

**Attention ASX Company Announcements Platform
Lodgement of Open Briefing**



Challenger Financial Services Group
Aurora Place
Level 41, 88 Phillip Street
Sydney NSW 2000

Date of lodgement: 10-Sep-2004

Title: Open Briefing. Challenger. Briefing Day Update

Record of interview:

The content of this Open Briefing reflects management and analyst discussion at Challenger Financial Services Group's investor briefing days held in Sydney on Monday September 6, Tuesday September 7 and Wednesday September 8, 2004.

corporatefile.com.au

Challenger Financial Services Group Limited is emerging from a period of substantial change. What is the focus of your three main businesses?

CEO Mike Tilley

Within Challenger Life we've clearly committed to the annuities business. While there's some uncertainty about complying annuities post September 20, we continue to think the annuities business has great potential. Annuities provide a low-cost source of funding to invest in a diverse portfolio of assets and we think there are enormous opportunities to generate value from that asset base. In terms of asset allocation, Challenger Life is pursuing an appropriate mix at the appropriate stage of the cycle. Our recent investment in infrastructure assets and our recent property sales highlight our current thinking.

Challenger Wholesale Finance and within it, the Interstar business, is in a strong growth phase and will be a significant profit and wealth driver for Challenger over the next five to ten years. This year, the business is expected to at least meet our 18 percent return on net assets (RONA) target.

In Challenger Wealth Management, we've nearly completed the clean-up within Funds Management and we've continued to build the new business with new people and new systems. Funds under management (FUM) are now growing at a rate of about \$500 million per quarter. Profitability will emerge as we implement our new registry and administration systems and build scale in FUM. Financial Planning has already established genuine scale following the acquisition of Associated Planners, which should begin to make a positive EPS contribution within six months.

corporatefile.com.au

Challenger Life has undergone significant restructuring in the past year. How has the business model and strategy changed?

Robert Woods, Chief Executive Challenger Life

Our strategy is to use our equity and annuities to invest in quality assets that provide multiple sources of income. The diversified investment model is designed to give us positive net cash flows at all points over the term of the annuity obligations. The previous model, which backed the annuity obligations with income from property, was cash-flow neutral over the term of the annuity, with a cash in-flow occurring at the end of the term, when the annuity obligations were extinguished and the property could be sold. In making investment decisions, we'll be focussing on choosing assets that meet our 18 percent RONA target and provide cash flows to service our annuity obligations.

Our model is more akin to an investment banking model than to that of other life insurance companies. We believe we can leverage our asset origination skills, which aren't exclusive to property, to purchase long-term predictable income streams, seed new businesses and create value.

The important message is that we'll make regular cash income on an invested yield basis, and that will be ongoing. We'll make income from realising assets and we'll make fee-related income from structuring transactions, underwritings and placements. And we believe there are opportunities in running an alternative asset management type of business that uses our skills to grow the assets, not only on balance sheet, but also off balance sheet through the Challenger Funds Management capability. We'll buy assets in bulk at wholesale prices and repack them to sell back to the retail market at retail prices. So we won't be reliant just on margin income.

corporatefile.com.au

Given the move away from investment in property, what's your preferred asset allocation model?

Robert Woods, Chief Executive Challenger Life

That's something we'll reassess on an ongoing basis. There are always asset classes that are more attractive at different times in the market cycle, and we'd hope our asset origination skills would allow us to identify the right assets at the right time. We'll continually reappraise the portfolio to ensure we have the best mix of long-term income streams. In general though, we want to be in Australian

property as an asset class, we want to be in infrastructure as an asset class and we want to be in fixed interest as an asset class.

corporatefile.com.au

There's a perception Challenger Life has been able to offer the most competitive pricing in the annuities market because of the returns from its leveraged property portfolio. How will you differentiate your product from the competition?

Robert Woods, Chief Executive Challenger Life

Our competitors have come primarily from an insurance company background, and the annuity is one small component of their total insurance business. Perhaps for that reason they don't devote the same level of resources to the business we do. My understanding is that our competitors tend to be far more into fixed-rate-bond style investment portfolios that are almost locked away and forgotten about. We've been number one in the market for four or five years now and our scale in the market gives us our advantage. An important differentiator for us is that we can invest more time and effort in actively improving the quality of our annuities, the quality of their asset backing, and their terms and conditions.

It's true we've offered the highest rates in the annuities market through most of our history. But we've been managing down our annuitant rates over the past year, and our competitors have been happy to follow our rates down. The big difference is that we now have a far more profitable business, generating positive cash flow every month.

corporatefile.com.au

On the "historical cost" accrual basis, Challenger Life booked pre-tax earnings of \$40 million in the second half to June, compared with \$15 million in the first half. A large part of the improvement appears to have come from one-off items such as asset disposals. How sustainable is the earnings improvement?

Robert Woods, Chief Executive Challenger Life

We believe any long-term investment has two elements of return: the running yield and the change in the capital value. We report both as profit and loss as they are both part of the return on investment. An important element of our business model is to realise assets regularly throughout the annuity term, not wait for annuity obligations to cease. You have to continue to pay back a little of the annuity's principal over its life, so we don't believe we should back it with one big asset, for example a property – you can't sell one floor of a building. The object is to have a more diverse portfolio and then sell particular assets at the right time when the economics are right rather than when the annuity obligation ceases. There'll definitely be an ongoing component of realising positive gains on assets.

In the second half we also saw an increase in investment income and that was a function of the increase in capital and profitability in the business. We believe that's sustainable.

corporatefile.com.au

Will the change in asset mix have any consequences for Challenger Life's solvency levels?

Tony Bofinger, COO & Appointed Actuary Challenger Life

A component of the solvency calculation relates to the mismatch in the impact of market movements on Challenger's policyholder liabilities and the assets. To the extent there is a mismatch, Challenger needs to hold a reserve to absorb certain adverse movements. We measure the interest rate and currency sensitivity of our assets and liabilities on an ongoing basis and have a hedging policy in place to address those risks. Focussing on a diversified pool of quality assets that provide good yields and match the cash-flow profile of our annuitant obligations will improve security for our policyholders.

corporatefile.com.au

Challenger Life's excess above solvency for its annuity products increased to \$271 million at the end of June 2004 from \$54 million a year earlier. What were the drivers of the increase in solvency?

Tony Bofinger, COO & Appointed Actuary Challenger Life

The solvency improvement was driven by a range of factors including increases in interest rates and increases in the value of our property portfolios, and partly by retained earnings.

corporatefile.com.au

To what extent was the increase in excess above solvency attributable to the \$235 million cash injection from CPHIC at the end of June 2003?

Robert Woods, Chief Executive Challenger Life

A lot happened at June 30, 2003, including changes in accounting policies to reflect a more conservative approach for valuing the Life properties. This resulted in a write-down in values in line with the capital injection at that time. Most of the solvency improvement is due to activities undertaken since June 2003, including the profits made and retained. The capital injection incurred in the year to June 30, 2003, so was not a contributor to the increase in excess above solvency for the 2004 year.

The solvency levels have increased materially over the last 12 months and management's very comfortable with the current asset valuations, which we believe are generally conservative. We certainly believe the portfolio is low risk in all respects and that we're managing it well.

corporatefile.com.au

What's the potential impact of rising interest rates on the Challenger Life's solvency levels?

Robert Woods, Chief Executive Challenger Life

Generally an increase in interest rates would be good for us. Over time, the earnings on our funds would increase, given the fixed cost of our annuitant obligations.

The debt relating to our properties is long-term debt and it's variable, but it's got an interest rate swap to meet the term of the lease obligation. We do measure our

interest rate risk fairly conservatively and we try and match that up as far as possible, for example by putting the CMBS structure in place.

corporatefile.com.au

Challenger Life's, long term annuity sales totalled \$351 million for the 2004 year, and you've indicated that sales have been at record levels in the current September quarter. To what extent do you expect sales to be impacted by the reduction of the 100 percent assets test exemption for complying annuities on September 20?

Robert Woods, Chief Executive Challenger Life

We're confident there'll still be demand for the annuity product post September. We believe three key factors will drive that. The first is the overriding secular growth in the retirement space given our aging population. The second is the advent of the superannuation choice of funds legislation in July 2005. That will result in the launch of new products and increases in advertising and marketing that will bring more people to the retirement product market. The third is that annuities are a capital guaranteed product, and that retirees are a risk-averse age group who want some portion of their income to have that kind of guarantee.

Also, we've got a number of new annuity products in the pipeline. One area of product development we're working on is a reverse mortgage-linked annuity, where our skills in property and annuity structuring should give us a competitive advantage.

corporatefile.com.au

What is the nature of the Challenger Wholesale Finance revenue and the business model?

Brian Benari, Chief Executive Challenger Wholesale Finance

There are three parts to our value chain: investors and funding; portfolio management; and mortgage origination.

The sourcing of investors ranges from banks, life companies and wealth management funds for warehousing, to global and domestic residential mortgage backed security (RMBS) investors. In the commercial segment, both retail and wholesale investors invest in the Howard Mortgage Trust. Challenger Wholesale Finance is analogous to a funds management business. We have a host of offshore and domestic investors who invest via residential mortgage backed securities (RMBS) in portfolios of mortgages, which are originated and managed by us for a fee.

The benefit of the excess spread accrues to Challenger. Essentially, we're sitting between investors and their ultimate borrowers, earning a fee. Accordingly, the business generates an annuity style income stream that's conservatively accounted for on an accruals basis.

The business has a scaleable and flexible platform and is a low capital intensity business. We have leading market positions in prime residential, through Interstar, non-conforming residential, through The Mortgage Alternative, and a strong and growing position in commercial lending, through the Howard Mortgage Trust.

Our net mortgage book has grown from \$2.1 billion at June 30 last year to \$16.2 billion. On acquisition, the Interstar book totalled \$11.2 billion and The Mortgage Alternative, which was launched in April this year, is already Australia's fastest growing non-conforming residential wholesale lender.

Interstar has over 540 white-label originators. These are all different brands supported by the Interstar funding, servicing and technology platforms. When the originators meet borrowers that aren't considered prime, they refer them to The Mortgage Alternative. Longer term, we think substantial opportunities exist in the origination area to leverage our financial planning network. Challenger has access to over 13,000 financial planners and they have traditionally focused on assets and now want to take a more holistic approach to their clients and have lending capability.

corporatefile.com.au

What has been your experience in relation to credit losses?

Brian Benari, Chief Executive Challenger Wholesale Finance

There's no recourse to Challenger. Credit losses on mortgage portfolios are absorbed by the insurers of the mortgages, the securitised pools and the investors in the RMBS. In respect to mortgage insurance, since 1995, Interstar has written over \$20 billion worth of loans and it's lodged 61 insurance claims, for a total value of \$2.2 million. Over that time, no claims have been rejected by our panel of mortgage insurers.

corporatefile.com.au

What is the business's exposure to interest rate swings?

Brian Benari, Chief Executive Challenger Wholesale Finance

Official interest rate changes don't impact the business, as both investors and the borrowers receive or pay floating rates of interest. The only thing that can impact us is the compression spread, that is, the difference between the RBA cash rate and the bank bill swap rate and that can have a positive or negative impact on earnings.

corporatefile.com.au

What is the current position in relation to the compression spread?

Drew Hall, CFO Challenger Wholesale Finance

The compression has been about 20 points over the last six months and that's higher than the average over the last 10 years of about 7 points. Compression spread is the difference between the official RBA cash rate, at which loans made by the trusts to borrowers reprice, and the 30 and 90 day bank bill swap (BBSW) rate which RMBS reprice.

corporatefile.com.au

Mortgage lending has been growing rapidly since the late 1990s. Are you seeing a slow-down and what growth rate is sustainable?

Brian Benari, Chief Executive Challenger Wholesale Finance

Since World War II mortgage credit has grown by a minimum of 8 percent per annum and averaged around 15 percent over the last 10 years. Of late we've had growth as high as 24 percent but in recent months it's normalised. That normalisation's something we're very comfortable with. RBA figures released in February show that even if lending volumes fell by 4 percent per month for the 2004 calendar year, housing credit growth would settle at a level of around 10 percent.

corporatefile.com.au

Isn't there a reasonable chance that your funding sources could shrink as the market for RMBS hits saturation point?

Brian Benari, Chief Executive Challenger Wholesale Finance

Our first Euro deal last year, the biggest Australian RMBS Euro deal ever, was three times over subscribed and this year we completed the market's first Australian RMBS Sterling deal and the largest ever non-bank RMBS issuance. Interstar's investor base for RMBS has increased from 61 to nearly 140 since becoming part of Challenger. As more markets open up and more issuers access the markets, they're becoming more sophisticated and liquid, facilitating the quality of the paper on offer being more appropriately priced. New jurisdictions are opening up and our funding is getting cheaper. We currently see demand increasing.

corporatefile.com.au

What are the attributes of the non-conforming market in which The Mortgage Alternative operates?

Brian Benari, Chief Executive Challenger Wholesale Finance

Market size is estimated between \$6 billion and \$10 billion. Interestingly enough, it's tending to be revised up over time. It's a new and growing market with good margins and it offers counter cyclical appeal as demand should grow as credit tightens.

corporatefile.com.au

In the latest six months the Interstar management fees and excess spread represented 1.3 percent of the average mortgage portfolio. What costs absorbed that 1.3 percent margin?

Drew Hall, CFO Challenger Wholesale Finance

Trailing commissions represented 0.43 percent, amortisation 0.39 percent, portfolio management costs 0.24 percent and the balance of 0.24 percent was profit. The 1.3 percent margin, which is the difference between the average borrower rate received by the managed securitisation trusts and the return paid to RMBS investors after trustee fees, includes the impact on compression spread. For example, the revenue margin would have been around 0.13 percent higher based on the last 10 years' compression spread of 0.07 percent.

corporatefile.com.au

What is the amortisation policy?

Brian Benari, Chief Executive Challenger Wholesale Finance

When an originator passes us a loan or originates a loan on our behalf, we pay the originator an upfront commission, we capitalise that item on our balance sheet and amortise its cost over time.

Drew Hall, CFO Challenger Wholesale Finance

We match the amortisation charge with the mortgage repayment profile to create a consistent, effective yield. This results in a higher dollar expense in the early years. Additionally, any unamortised deferred origination costs are expensed immediately if a mortgage is discharged early. This results in the weighted average life of the amortisation being shorter than the weighted average life of the managed loan portfolio. Deferred establishment fee income compensates for the expenses. It's a conservative policy.

corporatefile.com.au

What is the current structure of and outlook for Challenger Wealth Management?

Chris Cuffe, Chief Executive Funds Management

Wealth Management has two divisions: Funds Management headed up by myself and Financial Planning headed by Rob Adams.

We're positioning Challenger Wealth Management to participate in the industry's strong long-term growth outlook. We have a fundamental belief that the long-term winners will be those that keep their cost structures under control and those that have the best-of-breed technology and processes. We expect the business to enjoy attractive margins in the medium to long term. But, I wish to emphasise that we're building the business for the long term, we're not doing a short-term fix for short-term profit.

corporatefile.com.au

What are the priorities and what progress have you made within Funds Management?

Chris Cuffe, Chief Executive Funds Management

Our first priority is to deal with the remaining issues from the old structure by the end of calendar 2004. We're in the final stages of the clean up. We're nearing completion of new registry, asset management and administration systems. We're starting to take services that were previously out-sourced in-house and doing them much more efficiently time-wise, error-wise and cost-wise. We're developing a very good compliance culture. In the last year or so, we've simultaneously cleaned up the past and built a structure for the future.

Deriving revenue from multiple revenue sources is a major priority as we go forward and we're beginning to get some traction in this area. Last year we achieved a significant rise in FUM and a credible increase in funds under administration (FUA). FUM increased 53 percent to \$6.14 billion and FUA increased 14 percent to \$1.67 billion.

But the diversity within these figures is key. Australian equities funds and mandates increased 177 percent to \$1.48 billion, direct property via syndicates

increased 61 percent to \$175 million, mortgage funds increased 21 percent to \$3.18 billion, fixed-interest funds increased 234 percent to \$431 million, multi-sector funds increased 55 percent to \$539 million and alternative investment funds increased 24 percent to \$286 million. We've extended our distribution touch-points among retail researchers, dealer groups, platforms, and asset consultants and our ratings and industry recognition have lifted.

In the short term, the missing ingredient is scale. Our existing cost base is capable of handling a significant increase in funds. In Funds Management, we expect to move from losses to profit within an 18-month period. We're satisfied with our progress to date.

corporatefile.com.au

What are the objectives within the Financial Planning business given you've recently acquired Associated Planners?

Rob Adams, Chief Executive Financial Planning

Like Funds Management, success in Financial Planning requires scale and we've achieved that through the acquisition of Associated Planners. Also like Funds Management, the macro outlook for the business is very positive. Compulsory super and member choice, along with the complexity of the tax and regulatory framework, underwrite a level of growth. There's no doubt consumer demand will grow and the acquisition of Associated Planners positions us well. We now have scale and quality and we'll look to drive change within the industry as it moves to a corporatised profession with a focus on productivity and profit per planner.

We aim to develop a trusted advice brand, a gap in the current market. A trusted advice brand will be attractive to consumers and the leading financial planners as they rotate out of the larger organisations.

Our technology will enable our planners to provide advice across assets, liabilities and risk. It's a critical focus for us as we seek to ensure we consistently provide an open architecture environment to allow holistic financial planning. Better technology will also make it easier for the planners in relation to compliance and free them to spend more time with clients. Currently only 17 percent of a planner's time is spent face to face with clients. That's clearly not enough.

corporatefile.com.au

Within Financial Planning you've got the Associated Planners brand and the Garrisons brand. What's your branding strategy?

Rob Adams, Chief Executive Financial Planning

We're yet to make that decision. We're assessing both those brands and new brands. We're getting feedback from consumers, customers, planners and staff.

corporatefile.com.au

What earnings contribution are you expecting from Associated Planners?

Rob Adams, Chief Executive Financial Planning

We've assumed management control and the integration is well underway and should be complete by February next year and that's when we'd expect the business to be making a positive contribution to EPS.

corporatefile.com.au

Last year your Financial Planning business recorded a pre-tax loss of \$5 million not including any contribution from Associated Planners. Typically, financial planning businesses have been lucrative for individual financial planners but not for shareholders. Is it realistic to expect you'll achieve your targeted 18 percent RONA and if so what will be the main drivers?

Rob Adams, Chief Executive Financial Planning

Yes, we've already achieved significant cost reductions from the combination of Garrisons and Associated Planners in almost all expense lines including a more than 25 percent cost reduction in headcount. Financial Planning is a scale business and with \$7.5 billion in funds under advice, we now have scale.

Additionally Associated Planners has invested heavily in technology in recent years and with the marriage of this technology and the proprietary technologies in Challenger, we believe we can increase the face time our planners spend with clients from approximately 17 percent on average today, to 25 to 30 percent on average over the next two to three years. This can occur by using systems to manage back office functions. We know more client face time equals higher planner and dealer revenue.

If we can make our planners more profitable by easing the back office load, we'll attract new, high quality planners to the merged Garrisons and Associated Planners business, further enhancing our scale advantage. These systems developments are very scaleable and we can grow revenue far more quickly than we need to add costs.

corporatefile.com.au

Thank you.

For more information about Challenger, visit www.challenger.com.au or call Tanya Atkins on (+61 2) 9994 7125

For previous Open Briefings with Challenger, or to receive future Open Briefings by e-mail, visit www.corporatefile.com.au