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CHALLENGER FINANCIAL SERVICES GROUP
ANNUAL GENERAL MEETING
CHAIRMAN'S ADDRESS
12 NOVEMBER 2009
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MUSEUM OF CONTEMPORARY ART
140 GEORGE STREET
THE ROCKS, SYDNEY

Chairman's Address

Our Annual General Meeting is the only opportunity we have each year to discuss our past performance and future plans with the owners of Challenger Financial Services Group.

Today should be a more enjoyable experience for all of us than this time last year. In November 2009, and as reflected in our share price, the market seems to have gained a much greater appreciation of Challenger's financial strength.

Certainly, we feel that Challenger's ability to conduct a share buyback rather than issue expensive equity during 2009 is a remarkable achievement that stands alone among our financial services peers.

Before we turn to the 2009 results, it is worth considering the context in which these results were achieved, as well as the strong position Challenger commands today.

On the first of July 2008, our financial and operating environment commenced a second year of exceptional volatility and constraint arising from the knock-on effects of the Global Financial Crisis.

Governments and regulators around the world had commenced unprecedented interventions into their banking and financial systems in a desperate attempt to provide liquidity and capital to credit markets and stimulate flagging economies.

Throughout the rest of calendar 2008, equity markets continued their steep downward trend while Australian retail investors withdrew from investment markets and moved to government-guaranteed instruments including bank deposits.

Securitisation markets were not functioning, the cost of corporate debt remained high and government-guaranteed bank term funding became a type of super-security that crowded-out other lenders in institutional debt markets.

Calendar 2009 opened in an equally sombre mood, with the ASX tracking to a low point on March the ninth. A range of market and economic factors forced some financial services companies to turn to equity markets for capital when their share prices were at historic lows, heavily diluting existing shareholders who had already suffered investment losses. Some of these companies also received the benefit of government assistance in the form of guarantees over their debt issuance.

Meanwhile, within Challenger it was evident that our earlier actions meant we would not only survive a global financial crisis that claimed some of the biggest names in US investment banking and domestic financial services companies - we would actually come through the other side in a better financial position than many of our global peers.

What's more, this was being achieved without the benefit of the government guarantees given to the banks, and without the need to dilute shareholders by raising equity at deeply discounted prices.

Challenger's response to the crisis has been proactive and decisive. Our early and intensive focus on securing and managing our capital has reaped rewards.

The raising of $672 million before the GFC in 2007, a change to our tactical asset allocation to focus more on high grade income assets, and a swift reduction in our cost base combined to put us on a very solid footing by June 30 this year.

Throughout the year, our businesses were generating record levels of cash, which not only comfortably covered our working capital and regulatory needs, but permitted us to take advantage of market lows to buy-back our own shares, benefitting our shareholders by reducing the total number of shares on issue.

Consequently, with cash earnings continuing to grow throughout the GFC, Challenger has been able to maintain a full year dividend of 12.5c including a final dividend of 7.5c, which as previously flagged will be unfranked.

Please be assured that your Board's policy remains to frank dividends to the fullest extent possible however, we do not expect to have franking capacity in the short to medium term.

I'd now like to review the profit performance that has led to our current full year earnings and dividend.

Last year, we spoke in detail about normalized profits, Challenger's key measure of performance. Normalised profits look through the 'noise' of recent volatile investment markets to our underlying operating income; the income that funds our operations and is returned to you as dividends twice a year.

Volatile asset markets either reduce or inflate our reported statutory profits because of an accounting rule which requires our Life company to re-value its assets using the mark-to-market accounting methodology.

Irrespective of our intention to hold or sell an asset we must value that asset at its current market price, and make an adjustment to reflect this in our reported statutory profits. When markets go down, we must record a loss of value, and vice versa.

It is interesting to note that a bank holding the same type of assets is not required to adjust its statutory profits in the same way.

Despite this frustrating anomaly, between 2004 and 2007, the four years preceding the global financial crisis, our statutory profit after tax exceeded our normalized profit after tax.

In 2008, and again in 2009, the reverse has occurred and our statutory profit has come in below our normalized profit. Our statutory profit is negative $91 million while our normalized or underlying profit is positive $219 million, $1 million more than last year's result.

Fortunately, with some recovery in credit markets in the second half of the year, our statutory profit for the second half of 2009 was positive $17.2 million, which bodes well for a narrowing of the gap between statutory and normalized profits for 2010.

What is particularly pleasing about our slight increase in normalised profits after tax for 2009 is the fact that it reflects record levels of underlying cash flows of $287 million, a 33% increase on prior year.

In addition to producing a fifth consecutive year of underlying earnings growth, these exceptionally strong cashflows meant that we could report a regulatory capital surplus of approximately $530 million as at 30 June, a figure which we more recently reported had reached around $800 million.

The other event contributing to today's very strong cash and capital position is of course the divestment of the Mortgage Management residential lending and broking operations to the National Australia Bank, for $385 million.

The sale was announced in August this year and settlement occurred on the 30th of October.

As noted in the Annual Report, this transaction has a very positive financial impact on the Group, resulting in zero net debt, $350 million in additional cash and a higher capital surplus.

Challenger's ownership of this business over the last 6 years has been very profitable for our shareholders, with the original Interstar business growing into a highly strategic asset. We would like to thank our Mortgage Management colleagues and wish them the very best for the future.

While Challenger is no longer in the mortgage business, it's worth reiterating that we did not sell all of the business to NAB; just the residential lending and mortgage broking operations.

Challenger has retained the commercial lending business and the net interest income from the $11 billion term-funded mortgage loan-book, which was transferred to the Life company and will continue to generate secure, high quality cash flows that are well-matched to our annuitant liabilities.

Challenger's resilience throughout the Global Financial Crisis was no accident of serendipity. It was due to the hard work and exceptional performance of the company's key executives, who we aim to motivate and reward through contemporary remuneration policies that reflect community standards and expectations.

We continually update our remuneration policies to accord with corporate governance standards and global best practice within the markets in which we operate. To this end there have been a number of changes to remuneration policies over the last year.

Our policies are now simpler and continue to link remuneration to the value of your shareholdings. Challenger now has three main remuneration components: salary packaging; an Employee Incentive Plan which includes a discretionary bonus; and the Challenger Performance Plan which involves long term incentives such as options and performance rights.

The Challenger Performance Plan replaced a number of long term incentive schemes including the Long Term Incentive Plan.

It is worth noting that while these legacy schemes still appear in the annual report because they are still on foot, they have been dormant for 2 – 3 years and are rolling off, with most of the rights expiring and unlikely to be exercised over the coming year

In light of the Global Financial Crisis, a number of changes were also adopted reflecting your board's focus on aligning the rewards of the individuals with shareholders. For the 2009 year reviews, no salary increases was granted to key executives, nor were any cash bonuses paid.

Now as I'm sure you're all aware, the composition of the Board of Directors has changed this year. In September 2009, following the sale of shares by Consolidated Press Holdings and Bank of Tokyo Mitsubishi, Mr Tetsuya Wada, Mr James Packer and Mr Ashok Jacob resigned from the board.

This now means that all the directors on your Board are fully independent, with the obvious exception of your Managing Director Dominic Stevens.

The reduction in director numbers from nine to six was significant enough to prompt a review of Board sufficiency because in order to provide a high standard of corporate governance, the Board must of course be adequately and appropriately resourced.

This review concluded that our six remaining directors were sufficient to discharge the Board's various duties and obligations.

While nine directors were previously required to ensure that the interests of large shareholders were adequately represented, this number certainly exceeded the norm for a company of our size, and we are currently more than comfortable with the number of directors we have and mix of skills and experience they bring to the Board table.

Should the Board's workload or business conditions demand it, we will not hesitate to revisit this decision in the future.

Part of the business of today's meeting also deals with the re-election of a number of Board members. In accordance with Challenger's constitution, one-third of our directors are required to retire by rotation each year. In today's meeting, we will address the re-election of Mr Leon Zwier and myself, Peter Polson.

The Board unanimously recommends that shareholders vote in favour of the Directors re-elections and other matters before you today.

In conclusion, I would like to thank you our shareholders for your support and encouragement in 2009. This time last year, the economic and business environment was certainly not as positive as it is today, and I look forward to seeing you this time next year to report on a successful 2010.

I now invite our Managing Director and Chief Executive Officer Dominic Stevens to present his address.

CEO's Address

Thank you Peter.

Good Morning to you all and thank you for your attendance here today

It has now been a little over a year since I took over the job as your CEO and it has been a challenging, demanding but exciting year.

Last year, I discussed how Challenger entered the global financial crisis in a strong financial position with excess cash and capital on its balance sheet which allowed it to navigate through the difficult financial times.

Now that financial markets are showing ever increasing signs of stability, Challenger has emerged even stronger and in a great position to capitalise on some of the opportunities the crisis has provided.

We have a more focussed business, a streamlined organisational structure and a stable senior executive team.

I would like to look now at some of the primary actions which have helped shape Challenger over the last 12 months

Challenger's resilience through the crisis has been a product of decisive action in the early stages of the financial turmoil, including:

- The raising of cash and capital soon after the first signs of the financial crisis became clear in 2007

- Selling the non-core financial planning division in mid 2008
- De-risking our balance sheet through investing in high-grade fixed income assets
- Growing our asset base and market share through the AXA and Metlife annuity book transfers.
- Finally reducing costs in our business via the amalgamation of our two fiduciary Funds Management businesses.

The result of this swift and early action meant Challenger's underlying earnings remained not only strong, but over the last 12 months cash spread earnings grew by 30%.

Capital has regenerated at an increasing rate to levels now greater than at the beginning of 2007.

Importantly for our shareholders this has meant that Challenger was not forced into dilutive equity issuance like many of our peers. In fact it has been the opposite, as Peter mentioned, your company has in fact been engaging in a share buyback, taking advantage of a discounted share price to create significant earnings per share accretion for our shareholders.

More recently the sale of Mortgage Management to the National Australia Bank has further increased cash at group, reduced net debt to zero and led to a more streamlined and focussed business model.

This business model leverages off the significant tailwinds of growth in the Australian Investment Management arena.

So, why are we focussing our capital resources on investment management?

Well, Quite simply, the macro growth environment in Australia is very attractive for investment managers.

As many of you would know, Australia has the fourth largest funds management industry in the world, superannuation assets being the largest driver of growth.

Australian superannuation assets have been growing at 14.4% per annum which makes it the fastest growing market in the world. Our superannuation assets are worth over $1 trillion today and will grow to $2 trillion in 5 years' time and to $3 trillion in 9 years' time.

At Challenger, the process of asset management is at our core.

Within our funds management business, we manage or distribute products across equity, property, Infrastructure and fixed income – the very asset classes into which all this super money is flowing.

These may be managed in Challenger-branded products or as non-Challenger branded products via our fast growing boutique funds management model.

Importantly, in the broader investment management space we are the market leader in the original and authentic guaranteed income product for retirees, the annuity.

This strong market position allows Challenger to participate in what is the fastest growing sector of the savings market, the post-retirement market.

If we look closer at the composition of superannuation assets the Post retirement portion in 2008 only represented one fifth of total superannuation assets, however they are forecasted to grow at a compound annual rate of greater than 16%.

This is significantly faster than the accumulation portion which means the retirement pool is becoming much more important over time.

Looking out over the longer term Challenger has identified key trends that support its strategic focus on the retirement space

Firstly there are significant demographic changes that are taking place in Australia and around the world. That is, developed nations have ageing populations.
By way of illustration, next year is 65 years since 1945 meaning the baby boomer generation will begin retiring. In Australia, our public age pension is on the one hand a great safety net, but in financial terms is a large, under-funded government liability. Similar problems exist world-wide.

Our private pension scheme, otherwise known as our superannuation system, has been in place for more than 15 years, so we all expect to be earning more than just the age pension in retirement. We certainly know the age pension won't be enough to live on.

These are universal, long-term, structural problems that aren't going away, and need policy intervention to be resolved.

Secondly, over the course of the GFC many retirees have seen a significant portion of their super funds disappear due to allocations to risky assets. As a result we are seeing a significant change in the risk preference of the average Australian investor. This has also led to a greater scrutiny of the fees and commissions that tend to sit with more complex or risky products and we are also seeing a trend away from lump sums and into retirement income streams.

To take advantage of these trends, Challenger has significantly increased its focus on the distribution, marketing and advertising of its annuity products. When viewed in this broader context, Challenger annuities are clearly an evergreen product with a growing franchise for many years to come.

Given Annuities is your company's most significant product and I am suggesting that we are seeing a renaissance in demand for that product, I thought I would spend some time as to why this is so. Importantly, I am not questioning the validity of equities as a way to accumulate wealth, or that all investors should reduce their exposure to risky assets, far from it.

Our focus is purely on what happens when you get close to retirement age, and afterwards and how your tolerance for risky assets changes through time.

It is important to point out here that what we are saying is nothing new revolutionary. If you look at the bulk of work done internationally on this subject it is sympathetic to what we are saying. What Challenger is saying is that Australia needs to accept a reality that the rest of the world has accepted. That is, as we age, our exposure to equities should be reduced because our tolerance for risk is diminished.

Our viewpoint may not yet be common in Australia but it is universally supported by the academic literature and by pre-eminent authorities around the world.

For example, the father of Mutual fund investing John Bogle, who founded Vanguard group, one of the greatest equity management businesses in the world, famously said that you should keep your age invested in guaranteed income, with the balance in equities.

Meaning if you are 75 you should keep 75% invested in guaranteed income and 25% in equities, ie 25 year old would hold the reverse mix. Interestingly he is also a great proponent of the power of annuities, and in a submission to the US House of Representatives this year, said that simple, low cost annuities should be a feature of default super funds and that upon retirement, a mandatory allocation to such annuities should take place to mitigate against longevity risk. This kind of thinking hasn't quite hit home yet in Australia.

Annuities and other fixed income products flew under the radar during the equities bull market, which encouraged 70 year olds into holding the same equities exposure as a 30 or 40 year old should have. Australia's outlier status hasn't gone unnoticed abroad

Earlier this year, international authorities such as the OECD and the International Monetary Fund highlighted the fact that Australia's super funds were over-allocated to equities.

The OECD even remarked that the Australian government should encourage retirees to purchase annuities to protect against future share market falls. This risk of equities in retirement is also clear to Putnam Investments' President and CEO Robert L. Reynolds who advocated a limit or cap on equity allocations from ten years prior to retirement in order to protect against market volatility.

Further support for a greater allocation to defensive assets in retirement also comes from Prudential, who says it's imperative for retirees to protect against negative market performance in the five years before and after retirement; they call this the "retirement red zone"

Closer to home, only a month ago, the Melbourne Mercer Global Pension Index found that the Australian super system was well rated, however it could be improved by requiring that part of the retirement benefit must be taken as an income stream.

I could continue providing you with examples that highlight Australia's outlier status when it comes to share market exposure in retirement or quote additional research that shows the power of annuities in reducing reduce both market and longevity risk while leading to higher average retirement incomes.

What I will speak briefly about, is that these issues go beyond the individual and have profound ramifications for our society as a whole. The cost of managing longevity, of sustaining an ageing population, is widely regarded as the greatest public finance challenge in the world over the next 40 years.

The largest components of this cost are the aged pension, healthcare and long-term care. Aged pensions are expected to exert the most pressure on government spending with an average of 8.7% of GDP across the developed world in 2005 rising to an estimate of 12.8% in 2050.

Whether we like it or not, I think it's fair to say that these changes are only going in one direction. According to modelling performed by international ratings agency Standard and Poor's, the failure to take policy action in relation to age-related spending would be disastrous for Australia's and the western world's credit rating. Without action, Australia would plummet from AAA status down to A by 2030 and lower beyond that should we do nothing to ease the fiscal burden of our aging population.

While we've been reasonably good at public policy regarding saving for retirement we don't yet have a strong track record in managing these risks.

Fortunately, the Government currently has a 1 in 20 year reform opportunity with the Cooper and Henry Reviews opening the door for structural improvements to the post-retirement phase of superannuation. While we've all heard a lot about fees and contribution levels, we need to start understanding more about asset allocation
Appropriate asset allocation and management of longevity risk is currently a major blind spot in our retirement incomes policy
Our government has a major opportunity for reform to improve retirement incomes and a fiscal imperative to act.

Certainly, the early signs are good with the Chairman of the Super System Review, Jeremy Cooper focussed on removing from our super system any unnecessary costs, fees, commissions and complexity, and boosting returns and retirement incomes.

It's difficult to conceive of a product more suited to this brave new world than a simple annuity, which carries:

- No product or investment management fees
- No complexity – there are no expensive bells and whistles - just guaranteed cash flows from an A rated, APRA-regulated Life company
- Strong returns – our term-certain annuities offer returns greater than bond funds. Current rates are in excess of 7%
- Higher retirement incomes – importantly, our Henry Submission to government includes analysis from both Towers Perrin and Watson Wyatt demonstrating competitively priced lifetime annuities can provide higher and much more sustainable average retirement incomes.

Certainly, it seems that the simple virtues of annuities are being appreciated once again, as our recent annuities sales experiences reveal. On the chart you can see Challenger's annuity sales from December 2004 (which was after the last change to the asset test exemptions) to the present, on a quarterly basis. If you adjust for the two external factors highlighted,

- the final changes to social security legislation in September 2007 which created a one month sales spike; and
- the effect of the GFC, which slowed sales of almost every financial product except Government guaranteed deposits,

You can see sales have been steadily rising (off what was originally a low base) for 5 years. If you fit a line to this growth it has been running at more than 30%.

Challenger currently has a number of initiatives in progress intended to increase the growth rate of annuity sales in the future. Firstly focussing on organic growth, many of you will have seen a few weeks ago the product launch of our new annuity product the Guaranteed Income Fund on the BT wrap platform.

In addition to this we have recently also launched the product on the Macquarie wrap platform and over the next six months I hope to be able to announce these products on a number of other platforms.
As I have mentioned earlier Challenger, has launched a marketing and advertising campaign to increase the profile of annuities and begun to educate people on the benefits of the product and to dispel many of the myths that have commonly surrounded them.

Finally, Challenger has initiated an increase in its distribution teams to focus on the significant new distribution channels. Our Business Development Managers are gearing up for a fourfold increase in conversations with Planners and Dealer Groups
I have taken up much of our time here today on Annuities however this is important as it is a very relevant product to a fast growing demographic that has the potential to be transformational for Challenger

And so, to recap, Challenger now has an enviable cash and capital position, thanks to swift and early action prior to the onset of the GFC

We have significant future growth opportunities in the investment management industries in which we now specialise. In particular, the retirement income segment is growing rapidly due to our ageing population, and we have solid positioning as the leading annuities provider in the country.

There is international consensus on the role for annuities in retirement income portfolios and planning. There exists the potential for Challenger to lead the debate on appropriate superannuation policy reform. We are committed to putting the case for guaranteed fixed income products to government and the broader investment management industry.

We are passionate about the post retirement space not just because we are specialists, but because the logic of what Challenger is suggesting is compelling for not only the retiree but for the Australian Government as well.

Thank you and I’ll now hand back to your Chairman Peter Polson.

Challenger AGM

Chairman – Peter Polson

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Dominic Stevens

Chief Executive Officer

Challenger Annual General Meeting 2009

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Resilience through the GFC

- Swift and early action
- Underlying earnings remain strong
- No discounted dilutive equity issuance
- Sale of Mortgage Management
- Streamlined and focussed strategy
- Capitalising on Investment Management tailwinds

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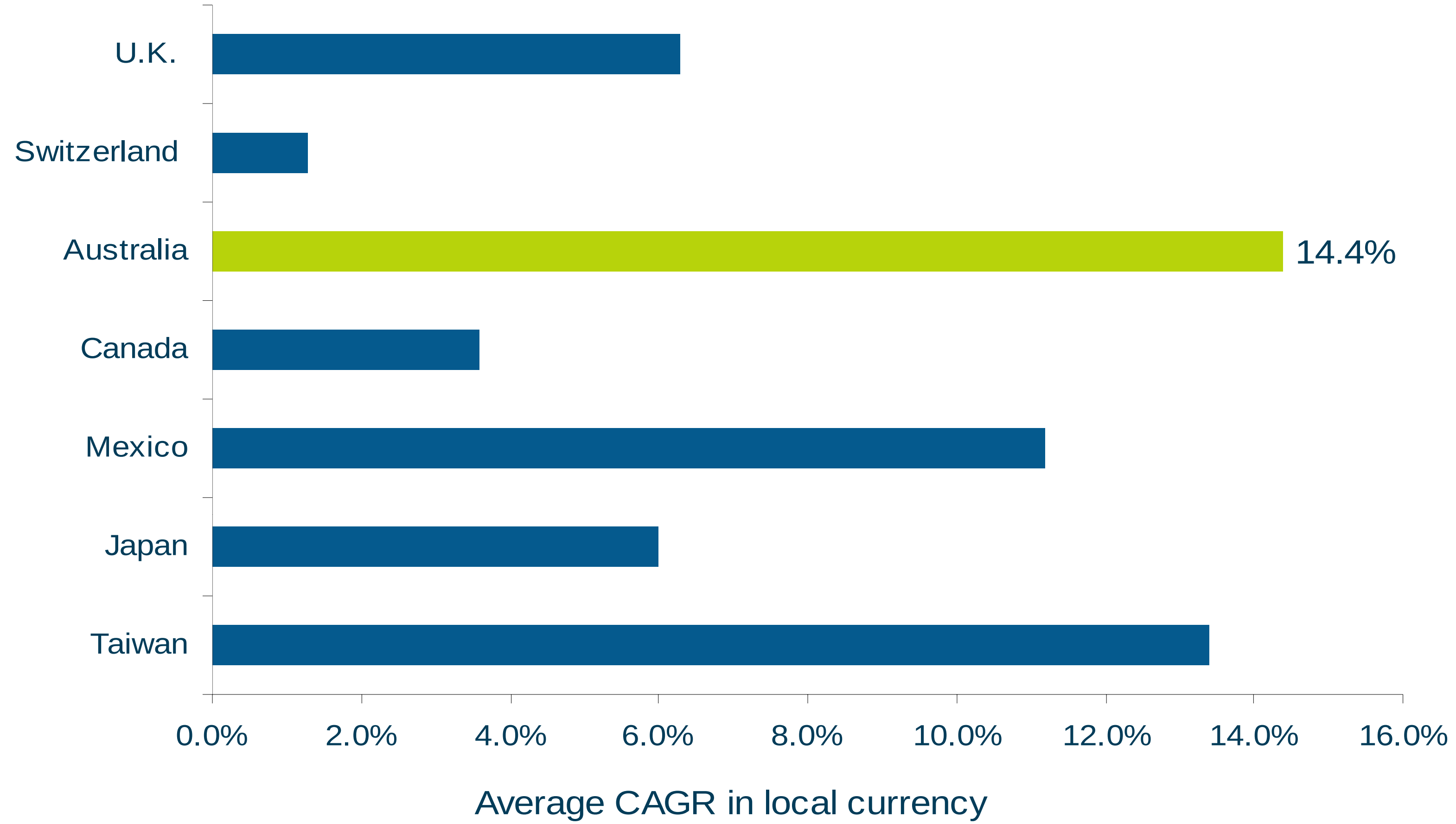
Mandated growth in investment management



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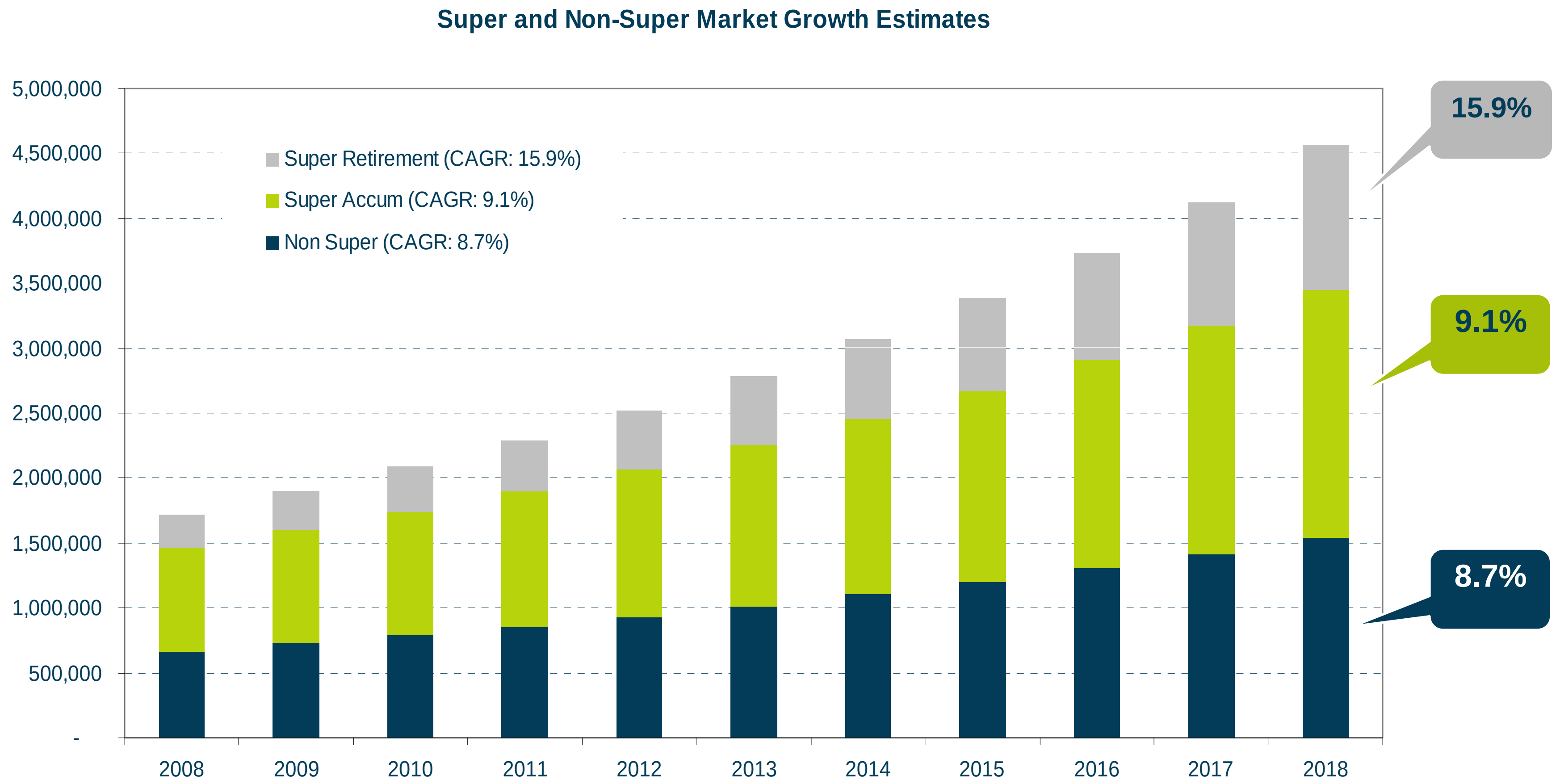
Source: Watson Wyatt /Pensions + Investments global 300 ranking 2009,
2003 -2008 average annualised growth by country.

Post-retirement is growing faster



Source: Challenger estimates based on DEXX&R Market Projections Report 2009-2019 (Nov 2009); Rainmaker Superannuation Projections 2008-2019 (Dec 2008).

The importance of annuities

- Focus of debate
  - Retirement age and beyond
  - Tolerance for risky assets in retirement
- As we age our risk tolerance reduces
- Accepted globally, less locally however
  - John Bogle, Vanguard – ideal system includes mandatory annuity
  - IMF – Australia over-allocated to equities in retirement
  - OECD – Government should encourage retirees to purchase annuities
  - Putnam – Limit or cap allocation to equities from 55 years
  - Prudential - "Retirement Red Zone"
  - Mercer MCFS – part of benefit must be taken as income stream

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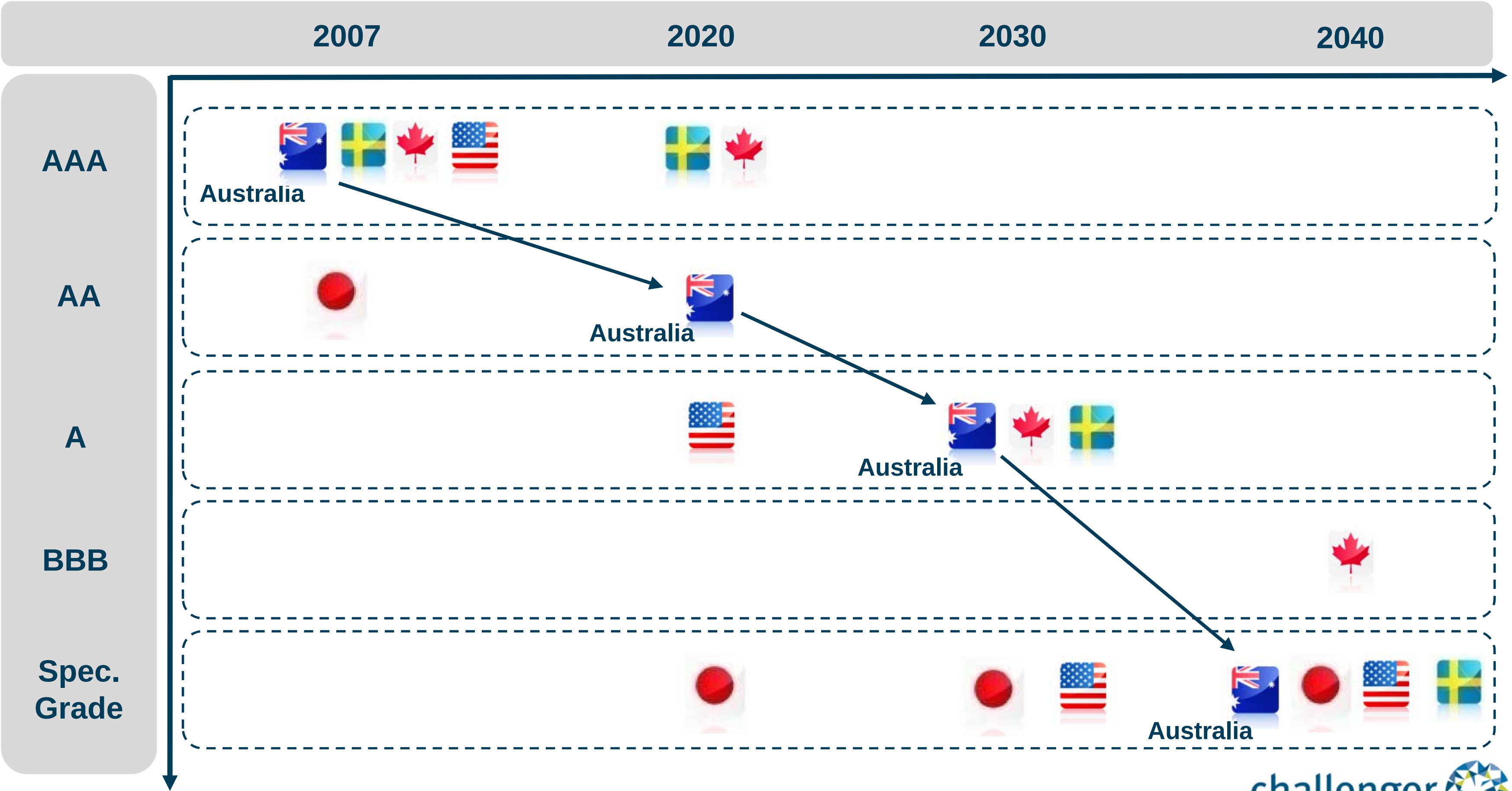
The need for policy action to address ageing populations

Hypothetical Ratings Outcomes under No Policy Change Scenario



Source – S&P Global Graying Report 2007

The relevance of annuities

"This will be the first comprehensive review into Australia's compulsory $1.1 trillion superannuation system, focussed on removing unnecessary costs, fees, commissions and complexity and boosting returns and retirement incomes".

Jeremy Cooper, Deputy Chairman of ASIC

✓	• no product fees
✓	• no complexity
✓	• strong returns
✓	• secure income

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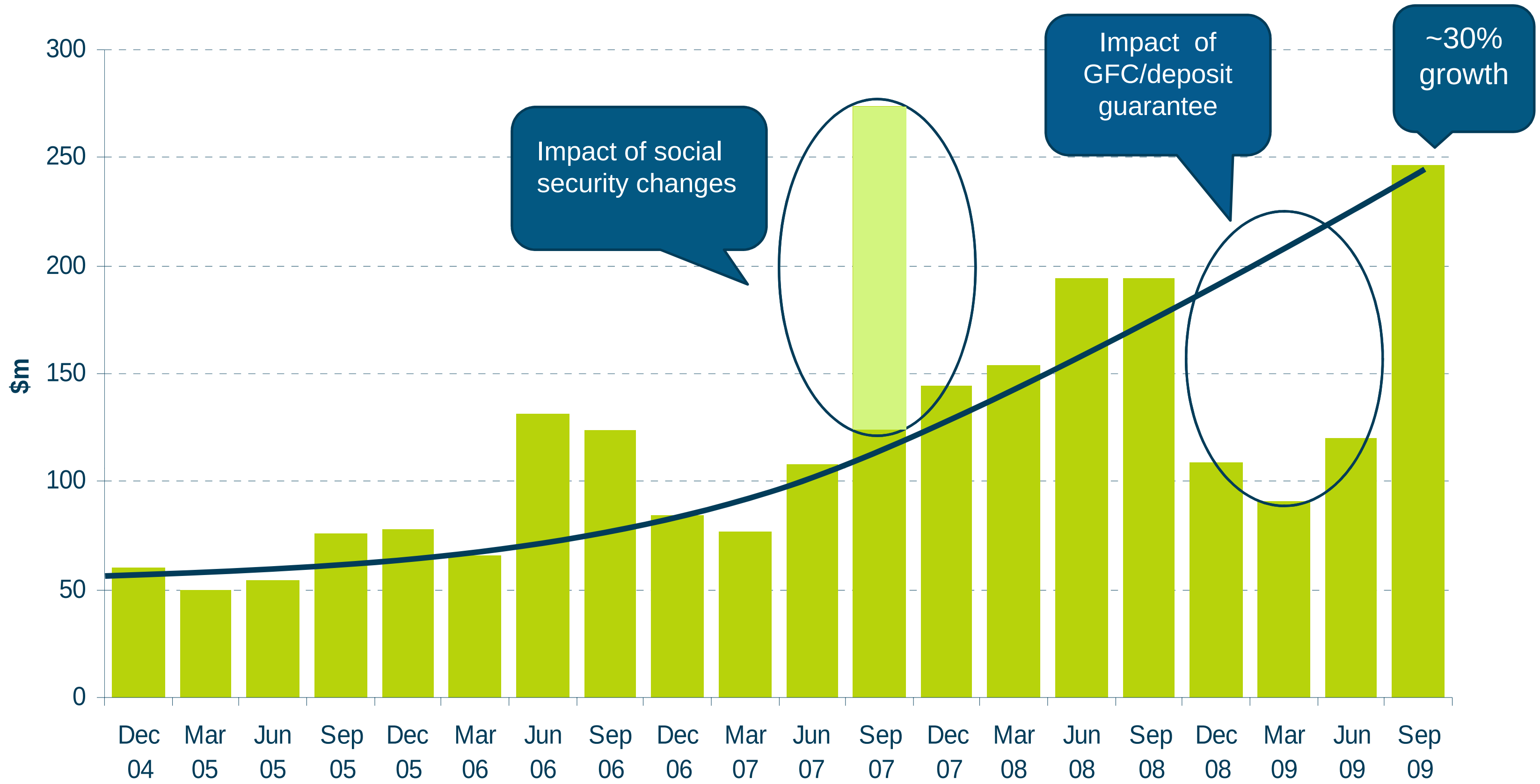
Challenger annuity sales growing



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The opportunity

- We have an enviable cash and capital position
- Significant future growth opportunities in Funds Management and Life
- In Life, market leadership and growing sales in annuities
  - a relevant product for the new environment
  - an internationally accepted solution for major public policy challenges facing Australia

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