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Analyst Pack 2023

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2023 Annual Report

can be downloaded from
Challenger's online
Shareholder Centre

> challenger.com.au/shareholder

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Challenger Limited ACN 106 842 371

Challenger acknowledges the Traditional Owners of Country throughout Australia and we pay our respects to Elders past and present.

We recognise the continuing connection that Aboriginal and Torres Strait Islander peoples have to this land and acknowledge their unique and rich contribution to society.

Important note

Information presented in the FY23 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 2023 Annual Report is available from Challenger's shareholder centre at: **www.challenger.com.au/shareholder**

The FY23 Analyst Pack is not audited. The statutory net profit after tax as disclosed in the consolidated profit and loss (page 10) 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 10), 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 2023 Annual Report.

The 2023 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 and accepts no liability 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.

FY23 financial highlights[1]

Group	Normalised net profit before tax $521m, up 10%
	Normalised net profit after tax $364m, up 13%
	Statutory net profit after tax $288m, up
	Normalised EPS[2] 53.3 cents per share, up 12%
	Statutory EPS[2] 42.1 cents per share, up 12%
	Net income $842m, up 8%
	Expenses $318m, up 6%
	Normalised cost to income ratio 37.7%, down 100 bps
	Group assets under management $105.0b, up 6%
	Normalised Return On Equity (pre-tax) 12.7%, up 80 bps
	Statutory Return On Equity (post-tax) 7.0%, up 60 bps
	Full-year dividend 24.0 cents per share (fully franked), up 4%
	Normalised dividend payout ratio 45.0%
Life	Normalised Cash Operating Earnings (COE) $653m, up 12%
	COE margin 2.82%, up 22 bps
	Expenses $113m, up 2%
	Normalised EBIT[3] $541m, up 14%
	Total Life sales $9.7b, unchanged
	Annuity sales $5.5b, up 8%
	Total Life book growth $0.9b, or 5.2% growth in opening liabilities
	Annuity net book growth $0.4b, or 2.8% growth in opening liabilities
	Average investment assets $23.1b, up 3%
	Investment assets $23.5b, up 6%
	Normalised Return On Equity (pre-tax) 15.1%, up 200 bps
	Prescribed Capital Amount (PCA) ratio 1.59 times, down from 1.60 times
	Common Equity Tier 1 (CET1) ratio 1.16 times, up from 1.11 times
	Capital intensity 11.4%, down from 11.5%
Funds Management	Net income $179m, down 7%
	Expenses $117m, up 8%
	EBIT[3] $62m, down 26%
	Net outflows $0.5b, down from net outflows of $8.5b
	Average Funds Under Management (FUM) $95.0b, down 9%
	Closing FUM $98.4b, up 5%
	Return On Equity (pre-tax) 21.7%, down from 31.2%

1 All percentage movements compare FY23 to the prior corresponding period (FY22) 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 leverages capabilities across its two core businesses, Life and Funds Management.

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

Australia's compulsory superannuation system commenced in 1992 and is now the fifth largest pension system globally[1] and one of the fastest growing, with assets increasing by 10% per annum over the past 20 years[2].

Australia's superannuation system is forecast to grow from $3 trillion today[3] to over $9 trillion[4] in the next 20 years.

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.

Growth in the retirement phase is also supported by ageing demographics and the Government's focus on enhancing the retirement phase of superannuation. Australian life expectancy is the fifth highest in the world[5], with the average time spent in retirement approximately 24 years[6].

Life

Life focuses on the retirement income phase of superannuation, with products helping customers convert retirement savings into safe, secure and reliable retirement income.

Life's annuity products appeal to retirees as they provide security and certainty of guaranteed[7] income, while protecting against the risks of investment markets and inflation. By providing certainty of income, Challenger ensures customers have more confidence to spend in retirement.

Lifetime annuities protect retirees from the risk of outliving their savings and pay an income for life. Depending on the payment option selected, payments can be either fixed, indexed to inflation, linked to changes in the RBA cash rate or indexed to investment markets.

The retirement incomes Life pays to its customers are backed by a high-quality investment portfolio, predominantly invested in investment grade fixed income. These investments generate reliable investment income, which is used to fund the retirement incomes paid to customers.

Life is Australia's leading retirement income brand[8] and has won the Association of Financial Advisers 'Annuity Provider of the Year' for the last 15 years, and won Plan for Life's Overall Longevity Cover Excellence Award in 2022.

Life is expected to continue to benefit from long-term growth in Australia's superannuation system and regulatory reforms are designed to enhance the retirement phase of superannuation.

As Australia's superannuation system grows, the retirement phase of superannuation is expected to increase significantly. The number of Australians over the age of 65 is expected to increase by nearly 50% over the next 20 years[9]. Reflecting these demographic changes, and growth in the superannuation system, the annual transfer from the savings phase of superannuation to the retirement phase was estimated to be approximately $87 billion[10] in 2022.

The purpose of superannuation is to provide income in retirement to substitute or supplement the Government-funded age pension. As the superannuation system grows and individual superannuation savings increase, retirees are transitioning from Government-funded age pensions to private superannuation-funded pensions. Retirees need retirement income products that convert their superannuation savings into safe, secure and reliable income, which helps provide financial security and confidence to spend 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 objective of the superannuation system. The Retirement Income Covenant took effect from 1 July 2022 as part of the ***Superannuation Industry Supervision Act 1993*** (SIS Act) and requires all APRA-regulated superannuation funds to have a documented retirement income strategy that outlines how they plan to assist their members in retirement.

In February 2023, the Australian Government released the Quality of Advice Review's (QAR) final report, focused on the effectiveness and availability of financial advice in Australia. The Government responded to the QAR on 13 June 2023 as part of its Delivering Better Financial Outcomes package that focuses on removing onerous red tape that adds to the cost of advice, expanding access to retirement income advice and exploring new channels for advice. Refer to page 33 for more detail on retirement income regulatory reforms.

These reforms provide an opportunity to increase the proportion of savings invested in products that deliver retirees stable, regular and reliable retirement income. Annuities deliver these benefits yet currently only represent a very small part of the retirement phase of superannuation.

Life's products are distributed in Australia via independent financial advisers and financial adviser administrative platforms. Life's products are included on all major advice hubs' Approved Product Lists (APLs) and are available on leading independent investment and administration platforms.

Life recently launched a new direct online channel to meet the needs of customers who prefer to invest directly and allow them to buy simple fixed term annuities.

Life is also building institutional partnerships with superannuation funds that are increasingly focused on supporting their members in retirement by providing more

[1] Thinking Ahead Institute Global Pension Assets Study 2023.
[2] APRA Annual Superannuation Bulletin.
[3] The Australian Prudential Regulation Authority (APRA), as at March 2023.
[4] Deloitte Dynamics of the Australian Superannuation System: The Next 20 Years to 2041.
[5] Source: Australian Bureau of Statistics, Institute of Health and Welfare.
[6] Challenger Retirement Income Research 2022, based on ABS data age at death.
[7] The word 'guaranteed' means payments are guaranteed by Challenger Life Company Limited (CLC) from assets of either its relevant statutory fund or shareholder fund.
[8] Plan For Life – March 2023 – based on annuities under administration.
[9] 2022–2042 comparison based on Australian Bureau of Statistics, Population Projections Series B, cat no. 3222.0.
[10] Based on Taxation Statistics 2020-21 from Australian Taxation Office.

comprehensive retirement income solutions. A number of funds have defined benefit pension liabilities and are looking to de-risk their liabilities. This provides significant growth opportunities for Challenger as funds seek trusted partners to deliver a range of de-risking solutions.

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 MS&AD Insurance Group Holdings Inc. (MS&AD).

Under the reinsurance arrangement, MS Primary reinsures at least ¥50 billion (equivalent to ~A$520 million)[11] of its Australian and US dollar annuities with Challenger Life each year[12]. This is subject to review in the event of a material adverse change for either MS Primary or Challenger Life.

MS&AD also holds approximately 15% equity interest in Challenger Limited and an MS&AD representative has been appointed to the Board.

Refer to page 32 for more detail on the MS Primary and MS&AD relationship.

Funds Management

Funds Management focuses on wealth accumulation, predominantly in the pre-retirement phase of superannuation, by supporting customers build savings through providing contemporary investment strategies and products that seek to deliver superior investment returns.

Funds Management is one of Australia's largest active fund managers[13] with funds under management (FUM) of $98 billion, which has more than doubled over the last 10 years (up from $41 billion in 2013).

Growth in FUM is supported by Challenger's award-winning retail and institutional distribution teams and business model, which is focused on high-quality managers with strong long-term investment performance and alignment with clients.

Funds Management comprises Fidante and Challenger Investment Management (CIM), with operations in Australia, the United Kingdom, Europe and Asia.

Funds Management, through its Fidante affiliates and CIM, invests across a broad range of asset classes, including fixed income, Australian and global equities and alternative investments.

Funds Management has extensive client relationships. For example, over 70% of Australia's top 50 superannuation funds are clients.

Fidante's business model involves taking minority equity interests in separately branded affiliate funds management firms, with Challenger providing distribution services and business support, and Artega Investment Administration (Artega) providing investment administration services, leaving investment managers to focus entirely on managing investment portfolios.

Fidante has been successful in attracting and building active equity, active fixed income and alternative investment managers, while also maintaining strong investment performance. Over the last five years, long-term performance of Fidante's Australian affiliates was strong with 99% of investments outperforming their respective benchmarks.[14].

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

CIM principally originates and manages fixed income and commercial real estate for leading global and Australian institutions, including Challenger Life. Challenger Life accounts for approximately 80% of CIM's FUM.

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

Bank

In October 2022, Challenger announced it had entered into a share sale agreement to sell the Bank to Heartland Group Holdings Limited (NZX/ASX:HGH). The Bank sale is subject to regulatory approval in Australia and New Zealand and expected to settle in 1H24.

Risks

The above business and market overview for the Life, Funds Management and Bank businesses is subject to the following key business risks:

- investment market volatility;
- 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, term deposits and managed funds;
- inflation risk; and
- operational risk.

[11] Based on exchange rate as at 30 June 2023.
[12] Reinsurance across both Australian and US dollar annuities, of at least ¥50 billion per year for a minimum of five years, commencing 1 July 2019.
[13] Calculated from Rainmaker Roundup, March 2023 data.
[14] As at 30 June 2023. Percentage of Fidante affiliates meeting or exceeding the performance benchmark, with gross performance weighted by FUM.

Purpose, corporate strategy and values

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

OUR STRATEGIC PRIORITIES

Challenger has four strategic priorities to ensure that it achieves its purpose of providing customers with financial security for a better retirement.

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

OUR VALUES

Act with integrity

We do things the right way

Aim high

We deliver outstanding results

Collaborate

We work together to achieve shared goals

Think customer

We make decisions with our end customers front of mind

At Challenger, our values are integral to our culture and linked to everything we do. They set out the behaviours we need to deliver on our purpose and strategy and to meet community expectations, now and in the future.

FY23 strategic progress

Progress over FY23 has been measured against Challenger's four strategic priorities.

1. Broaden customer access across multiple channels

FY23 progress:

Diversification strategy delivering strong Life sales

Challenger is delivering higher quality Life sales through focusing on longer duration business across both retail and institutional products and clients.

In FY23, the Life business achieved sales of $9.7 billion, driven by record annuity sales of $5.5 billion (up 8%).

Annuity sales benefitted from very strong domestic retail sales of $3.6 billion (up 53%) that included retail term annuity sales of $2.9 billion (up 53%) and lifetime[1] sales of $0.7 billion (up 49%).

Annuity sales are benefitting from a supportive market environment, rising demand for guaranteed lifetime income and a growing number of Australians entering retirement.

In March 2023,Challenger launched a targeted marketing campaign for lifetime annuities. Centering around longevity protection, the campaign highlighted how a lifetime annuity can benefit retirees by providing them with confidence to spend in retirement, while protecting against the risks of rising inflation and outliving their savings.

In FY23, demand for longer-dated annuities improved with 74% of new business annuity sales greater than 2 years[2] compared with 50% in FY22. The tenor on new business annuity sales also increased to 5.8 years, up from 4.9 years in FY22. The contribution of longer-dated annuity sales is helping to reduce the maturity rate, which is expected to fall to 26% in FY24, down from 33% in FY23.

Retail sales continue to benefit from stronger demand and are supported by an increase in adviser quoting levels, which increased 59% on the prior corresponding period (pcp).

Building a more customer-centric business and playing a more meaningful role in customer lives

Throughout FY23, Challenger took steps to reorganise itself around customers and focus on their needs, leveraging its core capabilities in much more meaningful ways.

The newly formed Customer division oversees all customer functions for the Group, including customer strategy, product development, sales and marketing, and customer service, delivering a clearer operating model and prioritising customers' needs.

In 1H23, an experienced sales, marketing and distribution executive, Ms Mandy Mannix, was appointed Chief Executive, Customer. The appointment follows the creation of a range of new leadership roles, as Challenger focuses on building a more customer-centric business. New leadership roles include the Chief Commercial Officer and expanding responsibilities of the Chief Executive, Life to include oversight for Life's Institutional Solutions Group.

Modernising the customer experience

As part of creating a more customer-centric business, Challenger is investing in its customer experience and customer journeys. These innovations are designed to make it easier and quicker for customers to do business with Challenger and expand customer reach and improve engagement.

In 1H23, Fidante launched a new registry service and a range of new digital tools. Fidante's new registry service now provides online transacting and registry services to over 60 funds managed by Challenger and support the expansion of Fidante's suite of Exchange Traded Funds (ETFs). Investors have access to a new online investor portal and can self-service, allowing investors and advisers to manage portfolios directly and provide easy access to a wide range of services.

The Life business is also working on a range of initiatives to improve its customer experience. In May 2023, Challenger launched a new direct online channel that allows customers to buy simple fixed term annuities online in under ten minutes. This new digital direct channel will allow Challenger to capture targeted growth by meeting the needs of customers who prefer to invest directly while providing greater process efficiencies.

In FY23, online digital branding across the Funds Management and Life businesses was refreshed to provide a more contemporary look and feel. This included the rebrand of Fidante and launch of its new website (Fidante.com).

The rebrand reflects Fidante's diverse, contemporary offering, which includes 19 affiliate partners and covers most major asset classes. The new website is more personalised and user friendly, offering greater content, comparison tools and interactive charts that will provide a more sophisticated and contemporary customer experience.

Deepening relationships with institutions

A key focus for FY23 for Challenger has been to build on institutional customer relationships, particularly with the leading superannuation funds.

Challenger's offering for institutional customers extends from simple, short-term yield products, through to longer-duration lifetime income and institutional longevity solutions.

As Australia's leading provider of longevity protection with decades of experience, Challenger via the Solutions Group is well placed to help superannuation funds simplify their business and de-risk their defined benefit liabilities. There are opportunities to support them to develop more comprehensive retirement income propositions to meet their members' needs.

Currently, Challenger has a business relationship with the 25 largest Australian superannuation funds[3]. Challenger sees partnerships with super funds as a key growth opportunity and has been engaging with funds to help support them as they develop their retirement income propositions, as required under the Retirement Income Covenant. Refer to page 33 for more information.

[1] Includes CarePlus annuity sales.

[2] FY23 new business annuity sales by tenor excluding reinvestment sales and Japanese sales.

[3] By total assets, quarterly My Super statistics as at 31 March 2023, APRA.

In May 2023, Challenger announced a strategic partnership with profit-to-member fund TelstraSuper to provide its members lifetime annuities, which provide them with longevity and inflation protection. The partnership is expected to commence in 1H24 and generate ongoing lifetime annuity sales for Challenger.

In July 2023, Challenger announced it had been selected as Aware Super Pty Ltd's (Aware Super) defined benefit fund partner. Commencing in July 2023, Challenger will provide a group lifetime annuity policy to the value of $619 million that will cover approximately 3,000 members and de-risk the fund's lifetime pension liabilities.

The defined benefit pension market presents a significant growth opportunity for Challenger as an increasing number of corporate pension plans and superannuation funds look to de-risk their defined benefit pension liabilities.

International Funds Management expansion

Funds Management is well positioned for growth opportunities in Australia and is diversifying its operations globally.

Funds Management has expanded its distribution business into Europe through its UK office and has established a presence in Japan.

To support offshore clients and provide access to its investment products, Fidante is establishing Undertakings for Collective Investment in Transferable Securities (UCITS) funds. Fidante is continuing to seek opportunities to bring new product to the offshore market through targeting institutional and wholesale UK, European and Asian investors.

In November 2023, Fidante's emerging markets affiliate, Ox Capital Management, launched the Ox Capital Dynamic Asia UCITS Fund investing in Asian equities, excluding Japan. The fund holds a concentrated portfolio of 30 to 50 stocks, focused on technology, healthcare, financials and consumer discretionary sectors.

Award-winning investment strategies and products

Challenger is a market leader in Australian retirement incomes. In March 2023, Challenger Life won the Association of Financial Advisers 'Annuity Provider of the Year' for the 15th consecutive year, along with the 'Long Term Income Stream' award.

93% of financial advisers regard Challenger as a leader in retirement income – more than 35 percentage points ahead of its closest peer[4].

Challenger was also the winner of Plan For Life's 'Overall Longevity Cover Excellence Award' for 2022, which recognises Australian life companies and fund managers who design products to assist retirees in meeting the challenges of longevity. Challenger also won the Plan For Life 'Longevity Product Award' for its Liquid Lifetime annuity and the 'Client & Adviser Technical Support Award', for its in-depth, ongoing support provided to advisers.

Fidante's investment managers continue to be externally recognised.

During FY23, the following affiliates won investment manager awards:

- Ardea Real Outcome Fund – Lonsec - Active Global Fixed Income Fund;
- Ardea Real Outcome Fund – Money Magazine - Best Australian Fixed Interest Fund (Diversified) and Financial Standard - Best Credit/Absolute Return Fund;
- Alphinity Investment Management – Zenith Investment Partners - Australian Equities, Large Cap; and
- Bentham Global Income Fund – Money Management - Global Fixed Income Fund of the Year.

Fidante was recognised as Australia's leading retail funds management distributor, winning Zenith Investment Partners (Zenith) Distributor of the Year in October 2022 for a third consecutive year. This award recognises the quality of Zenith's ratings across Fidante's product suite, access to Fidante affiliate investment professionals and the quality of its adviser support and sales team. Fidante's products are continually recognised externally as high quality, with 21 of the 30 strategies rated Highly Recommended by research houses[5].

2. Expand the range of financial products and services for a better retirement

FY23 progress:

Innovative retirement income solutions

With a 'One Challenger' approach, Challenger brings the best of the business to more customers.

Challenger does this by capitalising on the expertise across the Group and is expanding the Challenger brand from a leader in retirement incomes, to a brand synonymous with high-quality income products with a wider retirement offering. Challenger is also focused on improving the way it delivers its retirement products, longevity solutions and investment capability to customers and partners.

In July 2022, the Challenger Solutions Group launched the Challenger Solutions Liquid Alternatives Balanced Fund. The Fund seeks to deliver positive absolute returns in excess of the cash rate regardless of the market environment and is the first in a series of solutions being developed by Challenger's Solutions Group. The Fund delivered a gross annual return of 15.2% in the 12 months to 30 June 2023.

In September 2022, Challenger Life introduced a new accelerated payments option for its Market-Linked Annuity offering. This option allows customers to increase the starting lifetime annuity payment in exchange for lower future indexation.

In April 2023, Fidante's affiliate, Cultiv8, made three initial investments in early-stage agricultural and food technology companies as part of its Agriculture and Food Technology Fund. The fund focuses on capital growth and sustainability with a portfolio comprised of 20 to 30 seed to series B investments in Australian and global Agri-Food Technology companies. The fund targets a gross return of 20% per annum over the recommended nine-year timeframe.

[4] Marketing Pulse Adviser Study June 2023 based on (% agree / strongly agree).
[5] As at 13 June 2023.

Expanding distribution channels through active ETF market

There continues to be strong demand from investors for simple and easy-to-access liquid investment products. Exchange Traded Funds (ETFs) have experienced strong growth in a number of markets as they provide the ability to deliver diversified investment strategies in a liquid and easy-to-execute format.

In January 2023, Fidante launched two new ETFs to deliver diversified investment strategies in a liquid and easy-to-execute format: the Alphinity Global Equity Fund (Managed Fund) (ASX: XALG) and Alphinity Global Sustainable Equity Fund (Managed Fund) (ASX: XASG). The funds sit alongside Fidante's existing ETFs, which include the Ardea Real Outcome Bond Fund (Managed Fund) (ASX: XARO) and the Kapstream Absolute Return Income Fund (Managed Fund) (CBOE: XKAP).

The Alphinity Global Equity Fund (Managed Fund) seeks to build a portfolio of high-quality global companies that are identified as undervalued and within an earnings upgrade cycle. The Alphinity Global Sustainable Equity Fund (Managed Fund) aims to build a portfolio of high-quality companies that can have a net positive alignment with one or more of the 17 United Nations' Sustainable Development Goals (SDGs), exceed Alphinity's minimum environmental, social and governance (ESG) criteria, and which are also identified as undervalued and within an earnings upgrade cycle.

Fidante is committed to growing its series of ETFs and expects to launch more. Total Fidante FUM invested in ETF strategies at 30 June 2023 was $817 million, across approximately 11,000 investors[6].

New Fidante affiliates

Fidante is focused on growing its alternatives platform in response to increasing demand from investors for high-quality alternative investment capabilities.

In July 2023, Challenger formed a strategic real estate partnership with Elanor Investors Group (ASX:ENN), which will include an exclusive distribution arrangement whereby Fidante will distribute Elanor's existing and new funds and Elanor will become Challenger's commercial real estate partner in Australia and New Zealand.

As part of the agreement, Challenger sold its Australian real estate business (CRE) to Elanor for total consideration of $38 million[7] which was received in new securities issued by Elanor. Challenger's holding in Elanor represents approximately 14% of issued capital and Elanor will become a new Fidante affiliate manager offering a very compelling proposition for retail, high-net-worth and institutional customers.

In June 2023, Fidante expanded its existing distribution arrangement with Proterra Investment Partners Asia (Proterra Asia), a leading private equity investor focused on the Asian food and agribusiness sectors. Under an expanded relationship, Fidante has a 12.5% revenue share in the business. This strategic partnership builds on the existing well-established distribution agreement between Fidante and Proterra Asia in the UK and Europe, with the new arrangement including Australia, Japan, and other agreed jurisdictions.

In July 2023, Fidante completed commercial agreements to acquire an equity stake in Resonance Asset Management (Resonance) and now has 35% ownership of the company. Fidante is also the exclusive distributor in covered regions for future strategies.

3. Leverage the combined capabilities of the Group

FY23 progress:

Sale of Challenger Bank

In October 2022, Challenger announced it had entered into a share sale agreement with Heartland Group Holdings Limited (NZX/ASX:HGH) (Heartland) to sell the Bank for cash consideration of approximately $36 million[8].

The sale is expected to generate a pre-tax gain on sale of approximately $11 million, which will be reported as a significant item once completed[9]. The sale is subject to regulatory approvals in both Australia and New Zealand and is expected to complete in 1H24.

In April 2023, Challenger received approval from APRA to release $50 million of excess Bank capital, which was injected into Challenger Life. The remaining excess capital of approximately $40 million is expected, subject to regulatory approvals in Australia and New Zealand, to be returned to Challenger on or prior to completion of the sale providing additional financial flexibility to support growth in the Life business.

Capital notes and Tier 2 subordinated debt finance

In September 2022, Challenger Life Company Limited (CLC) issued $400 million of fixed-to-floating rate, unlisted, unsecured subordinated notes. The proceeds from the issuance were used to repay $400 million of subordinated notes that had a call date in November 2022.

In April 2023, Challenger issued $350 million of Challenger Capital Notes 4 (ASX:CGFPD) to help fully repay $460 million Challenger Capital Notes 2 (ASX:CGFPB) that had an Optional Exchange Date in May 2023. Refer to page 45 for more information.

These refinancing initiatives reflect Challenger's long-standing approach to proactively managing the Group's capital position, ensuring it remains well capitalised and ensuring there is no shareholder dilution with existing subordinated notes converting into Challenger shareholder equity.

4. Strengthen resilience and sustainability of Challenger

FY23 progress:

Apollo strategic relationship

Apollo (NYSE:APO) and Athene are Challenger strategic partners and hold a minority interest of approximately 20% of issued share capital.

Challenger and Apollo share a common purpose, with strong complementary skills and capabilities.

Both parties are working together on a range of opportunities to help Challenger's customers achieve financial security in retirement and deliver meaningful value for shareholders,

[6] Includes listed FUM and holders only.
[7] Before tax, transaction costs and other adjustments and subject to certain milestones being met.
[8] Price subject to completion adjustments and based on a target net asset value of approximately $25 million.
[9] Any difference between purchase price and target net assets of ~$25 million will be reduced by transaction costs and other costs associated with the sale.

including balance sheet investment, capital, product development and distribution opportunities.

Over the course of FY23, Challenger and Apollo have agreed to enter a distribution agreement, under which Fidante will bring the Apollo Aligned Alternatives (AAA) strategy to the Australian market in 1H24.

AAA is positioned as an equity replacement product and will provide clients with access to a diversified portfolio of private market opportunities, investing side-by-side with more than US$10 billion of Apollo's own balance sheet capital.

Fidante Partners Limited will be the Responsible Entity and Distributor of the AAA in Australia.

Artega Investment Administration operational

In November 2022, Artega Investment Administration (Artega), an independently branded joint venture between Challenger and SimCorp (CSE:SIM), was launched. Artega will provide market-leading investment administration services to investment managers and asset owners across Australia.

Artega leverages the capabilities of both Challenger and SimCorp to provide Australia's first fully technology-led, integrated front-to-back cloud-based investment operations platform to service Challenger, Fidante and third-party investment managers and asset owners.

In 1H23, Artega became operational and commenced providing investment administration services to its existing clients, Challenger and Fidante affiliates. In 2H23, investment operations staff from Challenger Life and Funds Management transferred and became full-time employees of Artega to support its business activities.

To date, a number of clients have chosen Artega as their administration provider.

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 89% in its latest employee engagement survey (conducted March 2023). Results of the survey included:

- 95% of employees believe that gender-based harassment and sexual harassment is not tolerated; and
- 91% of employees believe Challenger has a working environment that genuinely supports equality between women and men.

In FY23, Challenger continued to be recognised as an employer of choice for women and was included as an Employer of Choice for Gender Equality by the Workplace Gender Equity Agency (WGEA) for the sixth year in a row.

Embedding ESG across the business

Challenger recognises its growth and success should be sustainable to benefit customers, partners and communities. This means factoring ESG considerations into all decision making.

In FY23, Challenger took significant steps to better understand current ESG performance against Challenger's purpose, operating model and core business activities. This included the completion of a comprehensive ESG review covering technology systems, data maturity, governance practices, risk identification and ESG related decision-making processes. The review benchmarked current ESG practices against a range of stakeholder perspectives. This provided a comprehensive understanding of areas Challenger could improve over time and opportunities to strengthen Challenger's approach to ESG governance. Following this review, Challenger commenced a range of initiatives which are outlined in the 2023 Sustainability Report.

Challenger recognises the importance of incorporating ESG considerations into its investment process. Challenger has been a signatory to the Principles for Responsible Investment (PRI) since 2015. Investment managers follow a formal responsible investment policy, report on ESG risks across their portfolios and incorporate ESG considerations into internal strategies.

Sustainability affiliate investment managers include:

- Cultiv8 Funds Management, a sustainability-aligned fund focused on investments in innovative agricultural and food technologies;
- Proterra Asia, a private equity fund manager focused on the Asian food and agribusiness sectors; and
- Resonance Asset Management, an alternative asset management firm investing in sustainable water, energy, and waste management infrastructure.

Challenger believes climate change will impact every part of the economy. In 2023, Challenger undertook preliminary work to understand Scope 3 financed emissions across its investment portfolio, initially focusing on listed equities and corporate bonds.

In FY23, Challenger overhauled its Modern Slavery Statement, including implementing an improved structure for addressing and assessing modern slavery risks. Supporting this work, Challenger rolled out training for key teams to help them understand modern slavery risks and how to identify them, with over 90% of teams completing the training.

Challenger also plays an active role in advocating for public policy and reforms that are in the best interests of its customers, shareholders and wider stakeholders, particularly those in relation to retirement.

As a leading retirement income provider, Challenger also recognises the important role it plays in contributing to a more sustainable and equitable future for all Australians and is committed to supporting communities across the country.

In June 2023, Challenger established a new partnership with the Australian Academy of Technological Sciences and Engineering (ATSE) to support Indigenous leadership in STEM and technological innovation. This partnership reflects Challenger's commitment to investing in knowledge and embracing innovation.

Key performance indicators

	FY23	FY22	FY21	2H23	1H23	2H22	1H22	2H21	1H21
Earnings									
Normalised NPBT ($m)	520.7	472.3	395.8	270.3	250.4	234.8	237.5	199.6	196.2
Normalised NPAT ($m)	364.0	321.5	278.5	196.8	167.2	155.9	165.6	141.7	136.8
Statutory NPAT ($m)	287.5	253.7	592.3	164.8	122.7	(28.4)	282.1	369.5	222.8
Underlying operating cash flow ($m)	323.7	(101.3)	156.8	286.4	37.3	23.6	(124.9)	37.3	119.5
EBIT margin (%)	62.3%	61.3%	58.8%	63.1%	61.5%	60.7%	61.9%	56.7%	61.0%
Normalised cost to income ratio (%)	37.7%	38.7%	41.2%	36.9%	38.5%	39.3%	38.1%	43.3%	39.0%
Normalised effective tax rate (%)	30.1%	31.9%	29.6%	27.2%	33.2%	33.6%	30.3%	29.0%	30.3%
Earnings per share (cents)									
Basic – normalised	53.3	47.6	41.5	28.8	24.5	23.1	24.5	21.1	20.4
Basic – statutory	42.1	37.5	88.2	24.1	18.0	(4.2)	41.8	54.9	33.2
Diluted – normalised	46.3	40.9	33.8	25.2	22.3	19.9	20.7	17.8	17.5
Diluted – statutory	37.9	33.1	68.0	22.3	17.2	(4.2)	33.9	43.4	27.3
Return On Equity (%)									
Normalised ROE – pre-tax	12.7%	11.9%	11.2%	13.1%	12.3%	11.5%	12.1%	11.1%	11.5%
Normalised ROE – post-tax	8.9%	8.1%	7.9%	9.6%	8.2%	7.6%	8.4%	7.8%	8.0%
Statutory ROE – post-tax	7.0%	6.4%	16.8%	8.0%	6.0%	(1.4%)	14.3%	20.5%	13.0%
Capital management									
Net assets – average[1] ($m)	4,091	3,970	3,519	4,151	4,025	4,048	3,904	3,641	3,396
Net assets – closing ($m)	4,164	3,988	3,826	4,164	4,048	3,988	4,059	3,826	3,513
Net assets per basic share ($)	6.09	5.86	5.69	6.09	5.94	5.86	6.00	5.69	5.23
Net tangible assets ($m)	3,553	3,372	3,202	3,553	3,433	3,372	3,420	3,202	2,877
Net tangible assets per basic share ($)	5.20	4.96	4.76	5.20	5.03	4.96	5.06	4.76	4.28
Dividend (cps)	24.0	23.0	20.0	12.0	12.0	11.5	11.5	10.5	9.5
Dividend franking (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Normalised dividend payout ratio (%)	45.0%	48.3%	48.2%	41.7%	49.0%	49.8%	46.9%	49.8%	46.6%
CET1 Capital ratio (times)	1.16	1.11	1.14	1.16	1.12	1.11	1.20	1.14	1.09
Sales, net flows and assets under management									
Life annuity sales ($m)	5,517.3	5,122.7	4,566.0	1,973.4	3,543.9	2,606.4	2,516.3	2,375.0	2,191.0
Other Life sales ($m)	4,229.3	4,583.4	2,362.1	2,294.2	1,935.1	2,156.6	2,426.8	1,115.6	1,246.5
Total Life sales ($m)	9,746.6	9,706.1	6,928.1	4,267.6	5,479.0	4,763.0	4,943.1	3,490.6	3,437.5
Life annuity net flows ($m)	385.1	1,074.2	1,079.8	(416.9)	802.0	466.5	607.7	922.2	157.6
Life annuity book ($m)	13,930	13,595	13,670	13,930	14,278	13,595	14,093	13,670	12,770
Life annuity book growth (%)	2.8%	7.9%	8.6%	(3.1%)	5.9%	3.5%	4.4%	7.3%	1.3%
Total Life net flows ($m)	935.8	2,471.9	2,163.8	(49.1)	984.9	1,025.9	1,446.0	1,455.1	708.7
Total Life book[2] ($m)	19,199	17,982	17,302	19,199	18,899	17,982	18,474	17,302	15,801
Total Life book growth (%)	5.2%	14.3%	14.4%	(0.3%)	5.5%	5.9%	8.4%	9.7%	4.7%
Funds Management – net flows ($m)	(472.3)	(8,524.8)	16,111.5	1,353.9	(1,826.2)	(9,429.2)	904.4	9,688.1	6,423.4
Total Group AUM ($m)	104,952	98,570	109,960	104,952	99,393	98,570	114,907	109,960	96,087
Other									
Headcount – closing FTEs[3]	817	770	738	817	761	770	735	738	709
Weighted average number of basic shares on issue (m)	682.1	675.7	671.6	683.1	681.1	676.9	674.6	672.3	670.8
Number of basic shares on issue[4] (m)	683.8	680.0	672.6	683.8	682.0	680.0	676.0	672.6	672.2
Share price closing ($)	6.48	6.84	5.41	6.48	7.62	6.84	6.53	5.41	6.44

[1] Net assets – average calculated on a monthly basis.

[2] Total Life book includes the Life annuity book and Other Life liabilities.

[3] Full-time equivalent employees.

[4] Excludes CPP Trust Treasury shares.

Consolidated profit and loss

$m	FY23	FY22	FY21	2H23	1H23	2H22	1H22	2H21	1H21
Life Normalised Cash Operating Earnings	653.0	582.8	512.8	335.7	317.3	295.4	287.4	268.8	244.0
Funds Management net fee income	178.8	191.8	169.3	90.9	87.9	93.6	98.2	88.0	81.3
Bank net interest income	8.8	2.3	—	4.1	4.7	1.4	0.9	—	—
Other income	1.6	—	—	1.0	0.6	—	—	—	—
Total net income	**842.2**	**776.9**	**682.1**	**431.7**	**410.5**	**390.4**	**386.5**	**356.8**	**325.3**
Personnel expenses[1]	(201.9)	(204.5)	(179.9)	(94.9)	(107.0)	(103.4)	(101.1)	(93.7)	(86.2)
Other expenses[1]	(115.6)	(96.0)	(101.4)	(64.5)	(51.1)	(50.0)	(46.0)	(60.8)	(40.6)
Total expenses	**(317.5)**	**(300.5)**	**(281.3)**	**(159.4)**	**(158.1)**	**(153.4)**	**(147.1)**	**(154.5)**	**(126.8)**
Normalised EBIT	**524.7**	**476.4**	**400.8**	**272.3**	**252.4**	**237.0**	**239.4**	**202.3**	**198.5**
Interest and borrowing costs	(4.0)	(4.1)	(5.0)	(2.0)	(2.0)	(2.2)	(1.9)	(2.7)	(2.3)
Normalised profit before tax	**520.7**	**472.3**	**395.8**	**270.3**	**250.4**	**234.8**	**237.5**	**199.6**	**196.2**
Normalised tax	(156.7)	(150.8)	(117.3)	(73.5)	(83.2)	(78.9)	(71.9)	(57.9)	(59.4)
Normalised profit after tax	**364.0**	**321.5**	**278.5**	**196.8**	**167.2**	**155.9**	**165.6**	**141.7**	**136.8**
Life investment experience after tax	(67.8)	(81.2)	318.6	(25.4)	(42.4)	(190.3)	109.1	231.5	87.1
Bank impairments after tax[2]	(1.4)	(0.9)	—	0.7	(2.1)	(0.9)	—	—	—
Significant items after tax[3]	(7.3)	14.3	(4.8)	(7.3)	—	6.9	7.4	(3.7)	(1.1)
Statutory net profit after tax	**287.5**	**253.7**	**592.3**	**164.8**	**122.7**	**(28.4)**	**282.1**	**369.5**	**222.8**
Performance analysis									
Normalised EPS – basic (cents)	53.3	47.6	41.5	28.8	24.5	23.1	24.5	21.1	20.4
Shares for basic EPS calculation (m)	682.1	675.7	671.6	683.1	681.1	676.9	674.6	672.3	670.8
Normalised cost to income ratio (%)	37.7%	38.7%	41.2%	36.9 %	38.5%	39.3%	38.1%	43.3%	39.0%
Normalised tax rate (%)	30.1%	31.9%	29.6%	27.2 %	33.2%	33.6%	30.3%	29.0%	30.3%
Total net income analysis (%)									
Cash earnings (Life)	74.4%	68.7%	70.2%	76.3%	72.5%	69.0%	68.5%	70.3%	70.0%
Normalised capital growth (Life)	3.1%	6.3%	5.0%	1.5%	4.8%	6.7%	5.9%	5.0%	5.0%
Net fee income (Funds Management)	21.2%	24.7%	24.8%	21.1%	21.4%	24.0%	25.4%	24.7%	25.0%
Net interest income (Bank)	1.1%	0.3%	—	0.9%	1.1%	0.3%	0.2%	—	—
Other income (Corporate)	0.2%	—	—	0.2%	0.2%	—	—	—	—
Normalised EBIT by division ($m)									
Life	540.5	472.3	398.9	277.2	263.3	239.3	233.0	206.1	192.8
Funds Management	61.6	82.8	71.0	30.9	30.7	37.7	45.1	35.7	35.3
Bank	(8.8)	(11.1)	—	(4.5)	(4.3)	(7.8)	(3.3)	—	—
Corporate	(68.6)	(67.6)	(69.1)	(31.3)	(37.3)	(32.2)	(35.4)	(39.5)	(29.6)
Normalised EBIT	**524.7**	**476.4**	**400.8**	**272.3**	**252.4**	**237.0**	**239.4**	**202.3**	**198.5**

1 In 2H23, investment operation staff were transferred from Challenger to Artega Investment Administration. Artega expenses, which include personnel costs, are charged to Challenger through a rate card and are reflected as other expenses.
2 Represents provision for fair value adjustments on Bank lending and financing assets, a portion of which have been held for sale.
3 Significant items (after-tax) relate to transactions costs incurred in the sale of Challenger's Australian real estate business to Elanor and the sale of Challenger Bank, as well as one-off project costs relating to the implementation of AASB 17.

Consolidated profit and loss (continued)

Normalised profit after tax

FY23 normalised profit after tax was $364m and increased by $43m (13%) on FY22. The increase reflects higher normalised profit before tax (up $48m), partially offset by higher normalised tax (up $6m).

Normalised earnings per share (EPS)

Normalised EPS increased by 12.0% on FY22 to 53.3 cps. The increase reflects higher normalised profit after tax (up 13%) offset by a higher average number of basic shares on issue (up 1%).

The weighted average number of basic shares on issue in FY23 was 682m shares, up 6m shares on FY22 as a result of new shares issued as part of Challenger's dividend reinvestment plan in September 2022 and March 2023 and the mandatory conversion of a small remaining parcel of Challenger Capital Notes (ASX: CGFPA) in May 2022. Refer to page 45 for additional detail on the mandatory conversion of Challenger Capital Notes into Challenger ordinary shares.

Net income

FY23 net income was $842m and increased by $65m (up 8%) on FY22, with:

- Life Normalised Cash Operating Earnings (COE) of $653m was up $70m (12%), driven by higher cash earnings, which benefitted from a higher COE margin (up 22 bps) and growth in average investment assets (up 3%).
- Funds Management fee income of $179m was down $13m (7%), from lower FUM-based revenue (down $10m) and transaction fees (down $4m), partially offset by higher performance fees (up $1m); and
- Bank net interest income of $9m was up $7m, as a result of higher net interest margin and growth in lending and financing assets.

Expenses

FY23 total expenses were $318m and increased by $17m (6%). The expense increase was due to higher costs in Funds Management (up $8m), the Bank (up $4m), the Corporate division (up $3m) and Life (up $2m).

Personnel expenses decreased by $3m (1%) mainly driven by the transfer of Challenger investment operations employees to Artega, offset by higher salaries driven by higher average FTE.

Other expenses increased by $20m (20%) primarily due to Artega expenses ($10m), higher project spend ($4m), increased marketing and travel costs ($2m) and increased technology costs associated with software licensing ($2m).

Artega expenses, which include personnel costs, are charged to Challenger through a rate card and are reflected as other expenses ($10m). Artega costs were higher due to an increase in FTE driven by elevated affiliate trading and transaction volumes, and increased software and datafeed costs primarily due to FX and inflation impacts. This was offset by the transfer of Challenger staff to Artega, with personnel expenses decreasing by $4m. The net impact of the increase in Artega costs in FY23 was $6m.

The FY23 normalised cost to income ratio was 37.7% and decreased by 1.0 percentage point on FY22. The decrease in the ratio was driven by higher net income (up 8%), partially offset by higher expenses (up 6%).

Normalised EBIT

FY23 normalised EBIT was $525m, up $48m (10%). Higher Life EBIT (up $68m) and a lower Bank EBIT loss (down $2m) were offset by lower Funds Management EBIT (down $21m) and higher Corporate EBIT loss (up $1m).

Life EBIT increased by $68m (up 14%) to $541m and reflected higher normalised COE (up $70m).

Funds Management EBIT decreased by $21m (down 26%) to $62m, from lower FUM-based revenue (down $10m) due to lower average FUM (down 9%), lower transaction fees (down $4m) and higher expenses (up $8m).

Normalised Return On Equity (ROE)

FY23 normalised ROE (pre-tax) was 12.7% and increased by 80 bps on FY22. This was driven by higher Life ROE of 15.1% (up 200 bps) reflecting an increase in Normalised COE, partially offset by lower Funds Management ROE of 21.7% (FY22 31.2%) and the Bank ROE of -8.4%.

Challenger's Normalised ROE (pre-tax) target remains at the RBA cash rate plus a margin of 12%. Refer to page 14 for more detail. There is a lag between the timing of changes in the RBA cash rate and the resultant change in earnings as it takes time for the impact of interest rates to season into both profit and ROE.

In FY23, the average RBA cash rate was ~290 bps, resulting in Challenger's Normalised ROE target being 14.9%. Challenger's Normalised ROE in FY23 was 12.7% and below target. Excluding the Bank, Normalised ROE would have been 13.3%.

Normalised tax

Normalised tax was $157m and increased by $6m (4%) on FY22. Higher normalised tax reflects a higher normalised net profit before tax, offset by a lower normalised effective tax rate.

The normalised effective tax rate in FY23 was 30.1%, down from 31.9% in FY22.

The effective tax rate is similar to Australia's statutory rate of 30% and reflects interest payments on Challenger Capital Notes that are non-deductible ($13m) offset by a concessional tax benefit in relation to the offshore banking unit regime which ended on 30 June 2023.

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 63).

FY23 investment experience was a loss of $68m (after-tax) driven by a reduction in commercial property valuations and valuation losses on alternatives, partially offset by gains on the fixed income portfolio driven by the tightening of credit spreads.

Refer to page 28 for more detail, including investment experience by asset class.

Bank impairments after tax

In FY23, the Bank recognised a -$1m fair value adjustment on its lending and financing assets, a proportion of which have been classified as held for sale, as a result of the sale to Heartland. The Bank division has been classified as a discontinued operation (refer to page 57 for more detail).

Significant items after tax

FY23 significant items were negative $7m (after-tax) and represent:
- Transaction costs associated with the sale of Challenger's Australian real estate business (CRE) to Elanor of $4m;
- One-off project costs relating to the implementation of AASB 17[1] of $2m; and
- Transaction costs associated with the sale of Challenger Bank of $1m.

Statutory net profit after tax

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

FY23 statutory profit after tax was $288m, and increased by $34m (or) on FY22, and includes:

- Normalised net profit after tax of +$364m;
- Life investment experience of -$68m (refer to page 28 for more detail);
- Significant items of -$7m; and
- Bank fair value adjustment to assets classified as held for sale of -$1m.

[1] AASB 17 Insurance Contracts is an accounting standard that replaces AASB 4 Insurance Contracts, AASB 1038 Life Insurance Contracts and AASB 1023 General Insurance Contracts, and is effective for Challenger from 1 July 2023.

Dividends

Dividend policy

In FY23, Challenger targets a dividend payout ratio in the range of between 45% and 50% of normalised profit after tax and aims to frank dividends to the maximum extent possible.

FY23 dividend

The Challenger Board has determined to pay a fully franked final FY23 dividend of 12.0 cps, bringing the full year dividend to 24.0 cps (fully franked) compared to 23.0 cps (fully franked) in FY22.

Dates for the final FY23 dividend are as follows:

- ex-date: 28 August 2023;
- record date: 29 August 2023;
- Dividend Reinvestment Plan (DRP) election date: 30 August 2023; and
- payment date: 20 September 2023.

The FY23 dividend payout ratio was 45.0%, which is within Challenger's normalised dividend payout ratio target of between 45% and 50% of normalised profit after tax.

Challenger's franking account balance at 30 June 2023 was $288m. This amount is calculated from the balance of the franking account as at the end of the period, adjusted for franking debits that will arise from the settlement of accrued interest on Challenger Capital Notes and on ATO refunds from current tax assets.

The final dividend of 12.0 cps will result in a total dividend of $83m, which will reduce the franking account by $35m.

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 are issued based on a 10-day Challenger volume-weighted average price (VWAP), with no share price discount applied.

For the interim FY23 dividend paid in March 2023, the DRP participation rate was 33% of issued capital.

Credit ratings

In December 2022, Standard & Poor's Global Ratings (S&P) completed its annual ratings review and affirmed the credit rating and outlook for CLC.

Challenger’s S&P ratings are as follows:

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

FY24 outlook

Normalised net profit before tax guidance

Challenger's FY24 normalised net profit before tax guidance is a range of between $555m and $605m, which assumes:

- ~$5m investment in Artega's operating platform to migrate to the cloud and support onboarding new external clients[1];
- ~$5m in additional costs including initiatives focused on branding, risk and cybersecurity; and
- Given the pending sale of the Bank, it has been excluded from FY24 guidance, with the sale expected to complete in 1H24 subject to regulatory approval in Australia and New Zealand.

The mid-point of the FY24 normalised net profit before tax guidance ($580m) is 11% above FY23 normalised net profit before tax of $521 million.

Normalised Return On Equity (ROE) target

Challenger's Normalised ROE (pre-tax) target is the RBA cash rate plus a margin of 12%.

Challenger continues to make progress towards achieving its ROE target. However, in FY24, Challenger does not expect to achieve the Group ROE target due to the lower contribution to Group earnings from Funds Management.

Normalised cost to income ratio

Managing the business to a cost to income ratio ensures that any expense growth is appropriately positioned to drive revenue growth.

In FY24, Challenger will target a cost to income ratio of 35% to 37% which is below FY23 normalised cost to income ratio of 37.7%.

CLC excess capital position

CLC does not target a specific PCA or CET1 ratio. CLC's targeted PCA and CET1 ratio range is a reflection of internal capital models, and is not an input to them, and reflects asset allocation, business mix, capital composition and economic circumstances. The target PCA ratio range is 1.3 times to 1.7 times. This range may change over time. Refer to page 47 for more detail.

In FY24, Challenger's risk appetite will remain unchanged and Challenger will continue to apply the same approach to determining its target surplus.

Changes to the composition of the balance sheet over the past two years have resulted in a materially higher allocation to alternatives, which have a lower correlation to broader investment markets (but are treated as 100% correlated for regulatory capital purposes), and a higher proportion of CET1 regulatory capital within the regulatory capital base. As a result of these changes, in terms of the unchanged risk appetite and target surplus framework, the 30 June 2023 PCA ratio of 1.59 times is broadly equivalent to 1.69 times at 30 June 2021, which had a different balance sheet and regulatory capital composition.

Dividend

Commencing from FY24, Challenger will target a dividend payout ratio of between 30% and 50% of normalised profit after tax and seeks to frank the dividend to the maximum extent possible.

The target payout range has been extended from 45% to 50% (prior to FY24) to support Challenger's growth profile and provide flexibility, especially in periods of higher growth and attractive market conditions.

However, the actual dividend payout ratio will depend on prevailing market conditions and capital allocation priorities at the time.

[1] Challenger's share (80%) of Artega profit and loss will be accounted as Equity Accounted Profits and disclosed in Other Income within the Corporate financial result.

Group balance sheet[1]

$m	FY23	1H23	FY22	1H22	FY21	1H21
Assets						
Life investment assets						
Fixed income and cash[2]	17,799.6	17,621.0	16,659.4	17,031.1	16,418.2	14,821.1
Property[2]	3,062.4	3,178.3	3,227.0	3,583.3	3,467.5	3,316.2
Equity and infrastructure[2]	291.3	259.0	971.1	1,096.1	623.2	604.2
Alternatives	2,384.7	2,026.6	1,366.3	1,226.4	1,054.3	892.5
Life investment assets	**23,538.0**	**23,084.9**	**22,223.8**	**22,936.9**	**21,563.2**	**19,634.0**
Bank lending and financing assets						
Fixed income, cash and cash equivalents	133.3	271.9	285.2	132.8	—	—
Retail lending and non-retail lending	92.1	134.7	105.3	97.3	—	—
Bank lending and financing assets	**225.4**	**406.6**	**390.5**	**230.1**	**—**	**—**
Cash and cash equivalents (Group cash)	128.9	145.8	183.1	94.5	223.0	136.6
Receivables	174.6	164.4	355.1	153.7	115.9	127.7
Derivative assets	665.5	690.7	599.5	822.0	641.9	450.1
Investment in associates	81.9	74.3	74.9	79.7	83.2	63.3
Other assets	43.9	45.8	53.8	58.1	63.1	61.4
Fixed assets	23.5	24.0	24.8	26.4	28.2	25.1
Right-of-use lease assets	24.3	27.3	29.0	31.5	34.7	37.9
Tax assets	86.2	158.9	65.3	—	—	—
Goodwill and intangibles	587.4	586.8	587.2	607.4	589.1	597.5
Less Group/Life eliminations[3]	(6.1)	(13.9)	(21.5)	(25.1)	(31.3)	(36.3)
Total assets	**25,573.5**	**25,395.6**	**24,565.5**	**25,015.2**	**23,311.0**	**21,097.3**
Liabilities						
Payables	216.3	156.9	184.3	173.2	196.9	162.4
Tax liabilities	—	—	—	107.0	104.8	39.7
Derivative liabilities	611.3	730.8	839.6	676.8	507.6	143.7
Subordinated debt	403.0	399.3	398.4	401.6	404.5	401.7
Challenger Capital Notes	725.1	840.2	838.6	864.8	863.3	881.6
Group debt	—	—	—	—	—	50.0
Lease liabilities	54.7	59.2	62.5	66.3	70.3	72.4
Provisions	28.2	39.0	44.3	39.3	35.7	31.8
Life annuity liabilities	13,930.0	14,278.4	13,595.4	14,092.5	13,669.9	12,769.7
Other Life liabilities	5,268.8	4,620.2	4,386.4	4,381.8	3,632.2	3,031.5
Bank deposit liabilities	171.7	224.1	227.7	152.6	—	—
Total liabilities	**21,409.1**	**21,348.1**	**20,577.2**	**20,955.9**	**19,485.2**	**17,584.5**
Group net assets	**4,164.4**	**4,047.5**	**3,988.3**	**4,059.3**	**3,825.8**	**3,512.8**
Equity						
Contributed equity	2,513.1	2,496.9	2,481.5	2,451.8	2,425.5	2,422.6
Reserves	(35.8)	(49.8)	(49.3)	(55.0)	(50.9)	(55.5)
Retained earnings	1,683.1	1,600.4	1,556.1	1,662.5	1,451.2	1,145.7
Non controlling interest reserve[4]	4.0	—	—	—	—	—
Total equity	**4,164.4**	**4,047.5**	**3,988.3**	**4,059.3**	**3,825.8**	**3,512.8**

1 Excludes consolidation of Special Purpose Vehicles (SPVs) and non-controlling interests.
2 Fixed income, property and infrastructure are reported net of debt.
3 Group/Life eliminations represent the fair value of the SPV residual income notes (i.e. NIM) held by Challenger Life Company Limited.
4 In relation to SimCorp's minority stake in Artega Investment Administration.

Change in Group net assets

$m	2H23	1H23	2H22	1H22	2H21	1H21
Opening net assets	**4,047.5**	**3,988.3**	**4,059.3**	**3,825.8**	**3,512.8**	**3,249.6**
Statutory net profit after tax	164.8	122.7	(28.4)	282.1	369.5	222.8
Dividends paid	(82.1)	(78.4)	(78.1)	(70.7)	(64.0)	—
New share issue	27.4	10.6	1.7	13.4	2.9	34.8
Reserve movements	14.0	(0.5)	5.8	(4.2)	4.6	(4.6)
CPP[1] Trust movements	(11.2)	4.8	—	12.9	—	10.2
Issued under Capital Notes conversion	—	—	28.0	—	—	—
Non-controlling interest reserve[2]	4.0	—	—	—	—	—
Closing net assets	**4,164.4**	**4,047.5**	**3,988.3**	**4,059.3**	**3,825.8**	**3,512.8**

1 Challenger Performance Plan (CPP) Trust.
2 In relation to SimCorp's minority stake in Artega Investment Administration.

Issued share capital, dilutive share count and earnings per share

	FY23	FY22	FY21	2H23	1H23	2H22	1H22	2H21	1H21
Earnings per share (cents)									
Basic – normalised	53.3	47.6	41.5	28.8	24.5	23.1	24.5	21.1	20.4
Basic – statutory	42.1	37.5	88.2	24.1	18.0	(4.2)	41.8	54.9	33.2
Diluted – normalised	46.3	40.9	33.8	25.2	22.3	19.9	20.7	17.8	17.5
Diluted – statutory	37.9	33.1	68.0	22.3	17.2	(4.2)	33.9	43.4	27.3
Number of shares (m)									
Basic share count	683.8	680.0	672.6	683.8	682.0	680.0	676.0	672.6	672.2
CPP[1] Trust treasury shares	3.8	2.2	3.4	3.8	1.9	2.2	2.1	3.4	3.4
Total issued shares	687.6	682.2	676.0	687.6	683.9	682.2	678.1	676.0	675.6
Movement in basic share count									
Opening	680.0	672.6	663.1	682.0	680.0	676.0	672.6	672.2	663.1
CPP[1] Trust deferred share purchase	—	—	—	—	—	—	—	—	—
Net Treasury shares (acquired)/released	(1.5)	1.2	1.0	(1.8)	0.3	(0.1)	1.3	—	1.0
New share issues	5.3	6.2	8.5	3.6	1.7	4.1	2.1	0.4	8.1
Closing	683.8	680.0	672.6	683.8	682.0	680.0	676.0	672.6	672.2
Movement in CPP Trust Treasury shares									
Opening	2.2	3.4	4.4	1.9	2.2	2.1	3.4	3.4	4.4
Shares vested to participants	(0.9)	(1.2)	(1.0)	(0.6)	(0.3)	0.1	(1.3)	—	(1.0)
CPP[1] Trust deferred share purchase	2.5	—	—	2.5	—	—	—	—	—
Closing	3.8	2.2	3.4	3.8	1.9	2.2	2.1	3.4	3.4
Weighted average number of shares (m)									
Basic EPS shares									
Total issued shares	684.6	678.1	675.2	686.0	683.2	679.1	677.2	675.9	674.6
Less CPP[1] Trust Treasury shares	(2.5)	(2.4)	(3.6)	(2.9)	(2.1)	(2.2)	(2.6)	(3.6)	(3.8)
Shares for basic EPS calculation	682.1	675.7	671.6	683.1	681.1	676.9	674.6	672.3	670.8
Diluted shares for normalised EPS									
Shares for basic EPS calculation	682.1	675.7	671.6	683.1	681.1	676.9	674.6	672.3	670.8
Add dilutive impact of unvested equity awards	13.3	10.0	8.7	13.2	12.6	9.8	13.3	2.4	5.9
Add dilutive impact of Capital Notes	140.7	126.3	178.3	132.7	115.0	126.3	133.4	155.0	136.3
Add dilutive impact of subordinated notes	74.3	58.3	59.1	64.0	75.1	58.3	59.1	59.1	59.1
Add dilutive impact of restricted shares	1.7	0.7	—	2.0	1.5	0.7	—	—	—
Shares for diluted normalised EPS calculation	912.1	871.0	917.7	895.0	885.3	872.0	880.4	888.8	872.1
Diluted shares for statutory EPS									
Shares for basic EPS calculation	682.1	675.7	671.6	683.1	681.1	676.9	674.6	672.3	670.8
Add dilutive impact of unvested equity awards	13.3	10.0	8.7	13.2	12.6	—	13.3	2.4	5.9
Add dilutive impact of Capital Notes	140.7	126.3	178.3	132.7	115.0	—	133.4	155.0	136.3
Add dilutive impact of subordinated notes	74.3	58.3	59.1	64.0	43.5	—	59.1	59.1	59.1
Add dilutive impact of restricted shares	1.7	0.7	—	2.0	1.5	—	—	—	—
Shares for diluted statutory EPS calculation	912.1	871.0	917.7	895.0	853.7	676.9	880.4	888.8	872.1
Summary of share rights (m)									
Hurdled Performance Share Rights									
Opening	15.8	14.7	9.8	16.9	15.8	16.4	14.7	16.1	9.8
New grants	3.9	3.7	7.5	0.9	3.0	0.1	3.6	0.1	7.4
Vesting/forfeiture	(2.6)	(2.6)	(2.6)	(0.7)	(1.9)	(0.7)	(1.9)	(1.5)	(1.1)
Closing	17.1	15.8	14.7	17.1	16.9	15.8	16.4	14.7	16.1
Deferred Performance Share Rights									
Opening	1.6	2.9	2.1	0.9	1.6	1.7	2.9	2.9	2.1
New grants	—	—	1.8	—	—	—	—	—	1.8
Vesting/forfeiture	(0.7)	(1.3)	(1.0)	0.0	(0.7)	(0.1)	(1.2)	—	(1.0)
Closing	0.9	1.6	2.9	0.9	0.9	1.6	1.7	2.9	2.9
Restricted Share Rights									
Opening	0.8	—	—	1.9	0.8	—	—	—	—
New grants	1.4	0.8	—	0.1	1.3	0.8	—	—	—
Vesting/forfeiture	(0.3)	—	—	(0.1)	(0.2)	—	—	—	—
Closing	1.9	0.8	—	1.9	1.9	0.8	—	—	—

[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 2023 was 688m shares. The number of shares on issue increased by 5m shares in FY23, with new shares issued under Challenger's dividend reinvestment plans in September 2022 and March 2023 and the mandatory conversion of some Challenger Capital Notes (ASX: CGFPA) in May 2022. Refer to page 45 for additional detail on the mandatory conversion of Challenger Capital Notes.

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 3, Challenger Capital Notes 4 and subordinated debt) as determined by a probability of vesting test (refer to page 19 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 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 6m shares (up 1%) in FY23 to 682m shares.

The increase reflects the weighted impact of new shares issued under Challenger's dividend reinvestment plans in September 2022 and March 2023, and the mandatory conversion of $28m worth of Challenger Capital Notes in May 2022.

The weighted average number of shares used to determine normalised diluted EPS and statutory diluted EPS increased by 41m shares (up 5%) in FY23 to 912m shares. The increase primarily reflects:

- higher basic weighted average number of shares on issue (6m shares – refer above); and
- the issue of $400 million of subordinated notes in September 2022 that was used to repay $400 million of subordinated notes that had a call date in November 2017 (refer to page 45);
- higher dilutive impact on Challenger Capital Notes as a result of the decrease in the Challenger share price, which is used to calculate potential dilution (refer to page 19); and
- higher unvested equity awards and restricted shares to employees under the CPP.

Refer to page 19 for more detail on the accounting treatment of Capital Notes and subordinated debt.

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 Restricted Shares, which vest over a period of up to four years, subject to continued employment[1].

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 3, Challenger Capital Notes 4 and subordinated debt are effective sources of funding for Challenger. Refer to pages 45 and 46 for more detail.

Capital Notes 3, Capital Notes 4 and subordinated debt have convertibility features that would result in these instruments converting to ordinary shares under certain circumstances, including APRA determining Challenger Life to be non-viable. Challenger may choose to redeem or resell (rather than convert) all or some of the notes for their face value at a future date, subject to APRA approval and market conditions.

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 3 and 4, and subordinated debt) is based on the following formula:

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

The conversion factor for all of Challenger's convertible debt is 99%. The simple average of Challenger's 20-day volume weighted average share price (VWAP) 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 VWAP leading up to 30 June 2023 was $6.31.

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 3	25 Nov 2020	$385m	$2.5700
Challenger Capital Notes 4	5 Apr 2023	$350m	$3.2600
Subordinated debt	16 Sep 2022	$400m	$3.2250
Total		**$1,135m**	

Earnings per share

Normalised diluted EPS

The normalised basic EPS for FY23 of 53.3 cps is greater than the interest cost per potential ordinary share for each of the Challenger Capital Notes 3, Challenger Capital Notes 4 and subordinated debt. As a result, all debt instruments were considered to be dilutive in FY23.

The weighted average number of shares used to determine the normalised diluted EPS increased by 41m shares in FY23.

The increase is due to:

- an increase in weighted average number of basic shares on issue, which reflects the impact of new shares issued under Challenger's dividend reinvestment plans in September 2022 and March 2023, and the mandatory conversion of Challenger Capital Notes in May 2022 (collectively increasing the basic share count by 6m shares);
- an issue of $400 million of subordinated notes in September 2022 that were used to repay $400 million of subordinated notes issued in November 2017, increasing the diluted share count by 16m shares (refer to page 45 for more detail);
- an increase in the dilutive impact of the Challenger Capital Notes 3 and 4 as a result of a decrease in Challenger's weighted average share price over the last 20 days of FY23, increasing the diluted share count by 14m shares. The lower Challenger share price results in a higher number of potential shares being issued should the debt convert to shareholder equity; and
- a net increase in shares following the issue of unvested equity awards and restricted shares (increased diluted share count by 4m shares).

To determine the normalised diluted EPS, the normalised profit after tax is increased by $59 million in relation to Challenger Capital Notes 3, Challenger Capital Notes 4 and subordinated debt interest costs.

[1] Prior to 1July 2021, Deferred Performance Share Rights (DPSRs) were awarded instead of Restricted Shares. DPSRs represent the right to receive a fully-paid ordinary Challenger share for nil consideration subject to continued employment at the time of vesting.

Group regulatory capital

30 June 2023, $m	CLC	Challenger Bank Limited	Other (including Funds Management)[1]	Group
Regulatory capital base				
Shareholder equity	3,395.2	61.9	707.3	4,164.4
Goodwill and other intangibles	(70.0)	—	(517.4)	(587.4)
Other adjustments[2]	(214.7)	(1.4)	28.9	(187.2)
Eligible regulatory debt	1,146.3	—	—	1,146.3
Total capital base	**4,256.8**	**60.5**	**218.8**	**4,536.1**
Minimum Regulatory Requirement[3,4]	2,681.9	13.1	39.9	2,734.9
Excess over Minimum Regulatory Requirement	**1,574.9**	**47.4**	**178.9**	**1,801.2**
Common Equity Tier 1 (CET1) regulatory capital	3,110.5	60.5	—	3,171.0
Additional Tier 1 capital	735.0	—	—	735.0
Total Tier 1 regulatory capital	3,845.5	60.5	—	3,906.0
Tier 2 capital[5]	411.3	—	—	411.3
Other non-regulatory capital[1]	—	—	218.8	218.8
Total capital base	**4,256.8**	**60.5**	**218.8**	**4,536.1**
CET1 capital ratio (times)[6]	1.16	4.62	—	—
Tier 1 capital ratio (times)[7]	1.43	4.62	—	—
Minimum Regulatory Requirement ratio (times)[8]	1.59	4.62	5.48	1.66

31 December 2022, $m	CLC	Challenger Bank Limited	Other (including Funds Management)[1]	Group
Regulatory capital base				
Shareholder equity	3,317.4	114.5	615.6	4,047.5
Goodwill and other intangibles	(70.4)	—	(516.4)	(586.8)
Other adjustments[2]	(299.1)	(1.4)	93.6	(206.9)
Eligible regulatory debt	1,252.8	—	—	1,252.8
Total capital base	**4,200.7**	**113.1**	**192.8**	**4,506.6**
Minimum Regulatory Requirement[3,4]	2,637.1	26.9	39.8	2,703.8
Excess over Minimum Regulatory Requirement	**1,563.6**	**86.2**	**153.0**	**1,802.8**
Common Equity Tier 1 (CET1) regulatory capital	2,947.9	113.1	—	3,061.0
Additional Tier 1 capital	845.0	—	—	845.0
Total Tier 1 regulatory capital	3,792.9	113.1	—	3,906.0
Tier 2 capital[5]	407.8	—	—	407.8
Other non-regulatory capital[1]	—	—	192.8	192.8
Total capital base	**4,200.7**	**113.1**	**192.8**	**4,506.6**
CET1 capital ratio (times)[6]	1.12	4.20	—	—
Tier 1 capital ratio (times)[7]	1.44	4.20	—	—
Minimum Regulatory Requirement ratio (times)[8]	1.59	4.20	4.84	1.67

1 Includes Funds Management, Corporate and other Life/Bank entities. Funds Management Minimum Regulatory Requirement (MRR) for capital is based on requirements set by ASIC and regulators in other foreign jurisdictions. Challenger Retirement and Investment Services Limited MRR is based on APRA and ASIC requirements.
2 Other adjustments predominantly related to deferred tax asset and intercompany items.
3 Minimum Regulatory Requirement is equivalent to PCA for CLC.
4 Minimum Regulatory Requirement for Challenger Bank Limited represents total capital requirements of 8% (of risk weighted assets) plus the capital conservation buffer of 2.5% (of risk weighted assets) plus the counter cyclical buffer of 1% (of risk weighted assets), as stipulated under APS 110 *Capital Adequacy* as at 30 June 2023.
5 CLC represents subordinated debt.
6 CET1 capital ratio is Common Equity Tier 1 regulatory capital divided by Minimum Regulatory Requirement.
7 Tier 1 capital ratio is Total Tier 1 regulatory capital divided by Minimum Regulatory Requirement.
8 Minimum Regulatory Requirement ratio is total capital base divided by Minimum Regulatory Requirement.

Capital management

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

Challenger's Australian-based companies are regulated by APRA and/or the Australian Securities and Investments Commission (ASIC). Challenger's Funds Management business has operations in the United Kingdom, Europe and Asia, which are subject to regulation in each jurisdiction.

The relevant regulator in each jurisdiction requires a minimum level of regulatory capital to be held.

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

Following completion of the Bank acquisition in 1H22, Challenger commenced reporting a consolidated (or Level 3) equivalent capital position for the entire business.

Regulatory capital base

Challenger Group's total regulatory capital base at 30 June 2023 was $4.5b, and is based on the Group's shareholder equity adjusted for items such as goodwill, intangibles and investments in associates and other items.

Minimum Regulatory Requirement

The Minimum Regulatory Requirements of capital for Challenger's regulated businesses are determined as follows:

- CLC: capital requirements as specified under APRA Life insurance prudential capital standards;
- Bank: capital requirements as specified under APRA's ADI prudential standards; and
- Funds Management: capital requirements as specified by ASIC and regulators in other foreign jurisdictions.

Challenger Group's Minimum Regulatory Requirement at 30 June 2023 was $2.7b, and includes:

- CLC of $2.7b – refer to page 47 for more detail;
- Bank of $13m – refer to page 59 for more detail; and
- Other, which includes the Funds Management business, of $40m.

Group excess capital position

Challenger Group's excess regulatory capital above the Minimum Regulatory Requirement at 30 June 2023 was $1.8b.

The Group's Minimum Regulatory Requirement ratio was 1.66 times, which is equivalent to Challenger holding 66% more regulatory capital than minimum requirements.

Consolidated operating cash flow

$m	FY23	FY22	FY21	2H23	1H23	2H22	1H22	2H21	1H21
Receipts from customers	767.0	708.0	675.2	416.6	350.4	366.0	342.0	351.4	323.8
Dividends received	66.9	73.3	65.0	25.1	41.8	33.6	39.7	31.4	33.6
Interest received	900.2	605.0	604.7	494.3	405.9	297.7	307.3	294.4	310.3
Interest paid	(591.5)	(590.3)	(492.0)	(334.5)	(257.0)	(196.7)	(393.6)	(257.7)	(234.3)
Payments to suppliers and employees	(696.3)	(632.4)	(605.2)	(340.8)	(355.5)	(311.0)	(321.4)	(300.3)	(304.9)
Income tax (paid) / refunded	(122.6)	(264.9)	(90.9)	25.7	(148.3)	(166.0)	(98.9)	(81.9)	(9.0)
Underlying operating cash flow	**323.7**	**(101.3)**	**156.8**	**286.4**	**37.3**	**23.6**	**(124.9)**	**37.3**	**119.5**
Net annuity policy capital receipts/(payments)	385.1	1,074.2	1,079.8	(416.9)	802.0	466.5	607.7	922.2	157.6
Net other Life capital receipts/(payments)	550.7	1,397.7	1,084.0	367.8	182.9	559.4	838.3	532.9	551.1
Net Bank deposit receipts/(payments)	(56.0)	93.5	—	(52.3)	(3.7)	75.1	18.4	—	—
(Purchase)/Proceeds of investments	(1,046.8)	(2,078.1)	(596.8)	(129.2)	(917.6)	(1,389.0)	(689.1)	(238.2)	(358.6)
Capital expenditures	(4.5)	(2.9)	(12.9)	(1.4)	(3.1)	(1.1)	(1.8)	(9.5)	(3.4)
Net equity placement proceeds	(57.1)	43.2	34.6	(67.7)	10.6	29.8	13.4	(0.2)	34.8
Net (repayments)/proceeds from borrowings	(8.7)	(524.0)	(1,355.7)	17.0	(25.7)	134.3	(658.3)	(967.8)	(387.9)
Receipts/(Payments) for Treasury shares	(7.8)	(1.7)	0.7	0.1	(7.8)	(0.1)	(1.6)	(1.7)	2.4
Net dividends paid	(160.5)	(148.8)	(61.1)	(82.1)	(78.4)	(78.1)	(70.7)	(61.1)	—
Net non-operating cash flows SPVs	—	(8.1)	(1.9)	—	—	(1.2)	(6.9)	1.6	(3.5)
Other cash flow	**(405.5)**	**(155.0)**	**170.7**	**(364.7)**	**(40.8)**	**(204.4)**	**49.4**	**178.2**	**(7.5)**
Net increase/(decrease) in cash and cash equivalents	**(81.8)**	**(256.3)**	**327.5**	**(78.3)**	**(3.5)**	**(180.8)**	**(75.5)**	**215.5**	**112.0**

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.

FY23 underlying operating cash flow was $324m, up $425m on FY22.

FY23 underlying operating cash flow was $40m lower than normalised net profit after tax of $364m mainly due to:

- non-cash normalised capital growth (-$26m);
- accrued interest not yet received (-$49m); partially offset by
- tax timing variances (+$34m).

Net annuity policy capital receipts

FY23 net annuity policy capital receipts were +$385m and comprised:

- annuity sales of $5,517.3m; less
- annuity capital payments of $5,132.2m.

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

FY23 annuity net flows (+$385m) represents annuity book growth of 2.8% for the year year and is calculated as FY23 annuity total net flows divided by the opening period (FY22) annuity liability of $13,595m.

FY23 annuity net flows benefited from an increase in sales (up 7.7% on FY22), partially offset by a higher maturity rate. The maturity rate in FY23 was 33.2% (up from 27.6% in FY22).

Net Index Plus Life capital receipts

Index Plus Life sales represent Institutional Guaranteed Index Plus.

FY23 net Index Plus Life capital receipts were +$551m and comprised:

- Index Plus Life sales of $4,229.3m; less
- Index Plus Life capital payments of $3,678.6m.

A significant proportion of the maturities were reinvested and included in Index Plus Life sales. For Guaranteed Index Plus maturities of $3,679m, 87% were reinvested in a new Guaranteed Index Plus policy and form part of Index Plus Life sales.

FY23 total Life book growth was 5.2% for the year (FY22 14.3%) and can be calculated as total FY23 net flows ($935.8m) divided by the sum of the opening period (FY23) liabilities of $17,982m (Life annuity liabilities and Other Life liabilities – refer to page 31 for more detail).

Life financial results

$m	FY23	FY22	FY21	2H23	1H23	2H22	1H22	2H21	1H21
Investment yield – policyholders' funds	1,122.6	806.0	752.4	601.5	521.1	417.4	388.6	377.1	375.3
Interest expense	(705.5)	(412.4)	(396.3)	(387.7)	(317.8)	(221.9)	(190.5)	(192.1)	(204.2)
Distribution expense	(8.1)	(12.3)	(9.4)	(3.2)	(4.9)	(3.4)	(8.9)	(4.6)	(4.8)
Other income[1]	49.4	45.6	40.0	25.5	23.9	21.8	23.8	20.6	19.4
Product cash margin	**458.4**	**426.9**	**386.7**	**236.1**	**222.3**	**213.9**	**213.0**	**201.0**	**185.7**
Investment yield – shareholders' funds	168.6	107.1	92.0	93.3	75.3	55.5	51.6	50.0	42.0
Cash earnings	**627.0**	**534.0**	**478.7**	**329.4**	**297.6**	**269.4**	**264.6**	**251.0**	**227.7**
Normalised capital growth	26.0	48.8	34.1	6.3	19.7	26.0	22.8	17.8	16.3
Normalised Cash Operating Earnings	**653.0**	**582.8**	**512.8**	**335.7**	**317.3**	**295.4**	**287.4**	**268.8**	**244.0**
Personnel expenses	(71.8)	(73.5)	(72.7)	(34.8)	(37.0)	(38.0)	(35.5)	(38.3)	(34.4)
Other expenses	(40.7)	(37.0)	(41.2)	(23.7)	(17.0)	(18.1)	(18.9)	(24.4)	(16.8)
Total expenses	**(112.5)**	**(110.5)**	**(113.9)**	**(58.5)**	**(54.0)**	**(56.1)**	**(54.4)**	**(62.7)**	**(51.2)**
Normalised EBIT	**540.5**	**472.3**	**398.9**	**277.2**	**263.3**	**239.3**	**233.0**	**206.1**	**192.8**
Asset and liability experience[2]	(12.5)	(72.9)	466.0	3.1	(15.6)	(264.8)	191.9	345.4	120.6
New business strain[2]	(86.9)	(42.4)	(10.9)	(41.9)	(45.0)	(6.4)	(36.0)	(14.8)	3.9
Total investment experience	**(99.4)**	**(115.3)**	**455.1**	**(38.8)**	**(60.6)**	**(271.2)**	**155.9**	**330.6**	**124.5**
Net profit after investment experience before tax	**441.1**	**357.0**	**854.0**	**238.4**	**202.7**	**(31.9)**	**388.9**	**536.7**	**317.3**
Reconciliation of investment experience to capital growth									
Asset and liability experience	(12.5)	(72.9)	466.0	3.1	(15.6)	(264.8)	191.9	345.4	120.6
Normalised capital growth	26.0	48.8	34.1	6.3	19.7	26.0	22.8	17.8	16.3
Asset and liability capital growth	**13.5**	**(24.1)**	**500.1**	**9.4**	**4.1**	**(238.8)**	**214.7**	**363.2**	**136.9**
Performance analysis									
Cost to income ratio[3] (%)	17.2%	19.0%	22.2%	17.4%	17.0%	19.0%	18.9%	23.3%	21.0%
Net assets – average[4] ($m)	3,571	3,594	3,220	3,610	3,522	3,680	3,517	3,365	3,065
Normalised ROE (pre-tax) (%)	15.1%	13.1%	12.4%	15.5%	14.8%	13.1%	13.1%	12.4%	12.5%
Margins[5]									
Investment yield – policyholders' funds	4.86%	3.60%	3.82%	5.17%	4.54%	3.72%	3.46%	3.72%	3.92%
Interest expense	(3.05%)	(1.84%)	(2.01%)	(3.33%)	(2.77%)	(1.98%)	(1.70%)	(1.89%)	(2.13%)
Distribution expense	(0.04%)	(0.05%)	(0.05%)	(0.03%)	(0.04%)	(0.03%)	(0.08%)	(0.05%)	(0.05%)
Other income	0.21%	0.20%	0.20%	0.22%	0.20%	0.20%	0.22%	0.20%	0.20%
Product cash margin	**1.98%**	**1.91%**	**1.96%**	**2.03%**	**1.93%**	**1.91%**	**1.90%**	**1.98%**	**1.94%**
Investment yield – shareholders' funds	0.73%	0.48%	0.47%	0.80%	0.66%	0.49%	0.46%	0.49%	0.44%
Cash earnings	**2.71%**	**2.39%**	**2.43%**	**2.83%**	**2.59%**	**2.40%**	**2.36%**	**2.47%**	**2.38%**
Normalised capital growth	0.11%	0.21%	0.17%	0.05%	0.17%	0.23%	0.20%	0.18%	0.17%
Normalised Cash Operating Earnings (COE)	**2.82%**	**2.60%**	**2.60%**	**2.88%**	**2.76%**	**2.63%**	**2.56%**	**2.65%**	**2.55%**

1 Other income includes Life Risk revenue (premiums net of claims) and Solutions revenue.
2 Investment experience comprises asset and liability experience and net new business strain. Refer to page 63 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.
5 Ratio of normalised COE components divided by average investment assets.

Life flows

$m	FY23	FY22	FY21	2H23	1H23	2H22	1H22	2H21	1H21
Sales									
Fixed term sales – 1-year	1,156.4	901.4	821.3	422.7	733.7	411.4	490.0	392.3	429.0
Fixed term sales – 2-years or more	1,754.6	1,003.4	867.7	721.8	1,032.8	583.6	419.8	386.5	481.2
Lifetime sales	708.7	462.9	438.3	333.5	375.2	242.1	220.8	228.2	210.1
Total retail annuity sales	**3,619.7**	**2,367.7**	**2,127.3**	**1,478.0**	**2,141.7**	**1,237.1**	**1,130.6**	**1,007.0**	**1,120.3**
Fixed term sales – 1-year	902.3	1,778.1	990.8	59.7	842.6	954.1	824.0	750.0	240.8
Fixed term sales – 2-years or more	240.4	336.6	520.0	92.9	147.5	197.6	139.0	370.0	150.0
Lifetime sales	14.0	23.7	137.4	14.0	—	23.7	—	0.9	136.5
Total institutional annuity sales	**1,156.7**	**2,138.4**	**1,648.2**	**166.6**	**990.1**	**1,175.4**	**963.0**	**1,120.9**	**527.3**
Total domestic annuity sales	**4,776.4**	**4,506.1**	**3,775.5**	**1,644.6**	**3,131.8**	**2,412.5**	**2,093.6**	**2,127.9**	**1,647.6**
Japan sales	740.9	616.6	790.5	328.8	412.1	193.9	422.7	247.1	543.4
Total Life annuity sales	**5,517.3**	**5,122.7**	**4,566.0**	**1,973.4**	**3,543.9**	**2,606.4**	**2,516.3**	**2,375.0**	**2,191.0**
Maturities and repayments	(5,132.2)	(4,048.5)	(3,486.2)	(2,390.3)	(2,741.9)	(2,139.9)	(1,908.6)	(1,452.8)	(2,033.4)
Total Life annuity flows	**385.1**	**1,074.2**	**1,079.8**	**(416.9)**	**802.0**	**466.5**	**607.7**	**922.2**	**157.6**
Closing Life annuity book	13,930.0	13,595.4	13,669.9	13,930.0	14,278.4	13,595.4	14,092.5	13,669.9	12,769.7
Annuity book growth[1]	**2.8%**	**7.9%**	**8.6%**	**(3.1%)**	**5.9%**	**3.5%**	**4.4%**	**7.3%**	**1.3%**
Other Life sales	4,229.3	4,583.4	2,362.1	2,294.2	1,935.1	2,156.6	2,426.8	1,115.6	1,246.5
Other maturities and repayments	(3,678.6)	(3,185.7)	(1,278.1)	(1,926.4)	(1,752.2)	(1,597.2)	(1,588.5)	(582.7)	(695.4)
Other Life flows	**550.7**	**1,397.7**	**1,084.0**	**367.8**	**182.9**	**559.4**	**838.3**	**532.9**	**551.1**
Closing Other Life liabilities	5,268.8	4,386.4	3,632.2	5,268.8	4,620.2	4,386.4	4,381.8	3,632.2	3,031.5
Other Life net book growth	**12.6%**	**38.5%**	**44.9%**	**8.4%**	**4.2%**	**15.4%**	**23.1%**	**22.1%**	**22.8%**
Total Life sales	9,746.6	9,706.1	6,928.1	4,267.6	5,479.0	4,763.0	4,943.1	3,490.6	3,437.5
Total maturities and repayments	(8,810.8)	(7,234.2)	(4,764.3)	(4,316.7)	(4,494.1)	(3,737.1)	(3,497.1)	(2,035.5)	(2,728.8)
Total Life net flows	**935.8**	**2,471.9**	**2,163.8**	**(49.1)**	**984.9**	**1,025.9**	**1,446.0**	**1,455.1**	**708.7**
Closing total Life book[2]	19,198.8	17,981.8	17,302.1	19,198.8	18,898.6	17,981.8	18,474.3	17,302.1	15,801.2
Total Life book growth[1]	**5.2%**	**14.3%**	**14.4%**	**(0.3%)**	**5.5%**	**5.9%**	**8.4%**	**9.7%**	**4.7%**
Assets									
Closing investment assets	**23,538**	**22,224**	**21,563**	**23,538**	**23,085**	**22,224**	**22,937**	**21,563**	**19,634**
Fixed income and cash	17,365	16,759	14,961	17,721	17,046	16,842	16,715	15,574	14,328
Property	3,198	3,470	3,316	3,183	3,211	3,466	3,491	3,333	3,299
Equity and infrastructure	541	945	509	271	770	1,026	884	595	437
Alternatives	2,014	1,226	933	2,283	1,746	1,285	1,167	947	914
Average investment assets[3]	**23,118**	**22,400**	**19,719**	**23,458**	**22,773**	**22,619**	**22,257**	**20,449**	**18,978**
Liabilities									
Closing liabilities (excluding Other[4])	**20,345**	**19,227**	**18,579**	**20,345**	**20,151**	**19,227**	**19,749**	**18,579**	**17,095**
Annuities and Other Life liabilities	18,780	18,067	15,885	19,107	18,470	18,231	17,961	16,433	15,324
Capital Notes	838	868	856	832	845	865	873	887	830
Subordinated debt[5]	471	403	402	414	518	401	404	404	401
Average liabilities[3]	**20,089**	**19,338**	**17,143**	**20,353**	**19,833**	**19,497**	**19,238**	**17,724**	**16,555**

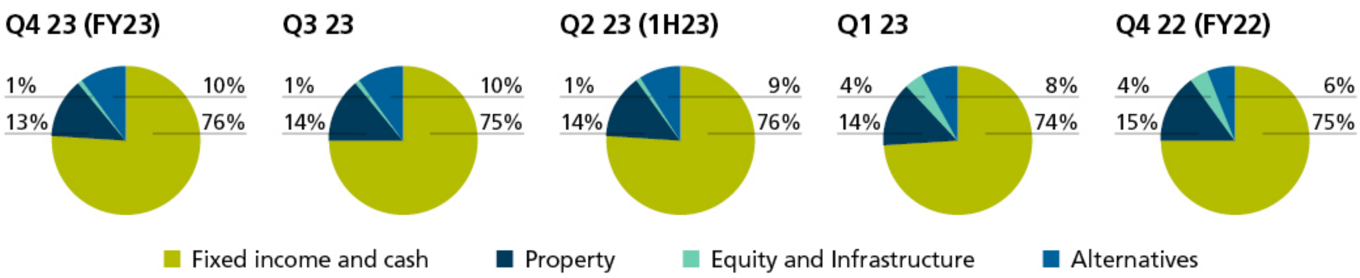
1 Book growth percentage represents net flows for the period divided by opening book value for the financial year.
2 Life annuity liabilities and Other Life liabilities.
3 Average investment assets and average liabilities calculated on a monthly basis.
4 Excluding Other liabilities. Refer to page 34 for more detail.
5 In September 2022, CLC issued $400 million of fixed-to-floating rate, unlisted, unsecured subordinated notes. The proceeds from the issuance were used to repay $400 million of subordinated notes that had a call date in November 2022.

Life quarterly flows

Life quarterly sales and investment assets

$m	Q4 23	Q3 23	Q2 23	Q1 23	Q4 22
Life sales					
Fixed term sales – 1-year	229	194	385	349	233
Fixed term sales – 2-years or more	327	394	573	460	372
Lifetime sales	187	147	195	180	135
Total retail annuity sales	**743**	**735**	**1,153**	**989**	**740**
Fixed term sales – 1-year	50	9	180	663	100
Fixed term sales – 2-years or more	5	88	145	2	45
Lifetime sales	14	—	—	—	24
Total institutional annuity sales	**69**	**97**	**325**	**665**	**169**
Total domestic annuity sales	**812**	**832**	**1,478**	**1,654**	**909**
Japan sales	117	212	225	187	131
Total life annuity sales	**929**	**1,044**	**1,703**	**1,841**	**1,040**
Maturities and repayments	(807)	(1,583)	(1,244)	(1,498)	(860)
Total Life net flows	**122**	**(539)**	**459**	**343**	**180**
Annuity book growth[2]	**0.9%**	**(4.0)%**	**3.4%**	**2.5%**	**1.3%**
Other Life sales	1,331	963	1,006	929	1,052
Other maturities and repayments	(993)	(933)	(891)	(861)	(698)
Other Life flows	**338**	**30**	**115**	**68**	**354**
Other Life net book growth	**7.7%**	**0.7%**	**2.6%**	**1.6%**	**9.7%**
Total Life sales	2,260	2,007	2,709	2,770	2,092
Total maturities and repayments	(1,800)	(2,516)	(2,135)	(2,359)	(1,558)
Total Life net flows	**460**	**(509)**	**574**	**411**	**534**
Total Life book growth	**2.5%**	**(2.8)%**	**3.2%**	**2.3%**	**3.1%**
Life					
Fixed income and cash[3]	17,800	17,506	17,621	16,816	16,659
Property[3]	3,062	3,236	3,178	3,228	3,227
Equity and infrastructure[3]	291	259	259	961	971
Alternatives	2,385	2,349	2,027	1,812	1,367
Total Life investment assets	**23,538**	**23,350**	**23,085**	**22,817**	**22,224**
Average Life investment assets[4]	**23,600**	**23,287**	**23,032**	**22,525**	**22,415**

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 are reported net of debt.
4 Average Life investment assets is calculated on a monthly basis.



Life financial results

Life focuses on the retirement income phase of superannuation, with products helping customers convert retirement savings into safe, secure and reliable retirement income.

Life's annuity products appeal to retirees as they provide security and certainty of guaranteed[1] income while protecting against the risks of investment markets and inflation. By providing certainty of income, Challenger ensures customers have more confidence to spend in retirement.

Lifetime annuities protect retirees from the risk of outliving their savings and pay an income for life. Depending on the payment option selected, payments can be either fixed, indexed to inflation, linked to changes in the RBA cash rate, or indexed to investment markets.

The retirement incomes Life pays to its customers are backed by a high-quality investment portfolio, predominantly invested in investment-grade fixed income. These investments generate reliable investment income, which is used to fund retirement incomes paid to customers.

Life is Australia's leading retirement income brand[2] and has won the Association of Financial Advisers 'Annuity Provider of the Year' for the last 15 years, and won Plan for Life's Overall Longevity Cover Excellence Award in 2022.

Life's products are distributed in Australia via independent financial advisers and financial adviser administrative platforms. Life's products are included on all major advice hubs' Approved Product Lists (APLs) and are available on leading independent investment and administration platforms. Life recently launched a new direct online channel to meet the needs of customers who prefer to invest directly and allow them to buy simple fixed term annuities.

Life is also focused on building institutional partnerships with superannuation funds that are increasingly focused on supporting their members in retirement by providing more comprehensive retirement income solutions. A number of funds have defined benefit pension liabilities and are looking to de-risk their liabilities. This provides significant growth opportunities for Challenger as funds seek trusted partners to deliver a range of de-risking solutions.

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 32 for more detail.

Life participates in wholesale reinsurance longevity and mortality transactions (refer to page 28 for more detail).

Challenger Life Company Limited (CLC) undertakes Challenger's guaranteed annuity and Index Plus 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 page 47.

Normalised EBIT and ROE

Life's normalised EBIT was $541m in FY23 and increased by $68m (14%) on FY22. The increase in EBIT reflects a $70m (12%) increase in Normalised Cash Operating Earnings (COE), partially offset by a $2.0m (2%) increase in expenses.

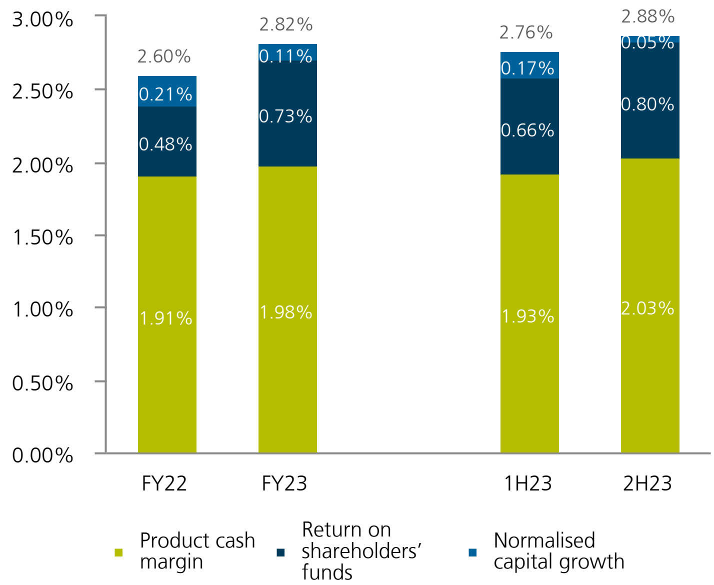
Life's normalised ROE (pre-tax) was 15.1% in FY23 and increased by 200 bps on FY22, driven by an increase in Normalised COE.

Normalised Cash Operating Earnings (COE) and COE margin

FY23 Normalised COE was $653m and increased by $70m (12%) on FY22. Normalised COE increased as a result of:

- higher average investment assets, which increased by 3% on FY22; and
- higher COE margin, which increased by 22 bps on FY22 to 2.82%.

Life COE margin composition



[1] The word 'guaranteed' means payments are guaranteed by CLC from assets of either its relevant statutory fund or shareholder fund.
[2] Plan for Life - March 2023 - based on annuities under administration.

FY22 to FY23 COE margin

Life's FY23 COE margin was 2.82% and increased by 22 bps on FY22 as a result of the following:

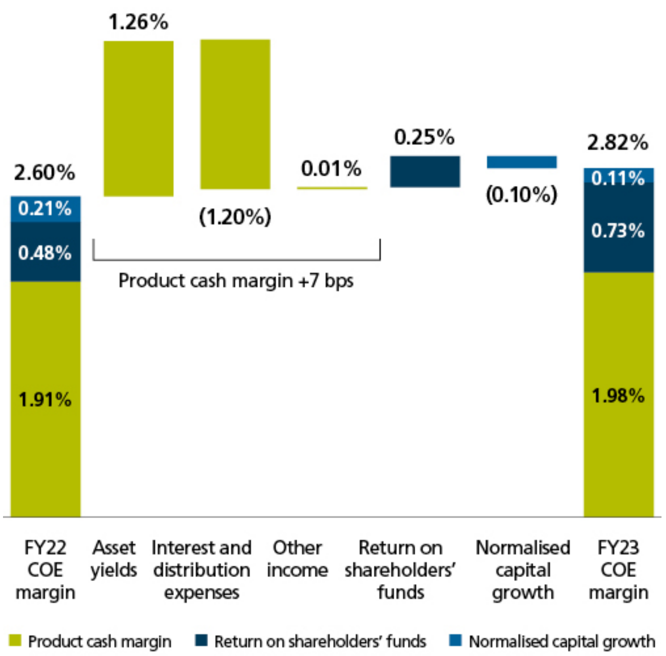
- Higher return on shareholder capital (+25 bps): Reflects the impact of higher interest rates. For example, the average 3-month Bank Bill Swap rate increased from 34 bps in FY22 to 320 bps in FY23, resulting in a significant increase in investment earnings on shareholder capital.
- Higher product cash margin (+7 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 and Solutions revenue (refer to page 28). The product cash margin drivers included:
  - Higher investment yield on policyholder funds (+126 bps): Reflects higher yields on fixed income securities and higher absolute return fund distributions;
  - Higher interest expense (-121 bps): Reflects higher annuity and institutional rates paid to customers, and higher capital notes and subordinated debt interest costs as a result of higher interest rates;
  - Lower distribution expenses (+1 bps): Distribution expenses relate to payments made for the acquisition and management of annuities; and
  - Higher other income (+1 bps): Reflects marginally higher Life Risk income and fiduciary income from the Solutions Group (refer to page 28 for more detail).
- Lower normalised capital growth (-10 bps): Reflects lower allocation to equities and infrastructure and property, and higher allocation to alternatives over FY23. Alternatives has a zero normalised growth assumption.

1H23 to 2H23 COE margin

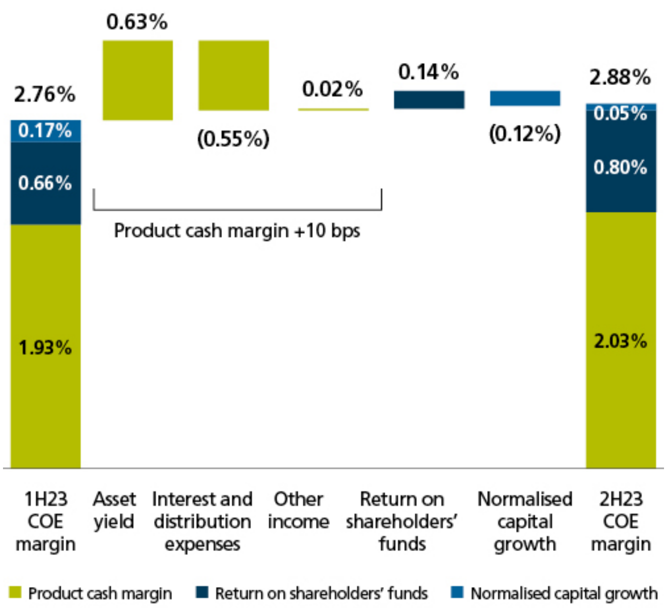
Life's 2H23 COE margin was 2.88% and increased by 12 bps on 1H23 as a result of the following:

- Higher return on shareholder capital (+14 bps): Reflects the impact of higher interest rates and average shareholder net assets. For example, the average 3-month Bank Bill Swap rate increased from 270 bps in 1H23 to 370 bps in 2H23.
- Higher product cash margin (+10 bps): The product cash margin drivers included:
  - Higher investment yield on policyholder funds (+63 bps): Reflects higher yields on fixed income securities and higher absolute return fund distributions;
  - Higher interest expense (-56 bps): Reflects higher annuity and institutional rates paid to customers, and higher capital notes and subordinated debt interest costs as a result of higher interest rates;
  - Lower distribution expenses (+1 bps): Primarily reflects a decrease in administration fees; and
  - Higher other income (+2 bps): Reflects higher Life Risk income and fiduciary income from the Solutions Group (refer to page 28 for more detail).
- Lower normalised capital growth (-12 bps): Reflects the lower allocation to equities and infrastructure, and higher allocation to alternatives over 2H23. Alternatives has a zero normalised growth assumption.

FY22 to FY23 COE margin



1H23 to 2H23 COE margin



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.

FY23 Life normalised COE includes $45m of income from Life Risk transactions, which represents the release of profit and expense margins, and was up $1m from FY22.

The present value of future profits arising from the Life Risk portfolio was $679m at 30 June 2023, down 15% from $798m at 30 June 2022, driven by higher interest rates which increases the discount rate, which is based on the UK Government bond rate.

The Life Risk portfolio has an average duration of 12 years.

Solutions Group

Challenger's Solutions Group works with clients to address their evolving investment and retirement needs. Benefitting from the scale of the broader Challenger Group, the Solutions Group provides innovative portfolio management and balance sheet solutions. These include alpha and beta solutions, income solutions, retirement solutions and defined benefit plan solutions.

During 1H23, the Solutions Group transferred from Challenger Investment Management to the Life business. Prior to 1H23, performance of the Solutions Group was reported as part of Funds Management.

Fiduciary revenue from the Solutions Group is included in other income within Life's normalised COE. Solution's FY23 revenue was $4m (FY22 $3m included in Funds Management).

Expenses

FY23 Life expenses were $113m and increased by $2.0m (2%) on FY22.

Personnel expenses in FY23 were $72m and decreased by $2m (-2%), reflecting the transfer of Challenger investment operations employees to Artega.

Other expenses were $41m in FY23 and increased by $4m (10%) primarily due to Artega expenses ($3m) following the transfer of personnel costs, higher project spend and increased marketing and travel costs.

The net impact of the increase in Artega costs in Life is $1m.

With normalised COE up 12%, Life's cost to income ratio decreased 180 bps to 17.2%.

Investment experience overview

Challenger Life is required by accounting standards and prudential standards to value 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 assets and policy liability experience and net new business strain.

FY23 investment experience was a loss of $99m (pre-tax), comprising a $12m assets and policy liability loss and a $87m loss in relation to new business strain.

($m)	Actual capital growth	Normalised capital growth	Investment experience
Fixed income	171	61	**232**
Property	(159)	(64)	**(223)**
Equity and infrastructure	(13)	(23)	**(36)**
Alternatives	(105)	—	**(105)**
Policy liability	120	—	**120**
Assets and policy liability experience	**14**	**(26)**	**(12)**
New business strain	(87)	—	**(87)**
Total investment experience (pre-tax)	**(73)**	**(26)**	**(99)**

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, bond yield and inflation factor assumptions, expense assumptions and other factors applied in the valuation of life contract liabilities.

Assets and policy liability experience was a loss of $12m in FY23, comprising the following:

- Fixed income (+$232m): Comprising a valuation gain of $171m and normalised capital growth of $61m (representing an allowance for credit defaults). The fixed income valuation gain is a result of movements in credit spreads, impacting the valuation of fixed income securities, and provisions for credit defaults.

In 2H23, credit spreads tightened with investment-grade credit spreads decreasing by ~10bps and sub-investment-grade credit spreads decreasing by ~50bps. The impact was a fixed income valuation gain of $209m.

Credit defaults in FY23 were -$38m (22 bps) predominantly representing 2 clients that were downgraded, per Life's policy to consider all investments rated below B- in default. Fixed income normalised capital growth of $61m represents an allowance for credit defaults of -35 bps per annum.

- Property (-$223m): Reflects the revaluation of Life's property portfolio, with a revaluation loss of $159m and normalised capital growth of $64m.

  All properties were independently revalued in June 2023. Carrying values across the portfolio were reduced by ~5%, with Australian office properties reduced by ~7% and Australian retail properties reduced by ~3% (excluding the sale of one direct property at carrying value in 1H23). The reduction in carrying values is mainly attributed to the rising interest rate environment.
- Equity and infrastructure (-$36m): Reflects a revaluation loss of $13m and normalised capital growth of $23m. In 2H23, the MSCI Daily Total Return Net World Index (Bloomberg NDDLWI) returned ~15% over the six months to 30 June 2023.
- Alternatives (-$105m): Relates to Challenger's absolute return portfolio, which underperformed Challenger's normalised growth assumption of 0% per annum for alternatives. Returns on Challenger's absolute return portfolio broadly correlated to movements in the Société Générale CTA Index throughout FY23.
- Policy liability (+$120m): Includes -$37m in relation to the illiquidity premium loss, more than offset by $157m of other gains on policy liabilities. Policy liabilities include changes in economic and actuarial assumptions, including the effects on policy liabilities of changes to bond yields and interest rates, expected inflation rates and expense assumptions. FY23 other policy liability gains reflect the impacts of relative movements of instruments used for hedging purposes, including inflation-linked and fixed-rate government and semi-government securities.

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.

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.***

Movements in credit spreads impact the illiquidity premium.

The illiquidity premium loss in FY23 was -$37m and reflects the impact of tighter credit spreads used to value policy liabilities.

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 a lower discount rate 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 contract period. 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 FY23 net new business strain was a loss of $87m, a result of net book growth over the year.

Life sales and AUM

Total Life sales

Challenger is delivering higher quality Life sales by focusing on longer duration business across both retail and institutional products and clients.

Total Life sales were $9.7b and stable on FY22, driven by record retail sales and strong Japanese annuity sales, largely offset by lower institutional sales.

Annuity and Other Life sales

In FY23, Challenger Life achieved record annuity sales of $5.5b, up $0.4b or 8% on FY22.

Annuity sales comprised:

- Domestic retail term and lifetime annuity sales of $3.6b, up $1.3b or 53% on FY22;
- Domestic institutional term and lifetime sales of $1.2b, down $1.0b or (46%) on FY22; and
- Japanese sales of $741m, up $124m or 20% on FY22.

Domestic retail annuity sales

Domestic retail annuity sales were $3,620m and comprised:

- term annuity sales of $2,911m, which increased by $1,006m or 53% on FY22; and
- lifetime annuity sales of $709m, which increased by $246m or 53% on FY22.

Retail annuity sales are benefitting from a supportive market environment, rising demand for guaranteed lifetime income and a growing number of Australians entering retirement.

Lifetime annuity sales comprise Liquid Lifetime sales of $382m (FY22 $238m) and CarePlus sales of $327m (FY22 $225m).

CarePlus is a lifetime annuity specifically designed for aged care.

Domestic retail annuity sales growth is supported through solid reinvestment by customers, with approximately 63% of term maturities reinvested in FY23 (FY22 60%).

Domestic institutional sales

Domestic institutional sales were $5,386m, down $1.3b (-20%) on FY22 and comprised:

- Institutional term annuity sales of $1,143m, down $972m or (46%);
- Institutional lifetime annuity sales of $14m; and
- Other Life sales of $4,229m, down $354m or 8%.

Institutional term annuity sales of $1,143m predominantly reflects lower reinvestment rates due to increased competition and clients rotating away from short-term secure fixed income investments.

Term annuities are a viable alternative to bank-issued term deposits and other short-term fixed income instruments. For institutional customers, these investments have typically been shorter duration, typically around 1-year.

A key focus for Challenger is growing longer duration business by deepening its relationships with institutional customers, particularly leading superannuation funds, and supporting them through the provision of innovative guaranteed income solutions. Refer to page 5 for more information as to how Challenger is supporting institutional customers.

Other Life sales represent the sales made on Guaranteed Index Plus products. The 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], prudentially regulated counterparty and zero fees.

Superannuation funds have had an intense focus and pressure on both fees and performance, which is aiding Guaranteed Index Plus sales, as it delivers contractual alpha in a zero fee product.

Other Life sales were $4,229m in FY23, with $1,023m of new inflows from existing clients, and $3,206m of maturities reinvested. The maturities reinvested represent 87% of total FY23 Other Life maturities.

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 32 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.

Under the reinsurance arrangements, MS Primary will provide Challenger an amount of reinsurance, across both Australian and US dollar denominated annuities, of at least ¥50b (currently ~A$520m[2]) per year for a minimum of five years from 2019. This is subject to review in the event of a material adverse change for either MS Primary or Challenger.

MS Primary annuity sales are included in term annuity sales and were $741m, up 20% from $617m in FY22. FY23 sales exceeded the annual minimum target by ~40%.

MS Primary annuity sales represented 13% of Challenger's FY23 total annuity sales.

New business tenor

The tenor on new business annuity sales[3] was 5.8 years in FY23, up from 4.9 years in FY22. The increase in Life's new business tenor is a result of longer-dated retail fixed term annuity sales and a higher contribution from Lifetime and Japanese annuity sales.

[1] Standard & Poor's Global Ratings (S&P) Challenger Life Company Limited 'A' rating with a stable outlook.
[2] Based on the exchange rate as at 30 June 2023.
[3] Including Japanese annuity sales.

Life book liability maturity profile

Maturities represent annuity maturities and repayments (excluding interest payments) in the year. Total annuity maturities in FY23 were $5.1b and represented 33% of opening period annuity liability (undiscounted liability of $15.4b).

FY24 maturities are expected to be $4.3b, down $0.8b on FY23. Given the lower maturities, the FY24 maturity rate is expected to fall to 26%.

The decrease in the FY24 maturity rate is consistent with Challenger's strategy to extend the duration of the book by delivering higher quality Life sales.

Challenger's strategy is to focus on longer duration more valuable business. Given institutional term annuities are typically 1-year business, in accordance with its strategy Challenger maintained a disciplined approach to institutional annuity pricing, which resulted in lower institutional term annuities reinvested, with 1-year term sales of $0.9b (FY22 $1.8b).

Net book growth

Across both annuity and institutional Guaranteed Index Plus, FY23 total Life net flows were $936m and represented total book growth of 5.2%.

Life annuity book growth

FY23 Life annuity net flows (i.e. annuity sales less capital repayments) were $385m, down from $1,074m in FY22. Net flows reflect higher Life annuity sales of $5,517m (up 8%) mainly benefitting from record retail and strong Japanese annuity sales, partially offset by higher maturities of $5,132m (up 27%) driven by lower reinvestments from institutional term annuities.

Based on the opening Life annuity book liability ($13,595m), FY23 annuity book growth was +2.8%.

Reflecting Challenger's strategy to improve the quality of the Life book through growing longer duration business, retail book growth was +8.6%.

Other Life book growth

Other Life net flows (i.e. other Life sales less capital repayments) represent net flows on the Guaranteed Index Plus products.

In FY23, Other Life net flows were $551m, down from $1,398m in FY22. Based on the opening Other Life liabilities ($4,386m), FY23 Other Life book growth was +12.6%.

Average AUM

Life's average investment assets were $23.1b in FY23 and increased by 3% ($0.7b) on FY22.

The increase in average investment assets reflects net book growth.

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.

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.

In March 2019, Challenger and MS&AD announced an expansion to their 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.

Under a reinsurance agreement with MS Primary, MS Primary provides Challenger an annual amount of reinsurance, across both Australian and US dollar annuities, of the least of ¥50 billion (equivalent to ~A$520 million[1]) per year[2].

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 the rest of 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 towards 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 were $741m, up 20% on FY22 and represented ~13% of Challenger Life's FY23 total annuity sales (~12% in FY22).

MS Primary is a key Challenger strategic partner and the two businesses engage extensively across a range of topics, including product development and partnering opportunities.

Reflecting on the strength and breadth of the strategic partnership, in April 2021 Challenger entered an Investment Management Agreement with MS Primary to assist in developing and executing its direct Japanese real estate strategy. This presents a significant growth opportunity for both Challenger and MS Primary.

MS&AD is a significant investor in Challenger and as at 30 June 2023, held ~15% of Challenger's issued capital.

In August 2019, a representative from MS&AD joined the Challenger Limited Board.

[1] Based on exchange rate as at 30 June 2023.
[2] Reinsurance across both Australian and US dollar annuities, of at least ¥50 billion per year for a minimum of five years, commencing 1 July 2019.

Retirement income regulatory reforms

Objective of superannuation

In 2023, the Australian Government launched a consultation to garner community feedback on legislating an objective of superannuation.

It proposed that such an objective would provide stability and and confidence to policy makers, regulators, industry and the community that changes to superannuation policy will be aligned to the purpose of the superannuation. It was also proposed that legislation would ensure that superannuation members and funds have a shared understanding of the purpose of superannuation throughout accumulation and retirement phases.

Challenger has been a strong advocate of retirement income reforms that will enhance the lives of older Australians. We supported the Federal Government's plan to legislate an objective for superannuation that will give guidance to policy makers to prioritise the provision of retirement income. We also believe the objective should contribute to the financial wellbeing and sustainability of retirement incomes for the growing number of Australian retirees, creating significant economic and social policy benefits.

Government response to Quality of Advice Review (QAR)

In June 2023, the Australian Government issued its response to the Quality of Advice Review (QAR), and announced plans to accept 14 of the 22 recommendations from the review chaired by Michelle Levy. Measures are to be developed over the second half of calendar year 2023 and early 2024 and are broken down into three streams of consultation.

Challenger supports the Government's response to the QAR review that will make quality financial advice more accessible to more Australians as they prepare for retirement.

Retirement Income Covenant

The Retirement Income Covenant (RIC) came into effect on 1 July 2022. It requires the trustees of APRA-regulated superannuation funds to formulate, review regularly and give effect to a retirement income strategy for their members in, and approaching, retirement. The trustee's strategy will assist members to achieve and balance the key objectives of the covenant, to:

- maximise their expected retirement income;
- manage the expected risks to the sustainability and stability of their expected retirement income; and
- have flexible access to funds during retirement.

Superannuation funds are working on their retirement propositions and are looking to engage with trusted partners to deliver components of their comprehensive retirement offering.

In July 2023, APRA issued a report setting out the findings of a recent joint review undertaken by APRA and ASIC on the implementation of the RIC by a sample of superannuation funds. The review found that while superannuation funds were improving their offerings of assistance to members in retirement, there was a variability in the quality of approach taken and an insufficient urgency in embracing the RIC to improve members' retirement outcomes.

Challenger is supporting superannuation funds to develop comprehensive solutions for their members in retirement and is confident that, over time, funds will deliver retirement income solutions that address the risks that members face in the retirement phase, giving them confidence to spend their retirement savings as intended.

Life balance sheet

$m	FY23	1H23	FY22	1H22	FY21	1H21
Assets						
Life investment assets						
Cash and equivalents	2,363.2	2,344.2	1,585.0	2,092.1	1,396.6	2,083.3
Asset-backed securities	10,133.8	9,920.3	9,994.6	9,300.6	8,246.2	6,964.8
Corporate credit	5,302.6	5,356.5	5,079.8	5,638.4	6,775.4	5,773.0
Fixed income and cash (net)	**17,799.6**	**17,621.0**	**16,659.4**	**17,031.1**	**16,418.2**	**14,821.1**
Australian – Office	1,656.9	1,762.5	1,775.0	2,139.6	2,081.8	1,947.9
Australian – Retail	697.6	726.5	787.4	756.5	722.9	709.1
Australian – Industrial	250.0	242.6	243.5	225.8	199.3	189.5
Japanese	358.6	337.5	320.9	358.4	357.7	366.8
Other	99.3	109.2	100.2	103.0	105.8	102.9
Property (net)	**3,062.4**	**3,178.3**	**3,227.0**	**3,583.3**	**3,467.5**	**3,316.2**
Equity and infrastructure	291.3	259.0	971.1	1,096.1	623.2	604.2
Alternatives	2,384.7	2,026.6	1,366.3	1,226.4	1,054.3	892.5
Life investment assets	**23,538.0**	**23,084.9**	**22,223.8**	**22,936.9**	**21,563.2**	**19,634.0**
Other assets (including intangibles)	619.7	619.7	543.0	696.1	773.9	896.0
Total assets	**24,157.7**	**23,704.6**	**22,766.8**	**23,633.0**	**22,337.1**	**20,530.0**
Liabilities						
Life annuity book	13,930.0	14,278.4	13,595.4	14,092.5	13,669.9	12,769.7
Other Life liabilities	5,268.8	4,620.2	4,386.4	4,381.8	3,632.2	3,031.5
Subordinated debt	411.3	407.8	399.7	401.6	404.5	401.7
Challenger Capital Notes	735.0	845.0	845.0	872.7	872.7	892.5
Other liabilities	81.3	50.9	7.7	224.5	210.7	269.8
Total liabilities	**20,426.4**	**20,202.3**	**19,234.2**	**19,973.1**	**18,790.0**	**17,365.2**
Net assets	**3,731.3**	**3,502.3**	**3,532.6**	**3,659.9**	**3,547.1**	**3,164.8**

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 liabilities 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 2023	30 June 2022
Fixed income and cash	76%	75%
Property	13%	15%
Equity and infrastructure	1%	4%
Alternatives	10%	6%

Fixed income portfolio overview

Life's fixed income and cash portfolio was $17.8b at 30 June 2023 and increased by 7% ($1.1b) from $16.7b at 30 June 2022. The increase primarily reflects FY23 net book growth.

The fixed income and cash portfolio represented 76% of Life's investment assets at 30 June 2023, up from 75% at 30 June 2022. The fixed income portfolio comprises approximately 1,800 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 provide the opportunity to invest in longer-term and less liquid fixed income investments, which generate an illiquidity premium.

Life targets to hold at least 75% of its fixed income portfolio as investment grade (i.e. BBB or higher). At 30 June 2023, 77% of the fixed income portfolio was investment grade, down 1% from 78% at 30 June 2022.

A total of 87% 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 60% 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%.

Fixed income credit default experience

Challenger's normalised growth assumption for fixed income is -35 bps, representing an allowance for credit default losses. In FY23, the credit default loss recognised in investment experience was -22 bps (-$38m), which is below Challenger's -35 bps per annum assumption. Credit defaults predominantly represented 2 clients that were downgraded, per Life's policy to consider all investments rated below B- in default.

Over the past five financial years, the average credit default loss experience recognised in investment experience has been -18 bps per annum.

Detailed disclosure of Life's fixed income portfolio is included on pages 36 to 39. The fixed income disclosures include the following tables:

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

Table 1: Fixed income portfolio overview

30 June 2023		$m	% portfolio	
Liquids		2,363	13%	Includes cash and equivalents and Government Bonds (net of repurchase agreements) and strategies earning a spread with limited credit risk
Asset-Backed Securities (ABS)	Residential Mortgage-Backed Securities (RMBS)	4,472	25%	Financing secured against a pool of underlying residential mortgages
	Other ABS	3,124	18%	Financing secured against underlying assets, where asset security includes motor vehicle, equipment and consumer finance
	Senior Secured Loans	2,283	13%	Senior debt secured by collateral and typically originated by Challenger
	Aviation Finance	74	—	Secured commercial aircraft financing
	Commercial Mortgage-Backed Securities (CMBS)	181	1%	Securitisations of underlying commercial property mortgages
Corporate Credit	Banks and Financials	1,275	7%	Corporate loans to banks, insurance companies and fund managers
	Infrastructure	873	5%	Long-dated inflation-linked bonds issued by Public Private Partnership projects and loans to infrastructure companies
	Senior Secured Loans	397	2%	Senior debt secured by collateral
	Non-Financial Corporates	2,222	13%	Traded commercial loans to non-financial corporates (includes exposures to retail, hotels, media, mining and health care)
	Commercial Real Estate	536	3%	Loans secured against commercial real estate assets and typically originated by Challenger
Total		**17,800**	**100%**	

Table 2: Fixed income portfolio by credit rating

30 June 2023 ($m)	Investment grade						Non-investment grade			Total
	Cash & Equivalents	AAA	AA	A	BBB	Total	BB	Less than BB	Total	$m
Liquids										
Government bonds[1]	887	—	—	—	—	**887**	—	—	**—**	**887**
Covered bonds	152	—	—	—	—	**152**	—	—	**—**	**152**
Cash & Equivalents[2]	1,324	—	—	—	—	**1,324**	—	—	**—**	**1,324**
Asset-Backed Securities										
RMBS	—	2,220	1,040	675	320	**4,255**	142	75	**217**	**4,472**
Other ABS	—	932	632	384	389	**2,337**	496	291	**787**	**3,124**
Senior Secured Loans	—	959	361	195	438	**1,953**	317	13	**330**	**2,283**
Aviation Finance	—	—	—	9	25	**34**	—	40	**40**	**74**
CMBS	—	14	35	47	45	**141**	33	7	**40**	**181**
Corporate Credit										
Banks and Financials	—	—	91	213	738	**1,042**	196	37	**233**	**1,275**
Infrastructure	—	—	104	142	358	**604**	154	115	**269**	**873**
Senior Secured Loans	—	—	—	—	24	**24**	82	291	**373**	**397**
Non-Financial Corporates	—	1	6	27	397	**431**	783	1,008	**1,791**	**2,222**
Commercial Real Estate	—	55	—	117	306	**478**	43	15	**58**	**536**
Total	**2,363**	**4,181**	**2,269**	**1,809**	**3,040**	**13,662**	**2,246**	**1,892**	**4,138**	**17,800**
Fixed income portfolio (%)	13%	24%	13%	10%	17%	**77%**	12%	11%	**23%**	**100%**
Average duration (years)	—	1.4	2.3	3.0	3.6	**2.4**	3.5	3.3	**3.4**	**2.7**

30 June 2023 (%)	Investment grade						Non-investment grade			Total
	Cash & Equivalents	AAA	AA	A	BBB	Total	BB	Less than BB	Total	%
Liquids										
Government bonds[1]	100%	—	—	—	—	**100%**	—	—	**—**	**100%**
Covered bonds	100%	—	—	—	—	**100%**	—	—	**—**	**100%**
Cash & Equivalents[2]	100%	—	—	—	—	**100%**	—	—	**—**	**100%**
Asset-Backed Securities										
RMBS	—	50%	23%	15%	7%	**95%**	3%	2%	**5%**	**100%**
Other ABS	—	31%	20%	12%	12%	**75%**	16%	9%	**25%**	**100%**
Senior Secured Loans	—	41%	16%	9%	19%	**85%**	14%	1%	**15%**	**100%**
Aviation Finance	—	—	—	12%	34%	**46%**	—	54%	**54%**	**100%**
CMBS	—	—	—	26%	25%	**78%**	18%	4%	**22%**	**100%**
Corporate Credit										
Banks and Financials	—	—	7%	17%	58%	**82%**	15%	3%	**18%**	**100%**
Infrastructure	—	—	12%	16%	41%	**69%**	18%	13%	**31%**	**100%**
Senior Secured Loans	—	—	—	—	6%	**6%**	21%	73%	**94%**	**100%**
Non-Financial Corporates	—	—	—	1%	18%	**19%**	35%	46%	**81%**	**100%**
Commercial Real Estate	—	—	—	22%	57%	**89%**	8%	3%	**11%**	**100%**
Total	**13%**	**24%**	**13%**	**10%**	**17%**	**77%**	**12%**	**11%**	**23%**	**100%**

[1] Government Bonds are shown net of $2,237m of Australian Government Bonds and $1,837m of Australian Semi-Government Bonds, which are held via repurchase agreements. Government Bonds refinanced with repurchase agreements are used to hedge movements in interest rates. Refer to page 45 for more detail.

[2] Includes strategies earning a spread with limited credit risk.

Table 3: Fixed income portfolio by rating type

	Investment grade						Non-investment grade			Total
30 June 2023 ($m)	**Cash & Equivalents**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**Less than BB**	**Total**	**$m**
Liquids										
Externally rated	2,363	—	—	—	—	**2,363**	—	—	—	**2,363**
Internally rated	—	—	—	—	—	**—**	—	—	—	**—**
Asset-Backed Securities										
Externally rated	—	4,097	2,043	1,148	675	**7,963**	538	239	777	**8,740**
Internally rated	—	28	24	162	543	**757**	450	187	637	**1,394**
Corporate Credit										
Externally rated	—	56	195	483	1,730	**2,464**	858	977	1,835	**4,299**
Internally rated	—	—	7	16	92	**115**	400	489	889	**1,004**
Total	**2,363**	**4,181**	**2,269**	**1,809**	**3,040**	**13,662**	**2,246**	**1,892**	**4,138**	**17,800**
Externally rated	100%	99%	99%	90%	79%	**94%**	62%	64%	**63%**	**87%**
Internally rated	—	1%	1%	10%	21%	**6%**	38%	36%	**37%**	**13%**

	Investment grade						Non-investment grade			Total
30 June 2023 (%)	**Cash & Equivalents**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**Less than BB**	**Total**	**%**
Liquids										
Externally rated	100%	—	—	—	—	**100%**	—	—	**—**	**100%**
Internally rated	—	—	—	—	—	**—**	—	—	**—**	**—**
Asset-Backed Securities										
Externally rated	—	47%	23%	13%	8%	**91%**	6%	3%	**9%**	**100%**
Internally rated	—	2%	2%	12%	39%	**55%**	32%	13%	**45%**	**100%**
Corporate Credit										
Externally rated	—	1%	5%	11%	40%	**57%**	20%	23%	**43%**	**100%**
Internally rated	—	—	—	2%	9%	**12%**	40%	48%	**88%**	**100%**
Total	**13%**	**24%**	**13%**	**10%**	**17%**	**77%**	**12%**	**11%**	**23%**	**100%**

Table 4: Fixed income portfolio by industry sector

	Investment grade						Non-investment grade			Total
30 June 2023 ($m)	**Cash & Equivalents**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**Less than BB**	**Total**	**$m**
Industrials and consumers	—	1,971	999	563	1,136	**4,669**	1,571	1,479	**3,050**	**7,719**
Residential property	—	2,131	955	617	365	**4,068**	152	75	**227**	**4,295**
Banks, financials & insurance	1,476	—	143	271	835	**2,725**	254	86	**340**	**3,065**
Government	887	—	—	—	—	**887**	—	—	**—**	**887**
Commercial property	—	79	39	182	307	**607**	64	24	**88**	**695**
Infrastructure and utilities	—	—	104	142	359	**605**	159	121	**280**	**885**
Other	—	—	29	34	38	**101**	46	107	**153**	**254**
Total	**2,363**	**4,181**	**2,269**	**1,809**	**3,040**	**13,662**	**2,246**	**1,892**	**4,138**	**17,800**

30 June 2023 (%)	Investment grade: Cash & Equivalents	AAA	AA	A	BBB	Total	Non-investment grade: BB	Less than BB	Total	Total: %
Industrials and consumers	—	26%	13%	7%	15%	**61%**	20%	19%	**39%**	**100%**
Residential property	—	50%	22%	14%	8%	**94%**	4%	2%	**6%**	**100%**
Banks, financials & insurance	48%	—	5%	9%	27%	**89%**	8%	3%	**11%**	**100%**
Government	100%	—	—	—	—	**100%**	—	—	**—**	**100%**
Commercial property	—	11%	—	26%	45%	**88%**	9%	3%	**12%**	**100%**
Infrastructure and utilities	—	—	12%	16%	40%	**68%**	18%	14%	**32%**	**100%**
Other	—	—	11%	—	15%	**39%**	18%	43%	**61%**	**100%**
Total	**13%**	**24%**	**13%**	**10%**	**17%**	**77%**	**12%**	**11%**	**23%**	**100%**

Table 5: Fixed income portfolio by geography and credit rating

30 June 2023 ($m)	Investment grade: Cash & Equivalents	AAA	AA	A	BBB	Total	Non-investment grade: BB	Less than BB	Total	Total: $m
Australia	1,409	2,926	1,326	1,067	1,832	**8,560**	1,176	995	**2,171**	**10,731**
United States	864	680	122	267	643	**2,576**	892	760	**1,652**	**4,228**
United Kingdom	—	102	239	115	148	**604**	11	5	**16**	**620**
Europe	26	282	527	279	294	**1,408**	16	21	**37**	**1,445**
New Zealand	—	181	50	81	68	**380**	92	103	**195**	**575**
Rest of world	64	10	5	—	55	**134**	59	8	**67**	**201**
Total	**2,363**	**4,181**	**2,269**	**1,809**	**3,040**	**13,662**	**2,246**	**1,892**	**4,138**	**17,800**

30 June 2023 (%)	Investment grade: Cash & Equivalents	AAA	AA	A	BBB	Total	Non-investment grade: BB	Less than BB	Total	Total: %
Australia	13%	28%	12%	10%	17%	**80%**	11%	9%	**20%**	**100%**
United States	20%	16%	3%	6%	15%	**60%**	22%	18%	**40%**	**100%**
United Kingdom	—	16%	38%	19%	24%	**97%**	2%	—	**3%**	**100%**
Europe	—	20%	37%	19%	20%	**98%**	1%	1%	**2%**	**100%**
New Zealand	—	31%	9%	14%	12%	**66%**	16%	18%	**34%**	**100%**
Rest of the world	32%	—	—	—	27%	**66%**	30%	4%	**34%**	**100%**
Total	**13%**	**24%**	**13%**	**10%**	**17%**	**77%**	**13%**	**11%**	**23%**	**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 $3.1b (net of debt) at 30 June 2023 and decreased by 5% from 30 June 2022, primarily reflecting revaluation decreases on property of $162m.

Primarily as a result of revaluations, the property allocation reduced from 15% of Life's investment portfolio at 30 June 2022 to 13% at 30 June 2023.

Life's property portfolio is mainly focused on domestic properties providing long-term income streams. Australian properties accounted for 88% of the property portfolio.

Challenger Life has a policy that all directly owned properties are independently valued each year with approximately 50% valued in June and 50% valued in December. Internal valuations are undertaken for properties not independently valued each June and December. An independent valuation is subsequently undertaken if the internal valuation shows a significant variance to the most recent independent valuation.

Given the economic uncertainty as a result of the rising inflation and interest rate environment, all direct properties were independently valued in June 2023.

For FY23, the movement in the valuation of properties was as follows:

- Australian office -6.7%;
- Australian retail -2.9% excluding the impact of the sale of one property at its carrying value of $78m and the acquisition of one property for ~$10m in 1H23;
- Australian industrial +2.7%; and
- Japanese portfolio -1.9%.

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 54% of the portfolio, with the Federal and State governments a major tenant, accounting for 54% of FY23 gross office rental income[1].

Australian direct retail assets account for 23% 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, major Australian banks or essential services.

The weighted average capitalisation rate on Life's Australian direct portfolio was 5.70% at 30 June 2023, up 37 bps for the year.

Property includes a net $359m exposure to Japanese property (12% of the portfolio), consisting of suburban shopping centres focused on non-discretionary retailing. Over half of the Japanese rental income is derived from supermarkets or pharmacies. The valuation of the Japanese portfolio was down 1.9% in FY23.

The property portfolio generates long-term cash flows to match long-term liabilities, with a weighted average lease expiry of 6.0 years and 53% of leasing area having contracted leases expiring in FY28 and beyond. The portfolio had an occupancy rate of 93% at 30 June 2023, which was up 1% on the prior year.

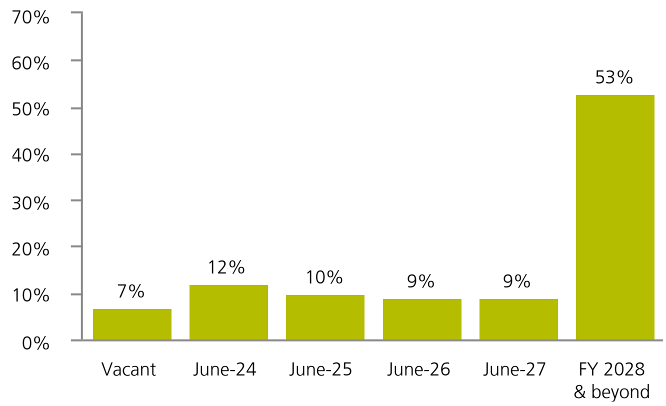
Approximately 72% of contracted leases have either annual fixed increases or inbuilt increases based on inflation or market outcomes (e.g. CPI).

Full details of Life's property portfolio are listed on pages 41 to 43.

Property portfolio summary

% of total portfolio	FY23	FY22
Australian office	54%	55%
Australian retail	23%	24%
Australian industrial	8%	8%
Other	3%	3%
Australian total	**88%**	**90%**
Japanese retail	12%	10%
Total	**100%**	**100%**

Portfolio lease expiry overview[2]



[1] Represents total gross passing Government income relative to direct office portfolio.
[2] Direct property portfolio and jointly held assets only.

Direct property portfolio overview[1]

30 June 2023		**Office**	**Retail**	**Industrial**	**Total**
Total rent (%)[2]		52%	41%	7%	100%
WALE[3] (years)		5.8	6.0	7.1	6.0
Tenant credit ratings					
	AAA	22%	—	—	22%
	AA	7%	1%	—	8%
	A	1%	3%	—	4%
	BBB	2%	8%	2%	12%
	BB	11%	13%	4%	28%
	B or below	2%	7%	—	10%
	Not rated	1%	8%	—	9%
	Vacant	6%	1%	—	7%
	Total	**52%**	**41%**	**7%**	**100%**
% of total gross net	Investment grade	32%	12%	2%	46%
	Non-investment grade	14%	28%	5%	47%
	Vacant	6%	1%	—	7%

1 Direct property portfolio and jointly held assets only.
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 2023	Acquisition date[1]	Total cost ($m)[2]	Carrying value ($m)	Cap rate FY23 (%)[3]	Last external valuation date
Australia					
Office					
6 Chan Street (formerly DIBP Building), ACT	01 Dec 01	128.6	265.0	4.88	30 Jun 23
14 Childers Street, ACT	01 Dec 17	101.3	81.5	6.50	30 Jun 23
35 Clarence Street, NSW	15 Jan 15	163.3	229.0	5.50	30 Jun 23
45 Benjamin Way (formerly ABS Building), ACT	01 Jan 00	152.9	247.0	5.25	30 Jun 23
82 Northbourne Avenue, ACT	01 Jun 17	62.9	45.5	6.13	30 Jun 23
215 Adelaide Street, QLD	31 Jul 15	266.6	209.5	6.88	30 Jun 23
565 Bourke Street, VIC	28 Jan 15	113.2	134.2	5.75	30 Jun 23
839 Collins Street, VIC	22 Dec 16	212.0	232.0	5.13	30 Jun 23
Discovery House, ACT	28 Apr 98	105.7	166.0	5.00	30 Jun 23
Executive Building, TAS	30 Mar 01	35.8	47.2	6.25	30 Jun 23
Retail					
Channel Court, TAS	21 Aug 15	89.1	86.5	7.00	30 Jun 23
Gateway, NT	01 Jul 15	123.6	108.7	6.61	30 Jun 23
Golden Grove, SA	31 Jul 14	162.3	153.0	6.25	30 Jun 23
Helicon Drive, SA	05 Oct 22	10.8	10.0	5.75	30 Jun 23
Karratha, WA	28 Jun 13	58.5	49.5	7.50	30 Jun 23
Kings Langley, NSW	29 Jul 01	16.6	28.0	5.50	30 Jun 23
Lennox, NSW	27 Jul 13	68.7	75.0	6.25	30 Jun 23
North Rocks, NSW	18 Sep 15	190.0	187.0	5.75	30 Jun 23
Industrial					
21 O'Sullivan Circuit, NT	27 Jan 16	47.9	28.9	7.25	30 Jun 23
31 O'Sullivan Circuit, NT	27 Jan 16	34.2	35.2	7.00	30 Jun 23
Cosgrave Industrial Park, Enfield, NSW	31 Dec 08	93.1	185.9	4.25	30 Jun 23
Total Australia		**2,237.1**	**2,604.6**	**5.70**	

1 Acquisition date represents the date of CLC's initial acquisition or consolidation of the investment vehicle holding the asset.
2 Total cost represents the original acquisition cost plus additions less partial disposals since acquisition date.
3 The capitalisation rate is the rate at which net market income is capitalised to determine the value of the property. The rate is determined with regard to market evidence.

Direct property investments

30 June 2023		Acquisition date[1]	Total cost ($m)[2]	Carrying value ($m)	Cap rate FY23 (%)[3]	Last external valuation date
Japan						
Retail						
	Aeon Kushiro	31 Jan 10	30.5	30.5	5.40	30 Jun 23
	Carino Chitosedai	31 Jan 10	119.2	110.1	4.40	30 Jun 23
	Carino Tokiwadai	31 Jan 10	77.9	68.1	4.50	30 Jun 23
	DeoDeo Kure	31 Jan 10	32.2	27.0	5.50	30 Jun 23
	Fitta Natalie Hatsukaichi	28 Aug 15	12.0	11.8	5.80	30 Jun 23
	Izumiya Hakubaicho	31 Jan 10	69.9	61.7	4.80	30 Jun 23
	Kansai Super Saigo	31 Jan 10	13.3	11.6	5.40	30 Jun 23
	Kojima Nishiarai	31 Jan 10	12.2	13.0	4.10	30 Jun 23
	Kotesashi Towers	28 Nov 19	25.2	18.7	5.00	30 Jun 23
	Life Asakusa	31 Jan 10	28.0	30.5	4.10	30 Jun 23
	Life Higashi Nakano	31 Jan 10	33.2	32.0	4.20	30 Jun 23
	Life Nagata	31 Jan 10	25.2	24.2	4.20	30 Jun 23
	MaxValu Tarumi	28 Aug 15	17.0	15.9	5.70	30 Jun 23
	Seiyu Miyagino	31 Jan 10	9.8	9.1	5.10	30 Jun 23
	TR Mall Ryugasaki	30 Mar 18	86.7	79.7	5.40	30 Jun 23
	Valor Takinomizu	31 Jan 10	28.0	21.0	5.70	30 Jun 23
	Valor Toda	31 Jan 10	42.5	36.3	5.20	30 Jun 23
	Yaoko Sakado Chiyoda	31 Jan 10	19.9	18.5	4.60	30 Jun 23
	Yorktown Toride	05 Mar 20	32.2	22.7	5.20	30 Jun 23
Industrial						
	Aeon Matsusaka XD	26 Sep 19	14.7	12.2	5.20	30 Jun 23
Total Japan			**729.6**	**654.6**	**4.89**	
Europe						
Retail						
	Aulnay sous Bois, Avenue de Savigny, France	31 Dec 08	20.3	10.0	7.75	30 Jun 23
Total Europe			**20.3**	**10.0**	**7.75**	
Total Overseas			**749.9**	**664.6**	**4.93**	
Total direct portfolio investments			**2,987.0**	**3,269.2**	**5.54**	

1 Acquisition date represents the date of CLC's initial acquisition or consolidation of the investment vehicle holding the asset.
2 Total cost represents the original acquisition cost plus additions less 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 $0.3b at 30 June 2023 and decreased by 70% ($0.7b) from 30 June 2022.

The decrease in equities and infrastructure in FY23 predominantly reflects the sale of $0.7b in low-beta equity investments, which has been redeployed largely into alternatives.

Equity and infrastructure represented 1% of Life's total investment assets at 30 June 2023, down from 4% at 30 June 2022.

Challenger's equity investments comprise beta and low-beta investments. For beta investments, total returns are expected to be broadly correlated to the MSCI Daily Total Return Net World Index (Bloomberg NDDLWI). For low-beta investments, total returns are expected to have lower volatility than beta investments, with a beta over the long term of approximately 0.5 times the MSCI Daily Total Return Net World Index (Bloomberg NDDLWI) .

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 57% of infrastructure investments with the remainder diversified across geographic regions and sectors.

Equity and infrastructure portfolio

30 Jun 2023	Domestic	Offshore	Total
Equity beta	52	86	**138**
Low beta	33	—	**33**
Infrastructure	68	52	**120**
Total equity & infrastructure	**153**	**138**	**291**

30 Jun 2022	Domestic	Offshore	Total
Equity beta	50	52	**102**
Low beta	126	615	**741**
Infrastructure	78	50	**128**
Total equity & infrastructure	**254**	**717**	**971**

Alternatives portfolio overview

The alternatives portfolio includes absolute return funds and insurance-related investments. These investments provide liquid capital and financial flexibility as they are expected to have a low correlation to credit and listed equity markets.

The absolute return portfolio includes systematic global macro funds and market-neutral long/short funds. 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 (Bloomberg NEIXCTA).

For general insurance-related investments, the total return is expected to be broadly correlated to the Swiss Re Cat Bond Index (Bloomberg SRCATTRR) over the long term.

Life's alternatives portfolio was $2.4b at 30 June 2023 and increased by 75% ($1.0b) from 30 June 2022. The increase was driven by an increase in absolute return funds and general insurance-related investments.

Alternatives portfolio

30 Jun 2023	Domestic	Offshore	Total
Absolute return funds	23	1,760	**1,783**
General Insurance	—	506	**506**
Life Insurance	—	96	**96**
Total alternatives	**23**	**2,362**	**2,385**

30 Jun 2022	Domestic	Offshore	Total
Absolute return funds	—	1,042	**1,042**
General insurance	—	212	**212**
Life insurance	—	112	**112**
Total alternatives	**—**	**1,366**	**1,366**

Challenger Life Company Limited (CLC) debt facilities

$m	FY23	1H23	FY22	1H22	FY21	1H21
Repurchase agreements	4,069.7	3,716.7	3,735.1	3,542.5	4,111.1	4,966.3
Controlled property debt	281.9	347.8	334.0	382.2	394.5	420.4
Subordinated debt	403.0	399.3	398.4	400.0	404.5	401.7
Challenger Capital Notes	735.0	845.0	845.0	872.7	872.7	892.5
Infrastructure debt	164.4	168.4	172.3	175.7	179.3	182.6
Other finance	0.7	0.7	0.7	0.7	0.7	0.7
Total CLC debt facilities	**5,654.7**	**5,477.9**	**5,485.5**	**5,373.8**	**5,962.8**	**6,864.2**

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 property and infrastructure investments.

Life debt facilities at 30 June 2023 were $5.7b and increased by $0.2b on 30 June 2022 due to an increase in repurchase agreements used to hedge interest rate movements (up $0.3b), partially offset by $0.1b decrease in debt following the issuance of Challenger Capital Notes 4 and repurchase of Challenger Capital Notes 2 (refer to pages below for more information).

Repurchase agreements

Repurchase agreements at 30 June 2023 were $4.1b, up from $3.7b at 30 June 2022.

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, other Life liabilities, and subordinated debt.

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, CLC issued $400m of Tier 2 subordinated notes. The subordinated notes fully qualified as Tier 2 regulatory capital under APRA's prudential standards and were floating rate notes, paying interest at a margin of 2.10% above the 3-month Bank Bill Swap rate.

Under the Terms and Conditions of the notes, CLC had the option to redeem all (but not some only) of the subordinated notes on 24 November 2022 (the Optional Redemption Date), subject to APRA's prior written approval. If the subordinated notes were not redeemed on the Optional Redemption Date, noteholders had the option to require conversion of the subordinated notes into ordinary shares in Challenger Limited in November 2024.

On 7 November 2022, Challenger announced that the redemption of the subordinated notes was approved by APRA and CLC had elected to redeem all the subordinated notes on the Optional Redemption Date. CLC's redemption of the subordinated notes does not imply or indicate that CLC or Challenger Limited will in the future exercise any right it may have to redeem any other outstanding regulatory capital instruments issued by CLC or Challenger Limited. Any such redemption would also be subject to the prior written approval of APRA (which may or may not be given).

In September 2022, CLC issued $400m of fixed-to-floating rate, unlisted, unsecured subordinated notes, paying a semi-annual fixed rate of 7.186% per annum for the first 5 years, before reverting to paying floating rate interest at a margin of 3.55% per annum above the 3-month Bank Bill Swap rate. The subordinated notes fully qualify as Tier 2 regulatory capital under APRA's prudential standards and have a term of 15 years, with a maturity date in September 2037. The subordinated notes include an option for CLC to redeem the subordinated notes in September 2027 subject to APRA's prior written approval (which may or may not be given).

Capital Notes

Over the past nine years, Challenger has issued four separate tranches of subordinated, unsecured convertible notes (Challenger Capital Notes, Challenger Capital Notes 2, Challenger Capital Notes 3 and Challenger Capital Notes 4), with proceeds used to fund qualifying CLC Additional Tier 1 regulatory capital. Challenger Capital Notes and Challenger Capital Notes 2 no longer remain outstanding and have been fully redeemed and/or converted to Challenger ordinary shares.

For Challenger Capital Notes 3 and Challenger Capital Notes 4, Challenger may choose to redeem or resell (rather than convert) all or some of the capital notes for their face value at a future date, subject to APRA's prior written approval.

Challenger Capital Notes (ASX code: CGFPA)

In October 2014, Challenger issued Challenger Capital Notes to the value of $345m. Challenger Capital Notes paid a margin of 3.40% above the 3-month Bank Bill Swap rate, with the total distribution reduced by available franking credits.

In October 2020, Challenger announced a new offer of capital notes, being Challenger Capital Notes 3, with the proceeds intended to be used to help refinance Challenger Capital Notes.

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 refinance Challenger Capital Notes.

It was Challenger's intention to fully redeem all Challenger Capital Notes with the proceeds of Challenger Capital Notes 3; however, noteholders were not required to participate in the reinvestment offer or repurchase invitation. As a result, at 25 May 2021, approximately $28m of Challenger Capital Notes remained on issue.

In May 2022, Challenger mandatorily converted the remaining balance of Challenger Capital Notes into Challenger ordinary shares in accordance with the Challenger Capital Notes Terms and issued approximately 3.8m fully paid ordinary shares.

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 3-month Bank Bill Swap rate, with the total distribution reduced by available franking credits.

In March 2023, Challenger announced a new offer of capital notes, being Challenger Capital Notes 4, with the proceeds intended to be used to refinance Challenger Capital Notes 2.

On 5 April 2023, Challenger announced the successful completion of the Challenger Capital Notes 4 offer, which raised $350m, including approximately $224m of reinvestment demand from Challenger Capital Notes 2 holders.

On 22 May 2023, the outstanding face value of approximately $236m of Challenger Capital Notes 2 were fully redeemed.

Challenger Capital Notes 2 are no longer trading and were removed from official quotation on the ASX at the close of trade on 22 May 2023.

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 3-month Bank Bill Swap rate, with the total distribution reduced by available franking credits.

Challenger Capital Notes 3 are convertible to Challenger ordinary shares at any time before 25 May 2028 on the occurrence of certain events, and mandatorily convert to Challenger 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, including prior written approval from APRA).

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 Capital Notes 4 (ASX code: CGFPD)

On 5 April 2023, Challenger issued Challenger Capital Notes 4 to the value of $350m. Challenger Capital Notes 4 pay a margin of 3.60% above the 3-month Bank Bill Swap rate, with the total distribution reduced by available franking credits.

Challenger Capital Notes 4 are convertible to Challenger ordinary shares at any time before 25 February 2032 on the occurrence of certain events, and mandatorily convert to Challenger ordinary shares thereafter, in both cases subject to meeting certain conditions.

Challenger may choose to redeem or resell (rather than convert) Challenger Capital Notes 4 on the occurrence of some of the events referred to above, including on any Optional Exchange Date on or about 25 May 2029, 25 August 2029, 25 November 2029 and 25 February 2030 (subject to certain conditions being met, including prior written approval from APRA).

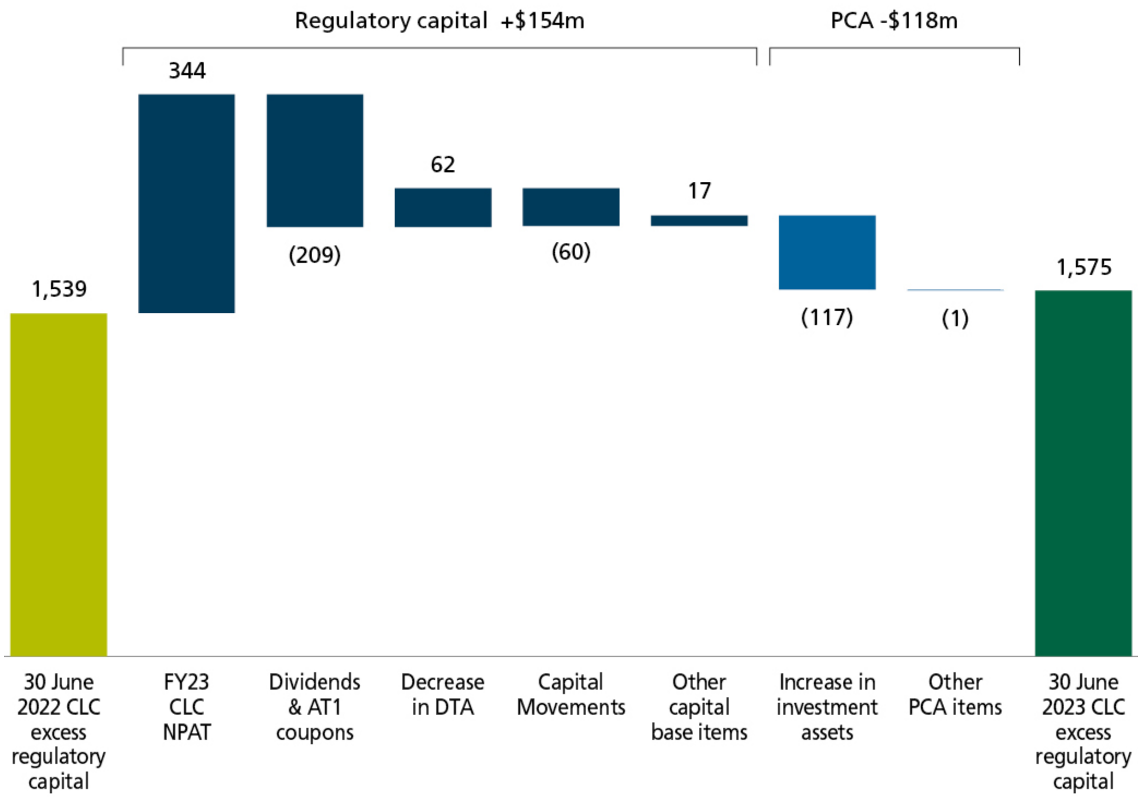
If Challenger exercises its option to redeem or resell, there will be no conversion of Challenger Capital Notes 4 to Challenger ordinary shares and no subsequent shareholder dilution.

Challenger Life Company Limited (CLC) regulatory capital

$m	FY23	1H23	FY22	1H22	FY21	1H21
CLC regulatory capital						
Common Equity Tier 1 (CET1) regulatory capital	3,110.5	2,947.9	2,858.0	3,120.3	2,971.2	2,622.9
Additional Tier 1 regulatory capital	735.0	845.0	845.0	872.7	872.7	892.5
Tier 2 regulatory capital – subordinated debt[1]	411.3	407.8	399.7	402.4	405.4	402.7
CLC total regulatory capital base	**4,256.8**	**4,200.7**	**4,102.7**	**4,395.4**	**4,249.3**	**3,918.1**
CLC Prescribed Capital Amount (PCA)						
Asset risk charge	2,582.0	2,541.7	2,467.5	2,470.6	2,481.8	2,290.2
Insurance risk charge	125.0	127.6	151.5	233.5	227.0	213.8
Operational risk charge	70.7	65.4	58.6	60.7	57.9	54.4
Aggregation benefit	(95.8)	(97.6)	(114.3)	(171.0)	(167.4)	(156.7)
CLC PCA	**2,681.9**	**2,637.1**	**2,563.3**	**2,593.8**	**2,599.3**	**2,401.7**
CLC excess over PCA	**1,574.9**	**1,563.6**	**1,539.4**	**1,801.6**	**1,650.0**	**1,516.4**
PCA ratio (times)	1.59	1.59	1.60	1.69	1.63	1.63
Tier 1 ratio (times)	1.43	1.44	1.44	1.54	1.48	1.46
CET1 capital ratio (times)	1.16	1.12	1.11	1.20	1.14	1.09
Capital intensity ratio (%)[2]	11.4%	11.4%	11.5%	11.3%	12.1%	12.2%

1 FY23 Tier 2 regulatory capital – subordinated debt ($411.3m) differs to the Group balance sheet ($403.0m) due to accrued interest and amortised costs.
2 Capital intensity ratio is calculated as CLC PCA divided by Life closing investment assets.

Movement in CLC excess regulatory capital ($m)



Challenger Life Company Limited (CLC) regulatory capital

Capital management

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

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

CLC's regulatory capital base and PCA (equivalent to its regulatory capital requirement) have been calculated based on the prudential standards issued by APRA.

CLC's regulatory capital base

CLC's regulatory capital base at 30 June 2023 was $4.3b and increased by $0.2b in FY23. The increase primarily reflects:

- CLC's statutory profit after tax for the year (+$344m) and a decrease in deferred tax assets (+$62m) primarily driven by increased unrealised gains on the fixed income portfolio, partially offset by the revaluation of the property portfolio; partially reduced by
- dividend and coupon payments on Additional Tier 1 instruments (-$209m); and
- decrease in capital base (-$60m) following the $460m redemption of Challenger Capital Notes 2 and subsequent issuance of $350m Challenger Capital Notes 4, partially offset by the return of $50m excess capital from Challenger Bank to CLC.

CLC's Prescribed Capital Amount (PCA)

CLC's PCA at 30 June 2023 was $2.7b and increased by $0.1b in FY23, primarily reflecting growth in investment assets (+$117m).

Reduction in capital intensity

CLC's capital intensity ratio, which is calculated as CLC PCA divided by Life's closing investment assets, decreased from 11.5% at 30 June 2022 to 11.4% at 30 June 2023.

The reduction in capital intensity from 11.5% to 11.4% primarily relates to a lower capital intensity on fixed income assets, partially offset by a higher allocation to alternatives, which carry a higher risk charge.

CLC's excess capital position

CLC's excess capital above PCA at 30 June 2023 was $1.6b and increased by $36m in FY23 as a result of the increase in CLC's regulatory capital base.

CLC's capital ratios at 30 June 2023 were as follows:

- PCA ratio 1.59 times – down 0.01 times from 1.60 times at 30 June 2022;
- Total Tier 1 capital ratio 1.43 times – down 0.01 times from 1.44 at 30 June 2022; and
- Common Equity Tier 1 (CET1) capital ratio 1.16 times – up 0.05 times from 1.11 times at 30 June 2022.

APRA's prudential standards require the capital base to be at least the PCA, Total Tier 1 capital to be at least 80% of the PCA and CET1 capital to be at least 60% of the PCA. Challenger's PCA ratio (1.59 times), Total Tier 1 capital ratio (1.43 times) and CET1 capital ratio (1.16 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, composition of capital base and economic circumstances. The target surplus produced by these internal capital models for FY23 corresponded to a PCA ratio of between 1.3 times and 1.7 times. This range may change over time.

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 target capital position.

The metric that generates the worst outcome relative to target forms CLC's constraining target. Given CLC's current mix of capital at 30 June 2023, CLC's constraining target was CET1. The target surplus produced by the internal capital models for FY23 corresponded to a CET1 ratio of between 0.8 times and 1.2 times. This ratio may change over time.

Additional Tier 1 regulatory capital and subordinated debt

Challenger Limited has on issue two separate subordinated, unsecured convertible notes (Challenger Capital Notes 3 and Challenger Capital Notes 4), with proceeds used to fund qualifying Additional Tier 1 regulatory capital for CLC.

In May 2022, Challenger converted the remaining balance of Challenger Capital Notes into Challenger ordinary shares in accordance with the mandatory conversion conditions under the Challenger Capital Notes Terms. In April 2023, Challenger successfully issued Challenger Capital Notes 4 offer, with the proceeds used to refinance Challenger Capital Notes 2. Refer to page 45 or more detail.

CLC has on issue one series of Tier 2 notes, issued in September 2022, with a face value of $400m, which fully qualify as Tier 2 regulatory capital under APRA's prudential standards. In November 2017, CLC issued $400m of Tier 2 subordinated notes. On 7 November 2022, Challenger announced that the redemption of the existing subordinated notes was approved by APRA and CLC elected to redeem all the subordinated notes on the Optional Redemption Date of 24 November 2022.

Further details on Challenger's convertible debt instruments are included on page 45.

Profit and equity sensitivities

$m	Change in variable	Profit/(loss) after tax FY23	Change in equity FY23	Profit/(loss) after tax FY22	Change in equity FY22
Credit risk					
Fixed income assets (change in credit spreads)[1]	+50 bps	(124.9)	(124.9)	(131.5)	(131.5)
	-50 bps	124.9	124.9	131.5	131.5
Policy liabilities (illiquidity premium change in credit spreads)	+50 bps	65.5	65.5	66.3	66.3
	-50 bps	(65.5)	(65.5)	(66.3)	(66.3)
Property risk					
Direct and indirect properties	+1%	21.4	21.4	22.6	22.6
	-1%	(21.4)	(21.4)	(22.6)	(22.6)
Equity and infrastructure risk					
Equity and infrastructure investments	+10%	20.4	20.4	68.0	68.0
	-10%	(20.4)	(20.4)	(68.0)	(68.0)
Alternatives risk					
Alternatives investments	+10%	166.9	166.9	95.6	95.6
	-10%	(166.9)	(166.9)	(95.6)	(95.6)
Life Insurance risk					
Mortality, morbidity and longevity[2]					
Life insurance contract liabilities	+50%	(25.4)	(25.4)	(20.3)	(20.3)
	-50%	25.4	25.4	20.3	20.3
Interest rate risk					
Change in interest rates	+100 bps	0.6	0.6	(2.8)	(2.8)
	-100 bps	(0.6)	(0.6)	2.8	2.8
Foreign exchange risk					
British pound	+10%	0.3	0.3	—	—
	-10%	(0.3)	(0.3)	—	—
US dollar	+10%	1.0	1.0	(0.8)	(0.8)
	-10%	(1.0)	(1.0)	0.8	0.8
Euro	+10%	—	—	(0.7)	(0.7)
	-10%	—	—	0.7	0.7
Japanese yen	+10%	0.3	0.7	0.3	0.4
	-10%	(0.3)	(0.7)	(0.3)	(0.4)
Other	+10%	0.3	0.3	—	—
	-10%	(0.3)	(0.3)	—	—

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 2023. If using these sensitivities as forward looking, allowances for changes post-30 June 2023, such as sales, asset growth changes in asset allocation and changes in market conditions, 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 62 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.

Challenger has a robust risk management framework which supports its operating segments, and its risk appetite distinguishes risks from which Challenger will seek to make an economic return from those which it seeks to minimise and which it does not consider will provide a return. The management of these risks is fundamental to Challenger's business, customers and to building long-term shareholder value. Challenger is also prudentially supervised by APRA, which prescribes certain prudential standards that must be met by Challenger, its life insurance subsidiary Challenger Life Company Limited (CLC), its banking subsidiary, Challenger Bank Limited (CBL) and its registrable superannuation entity licensee, Challenger Retirement and Investment Services Limited (CRISL).

CLC and CBL are both required under APRA prudential standards to maintain capital buffers in order to ensure that under a range of adverse scenarios they can continue to meet not only their contractual obligations to customers but also their regulatory capital requirements.

Challenger is exposed to a variety of financial risks, including market risk (including foreign exchange risk, interest rate risk, inflation risk, equity risk, and credit spread 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 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 infrastructure risk, other active trading strategy risk and life insurance risk.

Accept exposure[3]	Minimise exposure
• Credit risk • Property risk • Equity and infrastructure risk • Life insurance risk • Other active trading strategy risk	• Asset and liability mismatch risk • Foreign exchange risk • Interest rate risk • Inflation risk • 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 minimising 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.

[3] Subject to appropriate returns.

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 2023, a 50 bps increase/decrease in credit spreads would have resulted in an unrealised loss/gain of $125m (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 2023, a 50 bps increase/decrease in credit spreads would have resulted in an unrealised gain/loss of $66m (after-tax) on the 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 49 show the impact of a change in property valuations at 30 June 2023 and are based on Life's gross property investments of $3.4b (net investments of $3.1b plus debt of $0.3b).

A 1% move in the direct and indirect property portfolio at 30 June 2023 would result in a $21m (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 49 show a 10% move in the equity portfolio at 30 June 2023 would have resulted in a $20m (after-tax) movement in the valuation of 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, with both expected to have a low correlation to listed equity market returns.

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

Alternatives sensitivity

The alternatives risk sensitivity on page 49 shows a 10% market move in the alternatives portfolio at 30 June 2023 would have an impact of $167m (after-tax) in the valuation of alternatives investments.

Liquidity risk

Liquidity risk is the risk that 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 fair 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. Cash flows are well matched and the liquidity profile continues 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 and the market 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 0.4% 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 49 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 leading to a $25m (after-tax) impact.

Interest rate sensitivity

Interest rate risk is the risk of fluctuations in Challenger's earnings arising from movements in market interest rates, including changes in the absolute levels of interest rates, the shape of the yield curve, the margin between the different yield curves and the volatility of interest rates.

The impact of movements in interest rates on Challenger's profit and loss and balance sheet is set out on page 49.

The sensitivities assume the change in variable occurs on 30 June 2023 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 2023.

Foreign exchange risk

Foreign exchange risk is the risk of a change in asset values as a result of movements in foreign exchange rates.

It is Challenger's policy to seek to minimise the impact of movements in foreign exchange rates on balance sheet items contributing to CLC's regulatory capital base, with the exception of exposures arising from currency overlay positions.

Currency exposure arises primarily in relation to Life's investments in Europe (including the United Kingdom), Japan and the United States, and USD liabilities reinsured from MS Primary in Japan. 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 manage foreign currency exchange rate risk, Challenger enters into foreign currency derivatives.

Foreign exchange sensitivity

The impact of movements in foreign currencies on Challenger's profit and loss and balance sheet is set out on page 49. 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	FY23	FY22	FY21	2H23	1H23	2H22	1H22	2H21	1H21
Fidante									
Fidante income[1]	111.0	121.4	97.4	57.0	54.0	58.3	63.1	52.3	45.1
Performance fees	4.7	4.0	10.1	1.6	3.1	1.6	2.4	5.5	4.6
Net income	**115.7**	**125.4**	**107.5**	**58.6**	**57.1**	**59.9**	**65.5**	**57.8**	**49.7**
Challenger Investment Management									
Challenger Investment Management income[2]	63.1	66.4	61.8	32.3	30.8	33.7	32.7	30.2	31.6
Total net fee income	**178.8**	**191.8**	**169.3**	**90.9**	**87.9**	**93.6**	**98.2**	**88.0**	**81.3**
Personnel expenses	(63.0)	(70.3)	(63.2)	(27.0)	(36.0)	(35.4)	(34.9)	(34.0)	(29.2)
Other expenses	(54.2)	(38.7)	(35.1)	(33.0)	(21.2)	(20.5)	(18.2)	(18.3)	(16.8)
Total expenses	**(117.2)**	**(109.0)**	**(98.3)**	**(60.0)**	**(57.2)**	**(55.9)**	**(53.1)**	**(52.3)**	**(46.0)**
EBIT	**61.6**	**82.8**	**71.0**	**30.9**	**30.7**	**37.7**	**45.1**	**35.7**	**35.3**
Performance analysis									
Fidante – income margin (bps)[3]	15.6	15.0	14.8	15.6	15.7	15.0	14.9	14.8	14.9
Challenger Investment Management – income margin (bps)[3]	30.2	32.0	30.6	31.1	29.2	33.0	31.1	29.8	31.7
Funds Management – income margin (bps)[3]	18.8	18.4	18.3	19.0	18.7	18.7	18.0	17.9	18.8
Funds Management – FUM-based income margin (bps)[4]	17.7	17.1	16.3	17.8	17.6	17.3	16.7	16.2	16.6
Cost to income ratio	65.5%	56.8%	58.1%	66.0%	65.1%	59.7%	54.1%	59.4%	56.6%
Net assets – average[5]	284.3	265.7	256.0	279.7	289.0	267.6	264.3	260.3	251.4
ROE (pre-tax)	21.7%	31.2%	27.7%	22.3%	21.1%	28.4%	33.8%	27.7%	27.8%
Fidante	78,075	72,438	84,943	78,075	72,390	72,438	88,512	84,943	71,826
Challenger Investment Management	20,392	21,010	20,881	20,392	20,985	21,010	20,778	20,881	19,416
Closing FUM – total	**98,467**	**93,448**	**105,824**	**98,467**	**93,375**	**93,448**	**109,290**	**105,824**	**91,242**
Fidante	74,025	83,544	72,488	75,606	72,211	80,426	87,371	78,754	66,127
Challenger Investment Management	20,927	20,726	20,176	20,926	20,936	20,591	20,869	20,481	19,763
Average FUM – total[5]	**94,952**	**104,270**	**92,664**	**96,532**	**93,147**	**101,017**	**108,240**	**99,235**	**85,890**
FUM and net flows analysis									
Fidante[6]	379.6	(8,895.2)	14,346.5	2,045.9	(1,666.3)	(9,984.0)	1,088.8	8,582.2	5,764.3
Challenger Investment Management	(851.9)	370.4	1,765.0	(692.0)	(159.9)	554.8	(184.4)	1,105.9	659.1
Net flows	(472.3)	(8,524.8)	16,111.5	1,353.9	(1,826.2)	(9,429.2)	904.4	9,688.1	6,423.4
Distributions	(1,773.4)	(1,141.2)	(1,332.2)	(412.1)	(1,361.3)	(404.3)	(736.9)	(474.8)	(857.4)
Market-linked movement	7,264.7	(2,710.0)	9,609.9	4,150.2	3,114.5	(6,009.0)	3,299.0	5,368.9	4,241.0
Total FUM movement	**5,019.0**	**(12,376.0)**	**24,389.2**	**5,092.0**	**(73.0)**	**(15,842.5)**	**3,466.5**	**14,582.2**	**9,807.0**

[1] Fidante income includes equity-accounted profits, distribution fees, administration fees, and Fidante Europe transaction fees.
[2] Challenger Investment Management 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.
[6] 2H22 included the $5,162m FUM derecognition following the sale of Whitehelm Capital.

Funds Management financial results

Funds Under Management and net flows

$m	Q4 23	Q3 23	Q2 23	Q1 23	Q4 22
Funds Under Management					
Fidante					
Equities	44,020	40,632	37,991	36,101	35,661
Fixed income	32,337	32,339	32,040	31,205	34,274
Alternatives	1,718	1,600	2,359	2,665	2,503
Total Fidante	78,075	74,571	72,390	69,971	72,438
Challenger Investment Management					
Fixed income	16,356	16,884	16,710	16,796	16,658
Property	4,036	4,289	4,275	4,274	4,352
Total Challenger Investment Management	20,392	21,173	20,985	21,070	21,010
Total Funds Under Management	**98,467**	**95,744**	**93,375**	**91,041**	**93,448**
Average Fidante	77,145	73,808	71,760	72,102	76,807
Average Challenger Investment Management	20,899	21,014	21,015	20,891	20,587
Total average Funds Under Management[1]	**98,044**	**94,822**	**92,775**	**92,993**	**97,394**
Analysis of flows					
Equities	2,368	617	(491)	415	(1,200)
Fixed income	474	(713)	807	(2,296)	(2,088)
Alternatives	86	(786)	(276)	175	213
Total Fidante	**2,928**	**(882)**	**40**	**(1,706)**	**(3,075)**
Challenger Investment Management	(645)	(47)	(216)	56	552
Net flows	**2,283**	**(929)**	**(176)**	**(1,650)**	**(2,523)**

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

Reconciliation of total Group assets and Funds Under Management

$m	Q4 23	Q3 23	Q2 23	Q1 23	Q4 22
Funds Management Funds Under Management	98,467	95,744	93,375	91,041	93,448
Life investment assets	23,538	23,349	23,085	22,817	22,224
Bank lending and financing assets	225	322	407	415	391
Adjustments to remove double counting of cross-holdings	(17,278)	(17,555)	(17,474)	(17,821)	(17,493)
Total Assets Under Management	**104,952**	**101,860**	**99,393**	**96,452**	**98,570**

Funds Management financial results

Funds Management focuses on wealth accumulation, predominantly in the pre-retirement phase of superannuation, through supporting customers build savings by providing contemporary investment strategies and products that seek to deliver superior investment returns.

Funds Management is one of Australia's largest active fund managers[1] with funds under management (FUM) of $98 billion, which has more than doubled over the last 10 years (up from $41 billion in 2013).

Growth in FUM is supported by Challenger's award-winning retail and institutional distribution teams and business model, which is focused on high-quality managers with strong long-term investment performance and alignment with clients.

Funds Management comprises Fidante and Challenger Investment Management (CIM), with operations in Australia, the United Kingdom, Europe and Asia.

Funds Management, through its Fidante affiliates and CIM, invests across a broad range of asset classes, including fixed income, Australian and global equities and alternative investments.

Funds Management has extensive client relationships. For example, over 70% of Australia's top 50 superannuation funds are clients.

Fidante's business model involves taking minority equity interests in separately branded affiliate funds management firms, with Challenger providing distribution services and business support, and Artega Investment Administration (Artega) providing investment administration services, leaving investment managers to focus entirely on managing investment portfolios.

Fidante has been successful in attracting and building active equity, active fixed income and alternative investment managers, while also maintaining strong investment performance. Over the last five years, long-term performance of Fidante's Australian affiliates was strong with 99% of investments outperforming their respective benchmarks.

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

CIM principally originates and manages fixed income and commercial real estate for leading global and Australian institutions, including Challenger Life. Challenger Life accounts for approximately 80% of CIM's FUM.

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

EBIT and ROE

Funds Management EBIT was $62m and decreased by $21m (26%) on FY22. The decrease was due to lower FUM-based fee income (down $10m or 6%), with average FUM down $9b (9%), lower transaction fees (down $4m) and higher expenses (up $8m or 8%), partially offset by higher performance fees (up $1m).

Funds Management ROE was 21.7% and decreased from 31.2% in FY22. ROE was materially impacted by the 26% decrease in EBIT and a 7% increase in average net assets.

Total net fee income

FY23 total net income was $179m (down 7%) and comprised FUM-based fees of $168m (down 6%), transaction fees of $6m (down 37%) and performance fees of $5m (up 18%).

FY23 FUM-based fees decreased 6% as a result of lower average FUM (down $9b or 9%). However FUM-based income margin increased to 17.7 bps (FY22 17.1 bps) due to changes in business mix following the sale of Whitehelm Capital in 2H22 and low-margin fixed income mandate redemptions.

FY23 performance and transaction fees were $3m lower than FY22.

Expenses

FY23 Funds Management expenses were $117m and increased by $8m (8%) on FY22.

Personnel costs decreased by $7m (10%). This largely reflects the transfer of Funds Management operations staff to newly formed joint venture Artega in 2H23 and the transfer of Challenger Solutions Group staff to Life in 1H23. Refer to page 8 for more information on Artega.

Other expenses increased by $16m (40%) primarily due to increased Artega expenses ($10m), higher project spend ($5m) and increased technology costs ($1m). Artega expenses, which include personnel costs, are charged to Challenger through a rate card and are reflected as direct expenses. Artega costs were higher for Funds Management as a result of higher FTE driven by increased affiliate trading and transaction volumes, and increased software and datafeed costs primarily due to FX and inflation impacts.

The net impact of the increase in Artega costs in Funds Management was ~$5m.

The FY23 cost to income ratio was 65.5% and increased from 56.8% in FY22 due to lower net fee income (down 7%) and higher expenses (up 8%).

Fidante net income

Fidante's net fee income includes FUM-based distribution and administration fees, transaction fees, performance fees and a share in the equity-accounted profits of affiliate investment managers.

Fidante net income was $116m in FY23 and decreased by $10m (8%) on FY22.

Fidante net income comprised:

- FUM-based income of $110m, down $10m (8%) on FY22 as a result of a 11% decrease in average FUM, partially offset by an expansion in FUM-based income margin (refer to below for more information); and
- Performance fees of $5m, which increased by $1m (18%) on FY22.
- Transaction fees of $1m, which decreased by $1m (45%) on FY22.

Fidante income margin (net income to average FUM) was 15.6 bps, up 0.6 bps from FY22. FUM-based income accounted for 14.9 bps and increased by 0.5 bps, supported by changes in business mix following the sale of Whitehelm Capital in 2H22 and redemptions of low-margin fixed income mandates.

[1] Calculated from Rainmaker Roundup, March 2023 data.

Fidante FUM and net flows

Fidante's FUM at 30 June 2023 was $78.1b and increased by $5.6b (8%) for the full year.

The increase was a result of:

- net inflows of $0.4b reflecting $1.8b of institutional inflows predominantly across equity affiliate managers and $1.4b of retail outflows predominantly across fixed income managers;
- positive impact from investment markets of $7.0b, in particular positive equity markets; offset by
- net distributions of $1.8b.

Fidante's FUM at 30 June 2023 was invested in the following asset classes:

- 56% in equities (FY22 49%);
- 41% in fixed income (FY22 47%); and
- 3% in alternatives (FY22 4%).

Challenger Investment Management (CIM)

CIM's FY23 net income was $63m and decreased by $3m (5%) on FY22.

CIM's net income included:

- FUM-based income of $57m, stable on FY22, with lower real estate fees following the sale of one domestic property in 1H23 and County Court in FY22, offset by a 1% increase in average FUM; and
- transaction fees of $6m, down $3m (35%) on FY22 following the transfer of the Solutions Group from CIM to the Life business. Refer to page 28 for further details.

CIM's FY23 income margin (net income to average FUM) was 30.2 bps, down 1.8 bps from FY22 primarily due to lower transaction fees.

The FUM-based contribution was 27.4 bps, down 0.4 bps broadly reflecting the sale of one domestic property in 1H23 and County Court in FY22.

CIM FUM and net flows

CIM's FUM at 30 June 2023 was $20.4b and decreased by $0.6b (3%) for the full year.

The movements in the year include:

- net outflows of $0.9b predominantly due to fixed income mandate redemptions, the sale of one domestic property and transfer of the Solutions Group from CIM to the Life business; offset by
- positive market movement of $0.3b.

CIM's 30 June 2023 FUM is invested in the following asset classes:

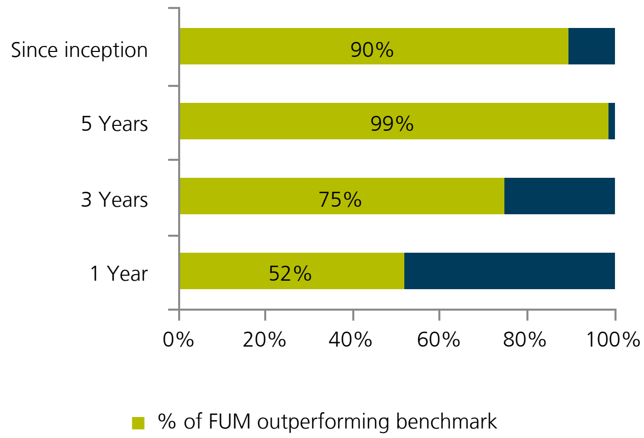
- 80% in fixed income (FY22 79%); and
- 20% in property (FY22 21%).

Approximately 20% of CIM's FUM is from third-party clients with the balance managed on behalf of Challenger Life.

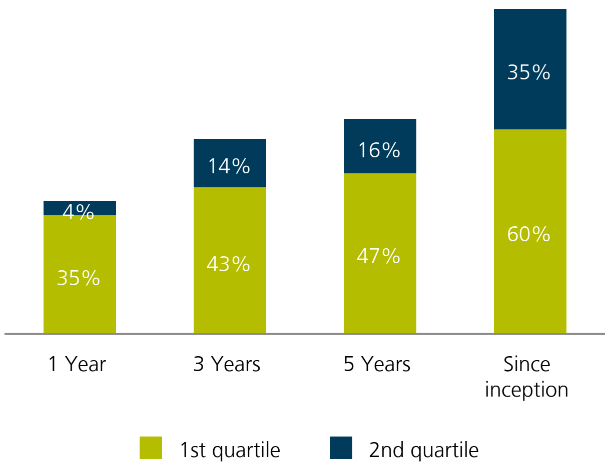
Funds Management investment performance

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

Long-term performance for Fidante's affiliates remains strong with 99% and 90% of investments outperforming benchmark over five years and since inception respectively[1].



For Fidante affiliates, 63% of funds achieved first or second quartile performance over five years and 95% of funds achieved either first or second quartile investment performance since inception[2].



[1] As at 30 June 2023. Percentage of Fidante affiliates meeting or exceeding the performance benchmark, with gross performance weighted by FUM.
[2] Mercer as at June 2023.

Bank financial results

$m	FY23	FY22	FY21	2H23	1H23	2H22	1H22	2H21	1H21
Interest income	14.2	3.4	—	6.8	7.4	2.1	1.3	—	—
Interest expense	(5.4)	(1.1)	—	(2.7)	(2.7)	(0.7)	(0.4)	—	—
Net interest income	**8.8**	**2.3**	**—**	**4.1**	**4.7**	**1.4**	**0.9**	**—**	**—**
Personnel expenses	(11.2)	(9.7)	—	(5.2)	(6.0)	(7.1)	(2.6)	—	—
Other expenses	(6.4)	(3.7)	—	(3.4)	(3.0)	(2.1)	(1.6)	—	—
Total expenses	**(17.6)**	**(13.4)**	**—**	**(8.6)**	**(9.0)**	**(9.2)**	**(4.2)**	**—**	**—**
Normalised EBIT	**(8.8)**	**(11.1)**	**—**	**(4.5)**	**(4.3)**	**(7.8)**	**(3.3)**	**—**	**—**
Bank impairments[1]	(1.4)	(0.9)	—	1.6	(3.0)	(0.9)	—	—	—
Net profit after impairments before tax	**(10.2)**	**(12.0)**	**—**	**(2.9)**	**(7.3)**	**(8.7)**	**(3.3)**	**—**	**—**
Performance analysis									
Net interest margin (%)	2.55%	0.93%	—	2.74%	2.37%	0.91%	0.99%	—	—
Cost to income ratio (%)	184.5%	574.0%	—	186.0%	182.6%	648.5%	464.7%	—	—
Net assets – average[2] ($m)	104.5	95.8	—	92.3	118.1	109.8	76.2	—	—

[1] Represents provision for expected credit losses and fair value movements for assets classified as held for trading.
[2] Calculated on a monthly basis.

Bank overview

In October 2022, Challenger announced it had entered into a share sale agreement with Heartland Group Holdings Limited (Heartland) to sell the Bank for cash consideration of approximately $36 million[3].

The sale is expected to generate a pre-tax gain on sale of approximately $11 million, which will be reported as a significant item once completed[4]. The sale is subject to regulatory approvals in Australia and New Zealand and is expected to complete in 1H24.

In April 2023, Challenger received approval from APRA to release $50 million of excess Bank capital, which was injected into Challenger Life. The remaining excess capital of approximately $40 million is expected, subject to regulatory approvals in Australia and New Zealand, to be returned to Challenger on or prior to completion of the sale providing additional financial flexibility to support growth in the Life business.

[3] Price subject to completion adjustments and based on a target net asset value of approximately $25 million.
[4] Any difference between purchase price and target net assets of ~$25 million will be reduced by transaction costs and other costs associated with the sale.

Bank financial results

$m	FY23	FY22	FY21	2H23	1H23	2H22	1H22	2H21	1H21
Sales ($m)									
Bank deposit sales[1]	208.5	219.3	—	78.9	129.6	146.7	72.6	—	—
Maturities and withdrawals	(264.5)	(125.7)	—	(131.2)	(133.3)	(71.5)	(54.2)	—	—
Bank net flows	**(56.0)**	**93.6**	**—**	**(52.3)**	**(3.7)**	**75.2**	**18.4**	**—**	**—**
Closing Bank deposits[1]	171.7	227.7	—	171.7	224.1	227.7	152.6	—	—
Bank book growth[2]	**(24.6%)**	69.7%	**—**	**(23.0%)**	(1.6%)	56.0%	13.7%	**—**	**—**
Lending and financing assets ($m)									
Closing lending and financing assets ($m)	**225**	**391**	**—**	**225**	**407**	**391**	**230**	**—**	**—**
Fixed income, cash and cash equivalents	133	285	—	133	272	285	133	—	—
SME Lending	21	—	—	21	13	—	—	—	—
Retail Lending	71	89	—	71	78	89	97	—	—
Corporate Lending	—	17	—	—	44	17	—	—	—
Average lending and financing assets ($m)[3]	**361**	**275**	**—**	**313**	**416**	**317**	**218**	**—**	**—**
Deposit liabilities ($m)									
Closing Bank deposits[1]	172	228	—	172	224	228	153	—	—
Average deposits[3]	**222**	**166**	**—**	**201**	**244**	**185**	**141**	**—**	**—**

1 Deposits include At Call accounts and Term Deposits.
2 Bank book growth percentage represents net flows over the period divided by opening book value for the financial year.
3 Calculated on a monthly basis.

Bank quarterly sales and lending and financing assets

$m	Q4 23	Q3 23	Q2 23	Q1 23	Q4 22
Deposit sales					
Bank deposit sales[1]	35	44	24	106	87
Maturities and repayments	(68)	(64)	(65)	(68)	(42)
Bank net flows	**(33)**	**(20)**	**(41)**	**38**	**45**
Closing Bank deposits	172	204	224	266	228
Bank net book growth (%)[2]	**(14.2%)**	**(8.8%)**	**(18.2%)**	**16.6%**	**33.6%**
Bank lending and financing assets					
Fixed income, cash and cash equivalents	133	225	272	277	285
SME Lending	21	24	13	6	—
Retail Lending	71	73	78	85	89
Corporate Lending	—	—	44	47	17
Total Bank lending and financing assets	**225**	**322**	**407**	**415**	**391**
Average Bank lending and financing assets[3]	**269**	**358**	**410**	**421**	**361**

1. Deposits includes At Call accounts and Term Deposits.
2. Bank book growth percentage represents Bank net flows over the period divided by opening book value for the financial year.
3 Calculated on a monthly basis.

Bank balance sheet

$m	FY23	FY22	FY21	2H23	1H23	2H22	1H22	2H21	1H21
Assets									
Cash and cash equivalents	58.1	40.8	—	58.1	35.9	40.8	55.9	—	—
Fixed income securities	75.2	244.4	—	75.2	236.0	244.4	76.9	—	—
SME Lending	21.4	0.2	—	21.4	12.8	0.2	—	—	—
Retail Lending	70.7	88.6	—	70.7	77.5	88.6	97.3	—	—
Corporate Lending	—	16.5	—	—	44.4	16.5	—	—	—
Lending and financing assets	**225.4**	**390.5**	**—**	**225.4**	**406.6**	**390.5**	**230.1**	**—**	**—**
Impairment Provisioning	(0.3)	—	—	(0.3)	(0.4)	—	—	—	—
Trade and Other Receivables	15.4	11.5	—	15.4	2.7	11.5	8.3	—	—
Prepayments and other assets	0.4	0.4	—	0.4	1.0	0.4	1.0	—	—
Other assets	2.6	0.8	—	2.6	1.4	0.8	(0.1)	—	—
Total assets	**243.5**	**403.2**	**—**	**243.5**	**411.3**	**403.2**	**239.3**	**—**	**—**
Liabilities			—						
Deposits	171.7	227.7	—	171.7	224.1	227.7	152.6	—	—
Long term borrowings	5.4	5.4	—	5.4	5.4	5.4	5.4	—	—
Repurchase Agreements	—	34.8	—	—	58.8	34.8	—	—	—
Provisions	2.3	0.9	—	2.3	—	0.9	—	—	—
Trade and other payables	2.3	14.4	—	2.3	8.6	14.4	4.8	—	—
Total liabilities	**181.7**	**283.2**	**—**	**181.7**	**296.9**	**283.2**	**162.8**	**—**	**—**
Net assets	**61.8**	**120.0**	**—**	**61.8**	**114.4**	**120.0**	**76.5**	**—**	**—**

Bank regulatory capital

$m	FY23	1H23	FY22	1H22	FY21	1H21
Regulatory capital base						
Common Equity Tier 1 (CET1) regulatory capital	60.5	113.1	119.3	76.0	—	—
Additional Tier 1 capital	—	—	—	—	—	—
Total Tier 1 regulatory capital base	**60.5**	**113.1**	**119.3**	**76.0**	**—**	**—**
Tier 2 capital	—	—	—	0.5	—	—
Total regulatory capital base	**60.5**	**113.1**	**119.3**	**76.5**	**—**	**—**
Minimum Regulatory Requirement[1]	**13.1**	26.9	24.3	11.0	—	—
Excess over Minimum Regulatory Requirement	**47.4**	**86.2**	**95.0**	**65.5**	**—**	**—**
Minimum Regulatory Requirement Ratio (times)	4.62	4.20	4.91	6.95	—	—
CET1 capital ratio (times)	4.62	4.20	4.91	6.90	—	—
Risk weighted assets ($m)	113.8	256.4	231.4	104.9	—	—
Capital Adequacy ratio (%)	53.2%	44.1%	51.5%	72.9%	—	—
Average RWA intensity ratio (%)	46.7%	62.3%	57.4%	43.8%	—	—

1. Bank Minimum Regulatory Requirement represents total capital requirements of 8% (of risk weighted assets) plus the capital conservation buffer of 2.5% (of risk weighted assets) plus the counter cyclical buffer of 1% (of risk weighted assets), as stipulated under APS 110 ***Capital Adequacy*** as at 30 June 2023.

Capital management

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

Bank is regulated by APRA and is required to hold a minimum level of regulatory capital. Bank's regulatory capital base and Minimum Regulatory Requirement of capital are specified under APRA's ADI prudential standards.

Regulatory capital base

Bank's regulatory capital base at 30 June 2023 was $61m and represents CET1 regulatory capital, and is similar to the Bank's 30 June 2023 net assets.

Excess over Minimum Regulatory Requirement and capital ratios

Bank's excess over Minimum Regulatory Requirement at 30 June 2023 was $47m and its capital ratios were as follows:

- Minimum Regulatory Requirement ratio 4.62 times;
- Common Equity Tier 1 capital ratio (CET1) 4.62 times; and
- Capital adequacy ratio 53.2%.

Currently, a significant portion of Bank financing and lending assets are invested in cash and cash equivalents and lending activity has been slowed during the period given the sale of the Bank.

Risk management framework

CBL is exposed to a variety of financial risks, including interest rate risk, credit risk and liquidity risk.

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

Interest rate risk

The Bank is exposed to interest rate risk in the banking book, that is, the exposure to risk as a result of interest rate changes on its fixed rate assets and liabilities, and the mismatches between repricing dates of these assets and liabilities.

The net interest rate margin risk on the banking book is measured and reported to the Bank Risk Management Committee and the Board.

The Bank does not currently undertake derivatives as this 'on book' hedging strategy is considered adequate in addressing its interest rate exposure given the Bank's size and complexity.

Credit risk

The credit risk on the Bank's loan assets is determined by the risk appetite of the Bank Board and responsibility for overseeing it is delegated to the Loans Committee. Credit risk provisioning is determined through the application of AASB 9 ***Financial Instruments*** and its requirements using the expected credit loss model. Refer to Note 7 Loan assets of the 2023 Annual Report for further details on the recognition of expected credit losses.

APRA prescribes prudential limits on exposure to an individual counterparty (or group of related parties) as a proportion of an ADI's Tier 1 regulatory capital. In the event that this is exceeded, a large exposure is considered to exist and APRA requires that the ADI must inform the regulator of these exposures through prudential reporting. The Bank currently has no reportable large exposures.

Liquidity risk

The Bank has separate policies and processes to manage liquidity risks. The policy is approved by the Bank Risk Committee and is subject to APRA's review for compliance with prudential standards. The Bank's policy is to maintain adequate cash reserves, liquidity support facilities and reserve borrowing facilities in order to meet customer withdrawal demands when requested. Prudential liquidity ratios are monitored regularly, daily cash flows and longer-term cash flow forecasts are reviewed continuously and contingency funding plans are in place to address liquidity shortfalls.

Corporate financial results

$m	FY23	FY22	FY21	2H23	1H23	2H22	1H22	2H21	1H21
Other income	**1.6**	—	—	**1.0**	**0.6**	—	—	—	—
Personnel expenses	(43.5)	(40.5)	(35.5)	(21.0)	(22.5)	(18.4)	(22.1)	(18.7)	(16.8)
Other expenses	(14.3)	(16.6)	(25.1)	(4.4)	(9.9)	(9.3)	(7.3)	(18.1)	(7.0)
Total expenses (excluding LTI)	**(57.8)**	**(57.1)**	**(60.6)**	**(25.4)**	**(32.4)**	**(27.7)**	**(29.4)**	**(36.8)**	**(23.8)**
Long-term incentives (LTI)	(12.4)	(10.5)	(8.5)	(6.9)	(5.5)	(4.5)	(6.0)	(2.7)	(5.8)
Total expenses	**(70.2)**	**(67.6)**	**(69.1)**	**(32.3)**	**(37.9)**	**(32.2)**	**(35.4)**	**(39.5)**	**(29.6)**
Normalised EBIT	**(68.6)**	**(67.6)**	**(69.1)**	**(31.3)**	**(37.3)**	**(32.2)**	**(35.4)**	**(39.5)**	**(29.6)**
Interest and borrowing costs	(4.0)	(4.1)	(5.0)	(2.0)	(2.0)	(2.2)	(1.9)	(2.7)	(2.3)
Normalised loss before tax	**(72.6)**	**(71.7)**	**(74.1)**	**(33.3)**	**(39.3)**	**(34.4)**	**(37.3)**	**(42.2)**	**(31.9)**

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

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 FY23, up $1m (2%) from FY22. The increase in EBIT loss was a result of higher personnel expenses (up $3m) and higher LTI expenses (up $2m), partially offset by higher other income (up $2m) and lower other expenses (down $2m).

Other income

Other income represents interest received on Group cash and was $2m in FY23 (nil in FY22) due to higher interest rates. The Group cash balance as at 30 June 2023 was $129m.

Other income also includes equity accounted profits (EAP) or losses associated with Challenger's joint ventures with SimCorp (Artega Investment Administration) and Apollo.

Total expenses

FY23 Corporate expenses were $70m and increased by $3m (4%) on FY22.

Corporate expenses include:

- Personnel costs of $44m, increased by $3m (7%) primarily due to an increase in average FTE and increased salaries;
- Other expenses of $14m, decreased by $2m (14%) due to lower project-related costs associated with strategic initiatives; and
- Long-term incentive costs of $12m, increased by $2m (18%) following the granting of hurdled performance share rights in FY23.

Interest and borrowing costs

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

FY23 interest and borrowing costs were $4m, reflecting line fees on the Group debt facility.

The $400m facility remained undrawn throughout FY23.

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 the Solutions Group (refer to page 28) and profits on Life Risk wholesale longevity and mortality transactions (refer to page 28).

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.

Normalised capital growth assumptions for FY23 are as follows:

Fixed income and cash (representing allowance for credit defaults)	-35 bps
Property	2.0%
Equity and infrastructure	4.0%
Alternatives	0.0%

Investment experience

Challenger Life is required by accounting standards and prudential standards to value 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 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.
Authorised Deposit-taking Institution (ADI)	A financial institution licensed by the Australian Prudential Regulation Authority (APRA) to carry on banking business, including accepting deposits from the public. This includes banks, building societies and credit unions.
Bank average RWA intensity ratio (%)	Risk Weighted Assets divided by Bank total assets.
Bank book growth	Net deposits over the period divided by the opening deposit book.
Bank Capital adequacy ratio (%)	Total regulatory capital divided by Risk Weighted Assets.
Bank impairments	Impairments relate to Bank lending and financing assets and represents provision for losses, realised losses or recoveries on the assets that are held at amortised cost.
Bank Minimum Regulatory Requirement ratio (times)	Total regulatory capital divided by Minimum Regulatory Requirement.
Bank Net Interest Margin (%)	Net interest income over average interest earning assets.
Bank Risk Weighted Assets	Risk weighted assets are used to determine the minimum amount of capital that must be held by banks and is a measure of the Bank's assets weighted according to risk.
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 capital ratio	Common Equity Tier 1 regulatory capital divided by Minimum Regulatory Requirement.
Challenger Index Plus	Institutional product providing guaranteed excess return above a chosen index. Index Plus is available on traditional indices and customised indices.
Challenger Investment Management income	Challenger Investment 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.
ESG	Environmental, Social, and Governance
Fidante income	Distribution and administration fees; Fidante's share of affiliate 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, Funds Management FUM and Bank lending and financing assets.
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, Challenger Capital Notes 2, Challenger Capital Notes 3 and Challenger Capital Notes 4).
Investment experience (Life)	Represents fair value movements on Life's assets and policy liabilities and net new business strain. Refer to page 63 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.

Glossary of terms

Terms	Definitions
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 Other Life liabilities).
Life investment assets	Total value of investment assets that are managed by the Life business.
Minimum Regulatory Requirement (MRR)	Represents the minimum capital requirement as required by regulators, including APRA, ASIC and other foreign jurisdictions.
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 income and Challenger Investment Management income.
Net management fees (FM)	Management fees for managing investments.
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 63 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 63 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, communications and investment management costs.
Other income (Corporate)	Includes interest received on Group cash balances and equity accounted profits (EAP) or losses associated with Challenger's joint ventures with SimCorp (Artega Investment Administration) and Apollo.
Other income (Life)	Relates to revenue from the Solutions Group and Life Risk. Refer to page 28 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.

Glossary of terms

Terms	Definitions
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 Bank net interest income plus other income (Corporate).

Key dates

Challenger Limited (ASX:CGF)	
Q1 2024 Sales and AUM	17 October 2023
2023 Annual General Meeting	26 October 2023
2024 Half-year financial results	13 February 2024
Q3 2024 Sales and AUM	18 April 2024
2024 Full-year financial results	13 August 2024
2024 Annual General Meeting	24 October 2024