Investment Management by 20% and now holds a 49.9% equity interest. Fidante Partners increased its equity holding in order to help support succession planning and expects to reduce its holding over time.

[1] Plan For Life Wholesale Trust Data, September 2020, December 2020 and March 2021.

[2] Consolidated FUM for Australian Fund Managers – Rainmaker Roundup, March 2021.

Fidante Partners' FUM and net flows

Fidante Partners' FUM at 30 June 2021 was $84.9bn and increased by $22.6bn (36%) for the year and included:

- net flows of $14.3bn, including $10.2bn of institutional flows and $4.1bn of retail flows;
- positive impact from investment markets of $9.5bn; and
- net distributions of $1.3bn.

Fidante Partners' 30 June 2021 FUM is invested in the following asset classes:

- 44% in equities (FY20 42%);
- 48% in fixed income (FY20 47%); and
- 8% in alternatives (FY20 11%).

Fidante Partners' closing FY21 FUM was 17% higher than the FY21 average, providing earnings momentum and support into FY22.

CIP Asset Management

CIPAM's net income was $62m in FY21 and was unchanged from FY20. CIP Asset Management's net income included:

- FUM-based income of $54m, up $1m on FY20 reflecting a 2% increase in average FUM; and
- transaction fees of $8m, down $1m on FY20 due to lower property development and leasing fees.

CIPAM's income margin (net income to average FUM) was 30.6 bps and was down 0.5 bps from FY20 due to lower transaction fees.

CIPAM's FUM-based income margin was 26.7 bps, up 0.3 bps with higher third-party fixed income offset by a lower mix of property assets.

CIP Asset Management's FUM and net flows

CIP Asset Management's FUM at 30 June 2021 was $20.9bn and increased by $1.8bn for the year and included:

- net flows of $1.8bn, predominantly from Challenger Life as it deployed excess cash and liquids into higher returning assets; and
- positive market movement of $0.1bn.

CIP Asset Management's 30 June 2021 FUM is invested in the following asset classes:

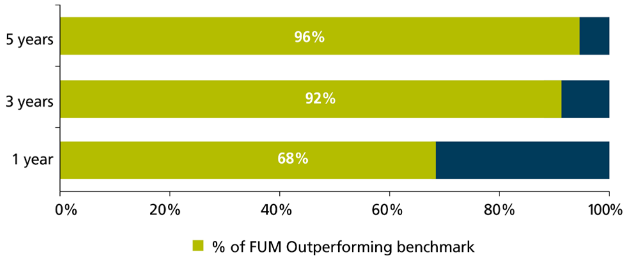
- 78% in fixed income (FY20 72%); and
- 22% in property (FY20 28%).

19% of CIP Asset Management's FUM is from third-party clients with the balance managed on behalf of Challenger Life.

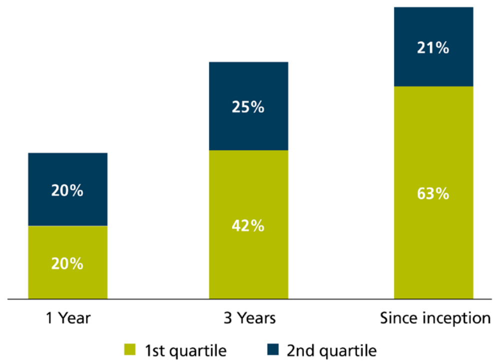
Funds Management investment performance

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 92% and 96% of FUM outperforming benchmark over three and five years respectively[1].



For Fidante Partners Australian boutiques, 67% of funds achieved first or second quartile performance over three years and 84% of funds achieved either first or second quartile investment performance since inception[2].



[1] As at 30 June 2021. Percentage of Fidante Partners Australian boutiques meeting or exceeding performance benchmark.

[2] Mercer as at June 2021.

Corporate financial results

$m	FY21	FY20	FY19	2H21	1H21	2H20	1H20	2H19	1H19
Other income	**0.0**	**0.4**	**1.0**	**(0.0)**	**0.0**	**0.2**	**0.2**	**0.5**	**0.5**
Personnel expenses	(35.5)	(32.5)	(38.6)	(18.7)	(16.8)	(14.4)	(18.1)	(19.6)	(19.0)
Other expenses	(25.1)	(28.3)	(10.3)	(18.1)	(7.0)	(18.5)	(9.8)	(4.8)	(5.5)
Total expenses (excluding LTI)	**(60.6)**	**(60.8)**	**(48.9)**	**(36.8)**	**(23.8)**	**(32.9)**	**(27.9)**	**(24.4)**	**(24.5)**
Long-term incentives (LTI)	(8.5)	(9.0)	(13.0)	(2.7)	(5.8)	(4.1)	(4.9)	(5.9)	(7.1)
Total expenses	**(69.1)**	**(69.8)**	**(61.9)**	**(39.5)**	**(29.6)**	**(37.0)**	**(32.8)**	**(30.3)**	**(31.6)**
Normalised EBIT	**(69.1)**	**(69.4)**	**(60.9)**	**(39.5)**	**(29.6)**	**(36.8)**	**(32.6)**	**(29.8)**	**(31.1)**
Interest and borrowing costs	(5.0)	(6.5)	(5.3)	(2.7)	(2.3)	(4.0)	(2.5)	(2.4)	(2.9)
Normalised loss before tax	**(74.1)**	**(75.9)**	**(66.2)**	**(42.2)**	**(31.9)**	**(40.8)**	**(35.1)**	**(32.2)**	**(34.0)**

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 $69m in FY21, unchanged from FY20 with lower other income (down $0.4m) offset by lower expenses (down $0.7m).

Other income

Other income represents interest received on Group cash and was nil in FY21 due to the low interest rate environment.

Total expenses

FY21 Corporate expenses were $69m and decreased by $1m on FY20.

Corporate expenses include:

- Personnel costs of $36m, increased by $3m on FY20 as a result of a change in variable reward mix, with higher cash and lower deferred equity payments;
- Other expenses of $25m, decreased by $3m due to lower non-recuring and insurance expenses; and
- Long-term incentive costs of $9m, decreased by $1m following forfeitures of hurdled performance share rights.

2H21 Corporate expenses (excluding LTI) were $37m and increased by $13m on 1H21. 2H21 personnel costs were $2m higher than 1H21 and included the full year impact of a change in variable reward mix, with higher cash and lower deferred equity payments. 2H21 other expenses were $11m higher than 1H21 and include $9m impairment in relation to cloud-based computing arrangements.

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 repaid in 2H21. The facility was undrawn at 30 June 2021.

FY21 interest and borrowing costs were $5m and decreased $2m on FY20, reflecting the line fee and lower drawdown of the Group debt facility.

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 29).

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

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, it 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.
CIPAM 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; performance fees and transactions fees.
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 61 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 CIPAM income.
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 61 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 61 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 29 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 *Capital Adequacy*.
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, it 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)

Q1 2022 Sales and AUM	20 October 2021
2021 Annual General Meeting	28 October 2021
2022 Half-year financial results	17 February 2022
Q3 2022 Sales and AUM	21 April 2022
2022 Full-year financial results	16 August 2022
2022 Annual General Meeting	27 October 2022