

Challenger Financial Services Group

The retirement income opportunity

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Chief Executive Officer
20 October 2009

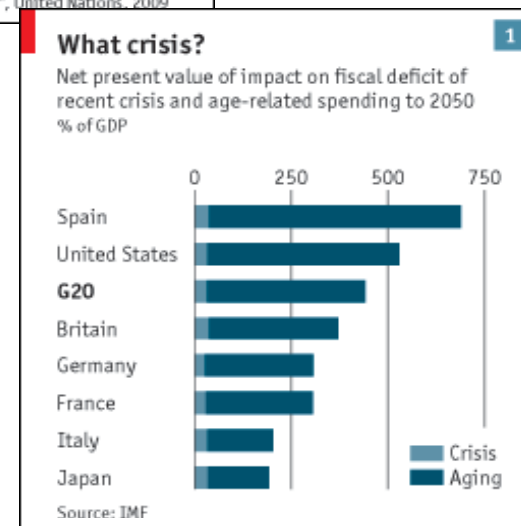
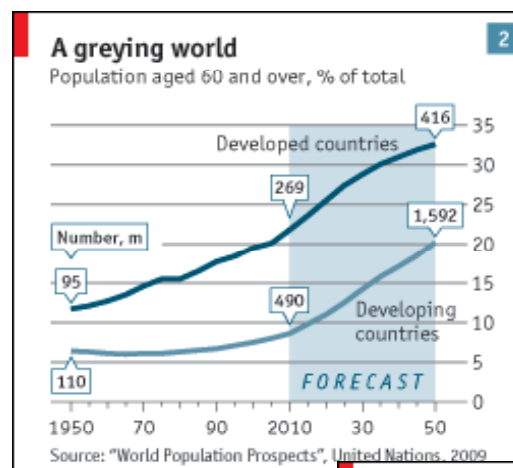


Agenda

- Significance of demographic changes in the retirement income market
- Organic growth developments
- Product and distribution initiatives
- Growing sustainable earnings
- Capital and balance sheet management
- Summary







The significance of demographic change

- At present, developed countries on average have about four people of working age for every person over 65. By 2050 this reduces to only two workers for every pensioner
- Australia faces similar demographic changes to other OECD nations
 - When pension at 65 yrs was introduced in 1909 average male life expectancy was 55 yrs – today it is 80 yrs
 - 2010 is the first year that baby boomers retire (1945 + 65 = 2010)
 - 1969 (8%); 2009 (13%); 2049 retiree segment to almost double (22%) in 40 years
- Total cost of managing an aging population is far greater than the cost of the GFC



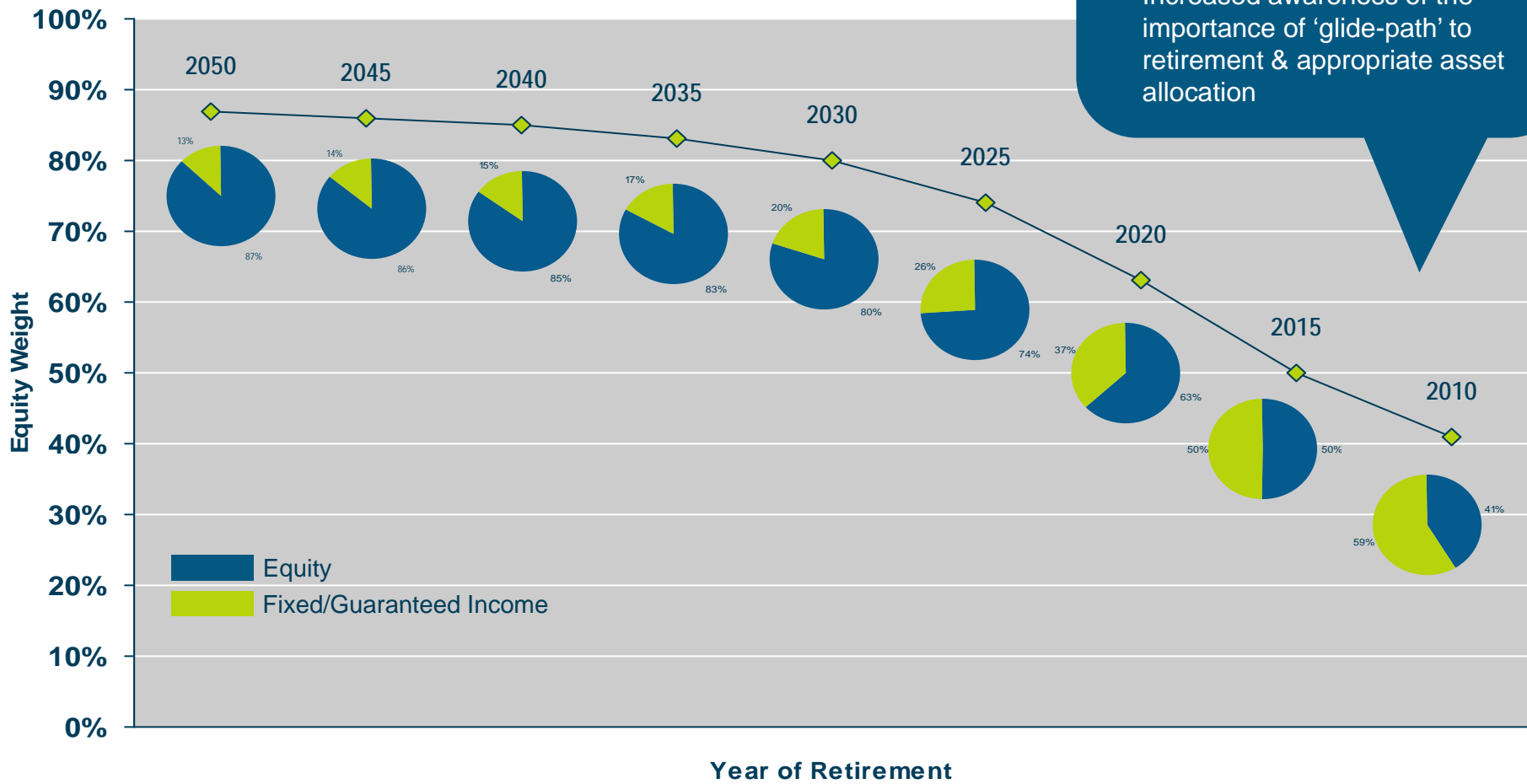
OECD 2009 Report

5. Scale of impact of the crisis on retirement-income provision by age group

		Age Group		
		Younger/prime-age	Nearing retirement	Retired
<div style="background-color: red; height: 100px; width: 100%;"></div> <div style="background-color: yellow; height: 100px; width: 100%;"></div> <div style="background-color: green; height: 100px; width: 100%;"></div>	Strong impact		<p>Individuals with long periods in defined-contribution, private plans</p> <p>Especially if heavily exposed to riskier assets</p> 	<p>Individuals who did not take an annuity on retirement</p> <p>Especially if heavily exposed to riskier assets</p> 
	Moderate impact		<p>Individuals in defined-benefit, private plans</p> <p>Especially if plan have solvency problems</p>  <p>In some public schemes</p> <p>Especially where public pension spending is high</p>  <p>Also where old-age safety nets are weak</p> 	<p>Retirees in schemes with automatic adjustment of benefits</p> 
	Little impact	Most individuals	Many individuals	Most retirees (with public or private pensions)

Glide path to retirement

- 2010 baby-boomers begin retiring
- Risk appetite is changing
- Reduced equity focus in retirement
- Increased awareness of the importance of 'glide-path' to retirement & appropriate asset allocation



OECD – global annuity markets

Figure 1: Schematic representation of selected annuity markets



Dispelling myths about annuities

- **Myth #1 – annuities are expensive**



- Facts:
 - Annuities are nil MER
 - Commissions to IFAs are low ~50bps

- **Myth #2 – annuities offer poor investment returns**



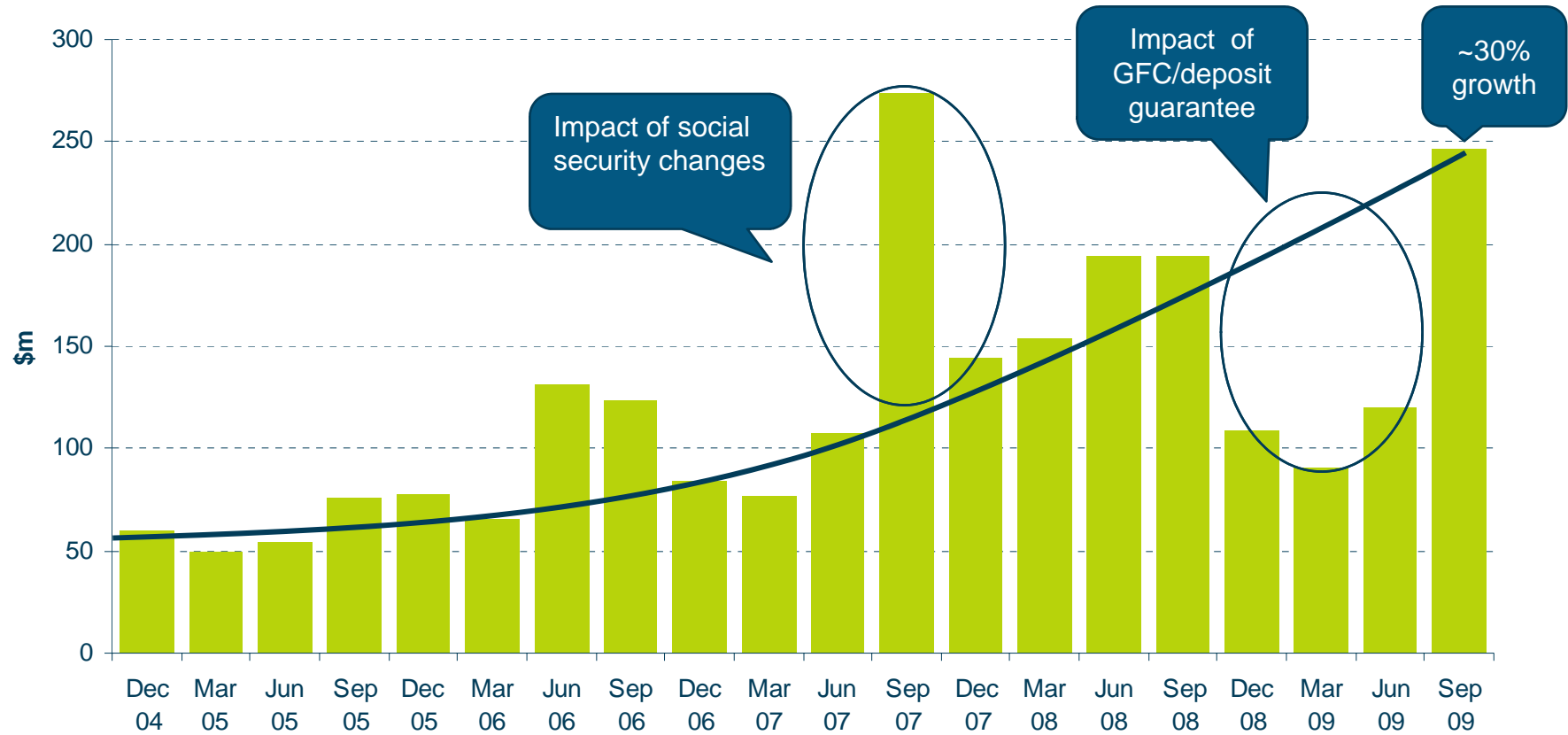
- Facts:
 - Returns significantly above cash or government bond rates
 - 7 year annuity currently offers circa 7.0%

- **Myth #3 – annuities are complicated / tax driven**



- Facts:
 - Capital protection, guaranteed income stream
 - Simple product offering regular monthly/quarterly cash flows

Underlying organic annuity sales growing



Expanded product & distribution footprint

- Significant work undertaken in the last 9 months to develop a platform 'friendly' annuity product in unitised form to meet market demand
- Challenger Guaranteed Income Fund (GIF) represents an innovative annuity based retirement income product
- GIF now available on BT Wrap's Administration Platform
 - 54 badged platforms
 - 5,600 planners
- Strong interest with other key platform partners for this product

Increased marketing and advertising

- Challenger No.1 in the annuities market
- Initiated new marketing and advertising campaign earlier this month
- Raise awareness with customers and financial planners of key issues
- Dispel 'myths' about annuities

Protecting your super from losses is no longer a challenge.

Knowing your super will last is no longer a challenge.

Taking the risk out of retirement is no longer a challenge.

Protecting your super from management fees is no longer a challenge.

Challenger annuities
Capital and Income-guaranteed.
High fixed rates. No product fees.

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Not In Annuities

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Potential for regulatory tailwinds

Date	Government	Industry
Oct 2008	<ul style="list-style-type: none"> Initial submission to Henry Review raising longevity and mandatory annuitisation as a possible response 	
Mar 2009	<ul style="list-style-type: none"> Main submission to Henry Review on Retirement Incomes Policy <ul style="list-style-type: none"> Challenger on international pension arrangements and problem of excessive market risk Towers Perrin on retirement income modelling, longevity risk and impact of compulsion Access Economics on impact on fiscal position Challenger on targeting Most comprehensive submission, which now leads public debate 	<ul style="list-style-type: none"> Appeared before Henry Panel as part of IFSA delegation Member of IFSA Henry Working Group
Jun 2009	<ul style="list-style-type: none"> Member of Henry Review Industry Reference Group on Longevity 	<ul style="list-style-type: none"> Challenger addressed Investment and Financial Services Association (IFSA) conference Challenger addresses NSW Uni Colloquium on Superannuation
Aug 2009	<ul style="list-style-type: none"> Third submission on key issues raised: <ul style="list-style-type: none"> Voluntary or mandatory Guaranteed or non-guaranteed Private or public provision Watson Wyatt on the UK experience 	<ul style="list-style-type: none"> Challenger addresses conferences: <ul style="list-style-type: none"> Australian Super Investment (ASI) Association of Financial Advisors (AFA) Association of Super Funds of Australia (ASFA)

Retirement income opportunity

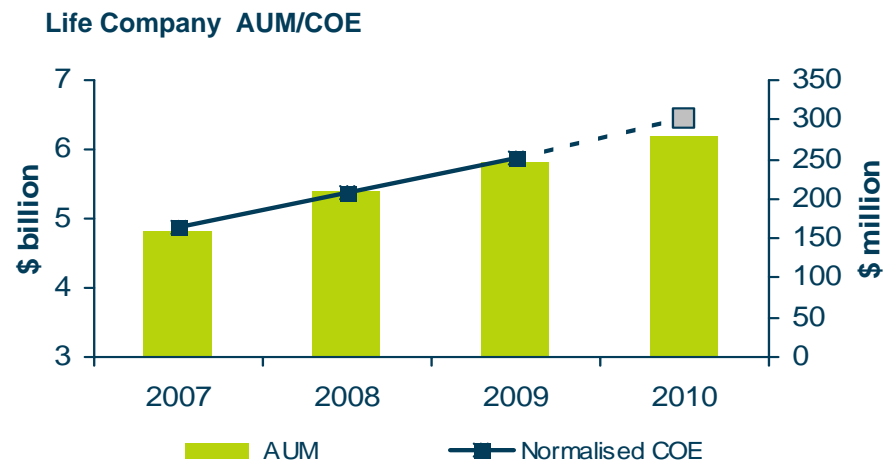
- Underlying demographic trends and change in risk appetite underpin organic book growth

- Expanded distribution footprint via platforms
- Innovative annuity-based product via GIF
- Increased marketing and advertising

- Expanded product offerings
- Potential for positive regulatory tailwinds
- Incremental book purchases – domestic and offshore

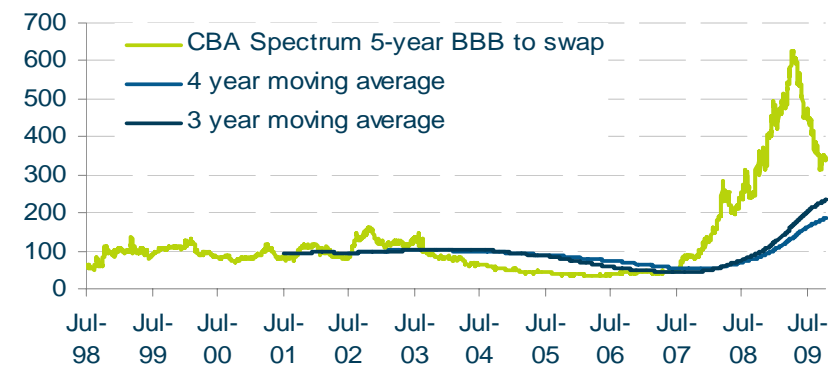
Sustainable earnings profile

- COE guidance of \$300m – FY10
- COE spread of ~5.0% sustainable over the medium term
- Challenger's assets purchased over time
 - Average spreads over time are key driver
 - Spreads will remain elevated for some time
- Property assets cash yield increases 2.5 – 3% p.a.
- Opportunities in markets that are 'out of favour'



Note: 2010 AUM – spot as at 30 September 09; \$300m COE guidance

Illustrative - long term average spreads

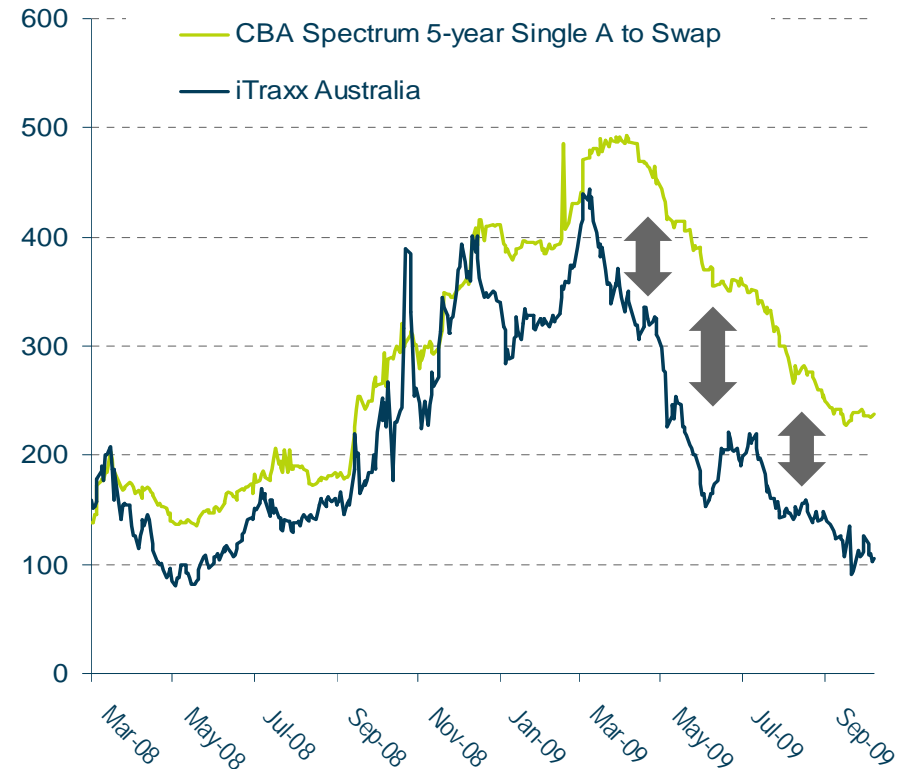


Source: CBA, Challenger

Putting capital to work – reinvestment of cash

- In last two months ~\$500m of cash balances have been reinvested in accretive assets at high margins
- Liquidity spread between cash bonds and derivatives around 150bps
- Longevity risk on AXA portfolio reinsured effective Sep 09 – assets currently providing greater returns on released capital

Cash bond spreads contracting but still historically wide



Source: CBA, Bloomberg

Capital & balance sheet management

- No requirement to undertake dilutive equity issues during GFC
- Net cash at group expected to be ~\$350m following completion of mortgage management sale to NAB¹
- Group borrowings to be repaid in full
- Surplus capital in Life ~\$800m as at 30 Sept 09:
 - accretion as positive mark-to-market impacts add to organic earnings; and
 - longevity risk from AXA portfolio reinsured effective Sept 09
- On-market buy-back continuing:
 - 47.1m shares repurchased at an average of less than \$2.00 delivering significant accretion in EPS for shareholders
 - Seeking approval at AGM on 12 November to refresh headroom and provide CGF with the ability to acquire up to another 10% of issued capital

Summary

- Growing franchise in the retirement income sector
 - Number 1 annuity provider in Australia
- Underlying book growing organically driven by:
 - Demographic trends
 - Favourable trends to risk aversion
 - Broader distribution footprint – extended via administration platforms
- Regulatory changes may provide further positive tail-winds
- May seek incremental books to supplement growth (both on and off-shore)
- Expanding cash operating earnings
 - Putting excess cash and cash equivalents to work in the Life business through reinvestment
 - Current blended portfolio risk premiums of assets expected to remain
 - Normalised COE spread of ~5.0% sustainable over the medium term
- Surplus capital continuing to accrete ~\$800m at 30 Sept 09
 - Capital headroom to pursue organic growth and investment opportunities