Market Release

01 December 2023

AASB 17 Update

Challenger Limited (ASX:CGF) is today holding its AASB 17 investor briefing, beginning at 9:30am (Sydney time).

The briefing will be held online via a webcast that can be accessed at the following link.

A copy of the presentation that will be delivered today by Challenger's Chief Financial Officer Alex Bell is attached.

ENDS

This release has been authorised by Challenger's Continuous Disclosure Committee.

About Challenger

Challenger Limited (Challenger) is an investment management firm focused on providing customers with financial security for a better retirement.

Challenger operates a fiduciary Funds Management division, an APRA-regulated Life division and an APRA regulated authorised deposit-taking institution. Challenger Life Company Limited is Australia's largest provider of annuities.

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AASB 17 Update

Alex Bell
Chief Financial Officer

O1 DECEMBER 2023

ACKNOWLEDGEMENT OF COUNTRY

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.

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Agenda

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Key messages

Does not impact normalised profit, cash generation or dividend policy

- AASB 17 Insurance Contracts is a change of accounting standard for insurance contracts effective for financial years beginning on or after 1 January 2023 (1 July 2023 for Challenger)
- The new standard does not change the economics of the underlying business[1] but does affect timing of statutory profit recognition
- Not impacted by AASB 17:
  - Accounting for investment contracts (~70%[2] of Annuity book)
  - Accounting of non-insurance businesses (Funds Management, Bank, JVs)
- No change to normalised profit reporting framework

Business Strategy

No change to business operations

APRA Capital

No change to regulatory capital calculations[3]

Cash and Dividend

No impact to dividend policy or cash generation[4]

Profits

No impact on normalised profit, but statutory profit will be more sensitive to interest rate changes[5]

1. Except from second order effects due to tax timing.
2. As at 30 June 2023.
3. During APRA's consultation period on impacts arising from the implementation of AASB 17, APRA had an overall objective of keeping capital levels across the industry broadly unchanged. However, there may be second order impacts on the capital position from tax timing effects. Initially adopted tax treatments are subject to ATO review.
4. Other than tax timing effects.
5. Due to mismatch between locked-in discount rates used for Contractual Service Margin and current discount rates used for Fulfilment Cash Flow comprised of Risk Adjustment and Best Estimate of Liability.

Key messages – AASB 17 impact

KPIs and line items impacted by AASB 17

Impacted by AASB 17

Life insurance liabilities

Increase in CLC's insurance policy liabilities resulting in a reduction in net assets

Statutory NPAT

Impact to timing of profit/loss recognition and will be more sensitive to interest rate changes[1]

Normalised ROE

Small reduction in net assets from increase in insurance policy liabilities

Investment Experience

Movements in policy liabilities recognised in investment experience

Not impacted by AASB 17

- Life investment liabilities (term annuities) – AASB 17 applies to insurance contracts only
- Life Investment Assets
- Normalised COE
- CLC PCA Ratio – No change to regulatory capital calculations[2]
- Normalised NPBT
- Normalised COE Margin

1. Due to discount rate mismatch on Contractual Service Margin and Fulfilment Cash Flow.
2. During APRA's consultation period on impacts arising from the implementation of AASB 17, APRA had an overall objective of keeping capital levels across the industry broadly unchanged. However, there may be second order impacts on the capital position from tax timing effects. Initially adopted tax treatments are subject to ATO review.

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Key concepts – Life insurance liabilities

AASB 17 introduces concepts of a Risk Adjustment (RA) and Contractual Service Margin (CSM) as part of the insurance contract liability

AASB 1038 (MoS)

AASB 17

- CSM valued at locked-in discount rate from inception
- Release based on coverage units (vs. MoS profit carrier)
- At initial recognition, a CSM is established such that there is no recognition of profits at day 0 which is similar to MoS PVFP

- New component representing the amount to compensate for uncertain liability cash flows

- Probability-weighted estimate of future cash flows to fulfil the contract
- Discounted to allow for the time value of money
- Only fully attributable expenses allowed for in cash flow

1. MoS = Margin on Service
2. PVFP = Present Value of Future Profit
3. BEL = Best Estimate of Liability
4. CSM = Contractual Service Margin
5. FCF = Fulfilment Cash Flows
6. RA = Risk Adjustment
7. PVFCF = Present Value of Fulfilment Cash Flows

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Challenger's contracts in scope of AASB 17

All Life insurance contracts will adopt the General Measurement Model (GMM)

Investment contracts (fixed term annuities), that represent a large component of policy liabilities are unaffected

Life contract liabilities

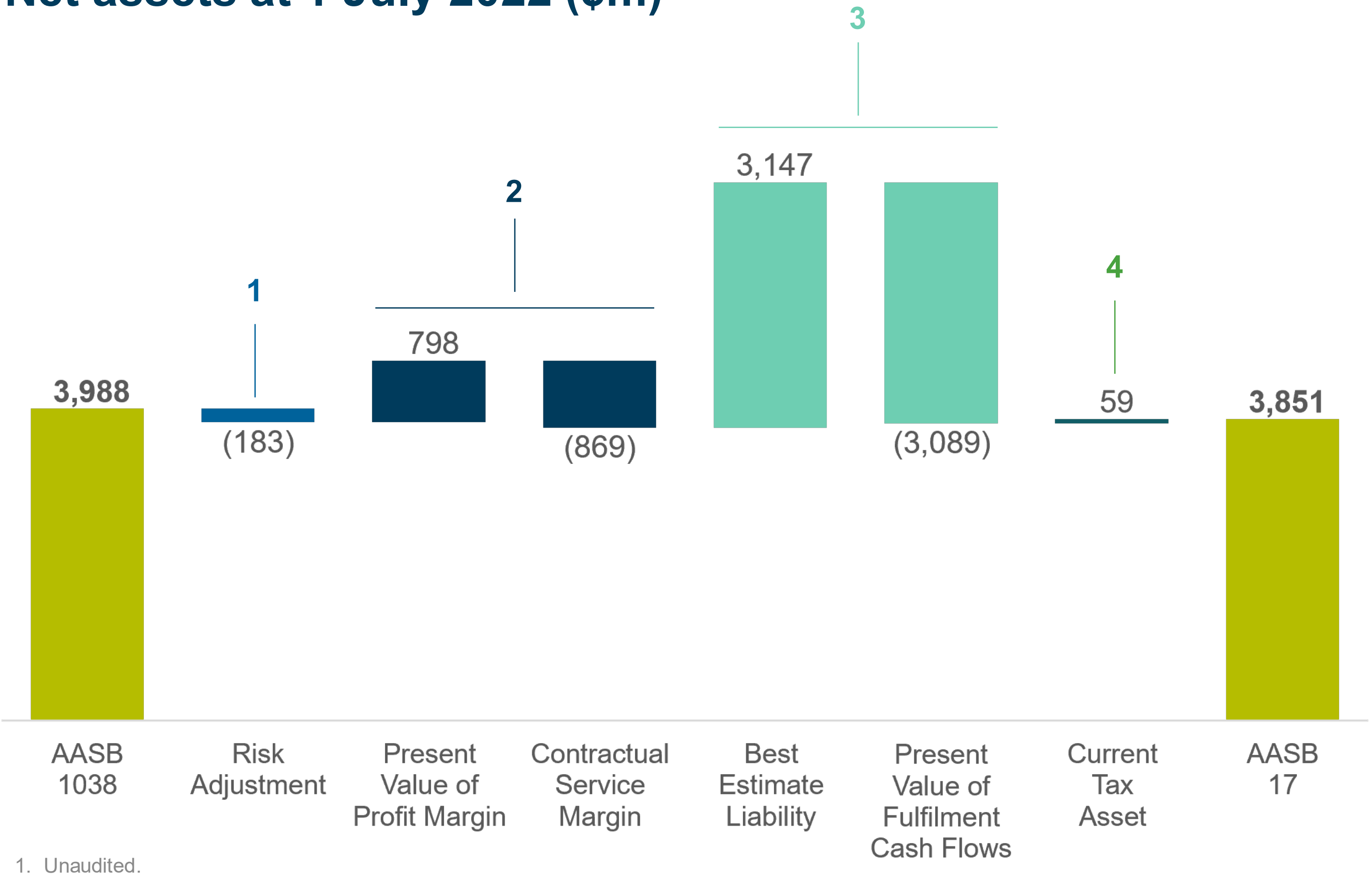
30 June 2023	AASB 1038 $m	%	AASB 17[2] $m	%	Change $m	AASB 17 implication
Life investment liabilities - Fixed term annuity[1]	**9,855**	**71**	**9,855**	**69**	**-**	• **Not in scope - no impact**
Life insurance liabilities	**4,075**	**29**	**4,437**	**31**		
Lifetime annuity – onerous	3,764	28	3,792	26	+28	• Day 1 increase in Policy Liability due to introduction of a Risk Adjustment
Lifetime annuity – non-onerous	187	1	262	2	+75	• Previously reported as part of larger onerous Lifetime annuity group • Expected to have positive CSM • Profit more sensitive to changes in interest rates • Profit affected by timing of revenue recognition due to locked-in rates for CSM and current rates for PVFCF
Life Risk (longevity swaps) – non-onerous	124	-	383	3	+259	• Expected to have positive CSM • Profit more sensitive to changes in interest rates • Profit affected by timing of revenue recognition due to locked-in rates for CSM and current rates for PVFCF
Total Life contract liabilities	**13,930**	**100**	**14,292**	**100**	**+362**	
Net asset impact (after tax)					**(253)**	

1. Accounted for under AASB 9 *Financial Instruments*.
2. Unaudited.

Transition impact – net assets

Net assets decrease $137 million at 1 July 2022 due to higher Life insurance liabilities

Net assets at 1 July 2022 ($m)



Key drivers of change in Life insurance liability[1,2]:

1. Introduction of a new AASB 17 Risk Adjustment -$183m
2. Removal of the AASB 1038 (MoS) profit margin, which is replaced by the new AASB 17 CSM -$71m
3. Impact of calculating BEL under AASB 1038 compared to AASB 17 PVFCF $58m
4. Tax treatment unchanged for AASB 17, CTA impact reflects 30% of change in policy liability $59m

1. Unaudited.
2. Standard effective date for Challenger is 1 July 2023.

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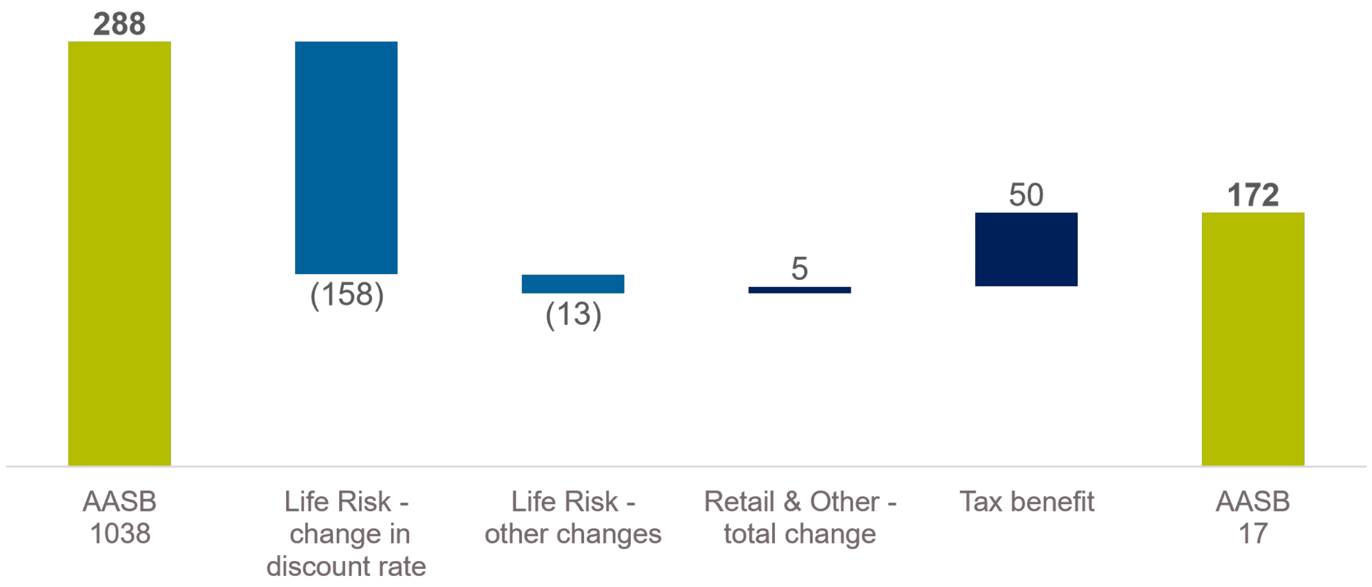
Comparative period impact – adjustment to statutory NPAT

FY23 statutory NPAT decreases $116 million due to changes in valuation of Life Risk liabilities which will unwind over time

Statutory NPAT ($m)



In addition to the transition impact, Challenger's net assets are expected to decrease by $116 million[1] (net of tax) on 1 July 2023[2], reflecting an increase in Life insurance liabilities during FY23

Key drivers of change in FY23 statutory NPAT:

- Higher UK interest rates increased the Life Risk policy liability due to accounting mismatches (CSM at locked-in rates versus PVFCF at current rates) within the liability calculation -$158m
- Tax treatment unchanged for AASB 17, tax benefit recognised at 30% of change in policy liability $50m

1. Unaudited.
2. Standard effective date for Challenger is 1 July 2023.

Comparative period impact – KPIs

Most Key Performance Indicators (KPIs) are not impacted by AASB 17

KPI	1H23 AASB 1038	1H23 AASB 17[3]	Change	FY23 AASB 1038	FY23 AASB 17[3]	Change	Comment
NOT IMPACTED BY AASB 17							
Normalised NPBT	$250m	$250m	-	$521m	$521m	-	
Normalised COE Margin	2.76%	2.76%	-	2.82%	2.82%	-	
Life Investment Liabilities[1]	$10,320m	$10,320m	-	$9,856m	$9,856m	-	
Life Investment Assets[2]	$23,085m	$23,085m	-	$23,538m	$23,538m	-	
IMPACTED BY AASB 17							
Statutory NPAT	$123m	$31m	($92m)	$288m	$172m	($116m)	Reduction due to timing of profit/loss recognition
Normalised ROE (pre-tax)	12.3%	12.8%	0.5%	12.7%	13.3%	0.6%	Increase on transition due to reduction in net assets (increase in policy liability)
Total Life Book Growth	5.5%	5.4%	(0.1%)	5.2%	5.1%	(0.1%)	Slight decrease due to higher liability (more significant at transition than ongoing)
Life Insurance Liabilities[1]	$3,959m	$4,286m	$327m	$4,075m	$4,437m	$362m	Increase in Life insurance liabilities
Group net assets	$4,048m	$3,819m	($229m)	$4,164m	$3,911m	($253m)	Decrease due to increase in Life insurance liabilities
CLC PCA ratio	1.59x	1.64x	0.05x	1.59x	1.65x	0.06x	Driven by assumption that tax treatment on policy liability movements is unchanged. ATO is yet to issue guidance for life insurers

1. Life annuity book is comprised of both Life insurance liabilities and Life investment liabilities.
2. Closing assets.
3. Unaudited.

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Statutory profit considerations arising from AASB 17

New treatments and concepts introduced by AASB 17
Statutory profit can be more variable

AASB 17 change	Impact on profit	Comments
Risk adjustment		• The release of RA from in force business increases profit relative to AASB 1038, however, the net impact depends on whether onerous portfolio is growing or not
Expected CSM release	Similar to MoS	• Release of CSM expected to have a similar pattern to MoS
Discount rate	Creates variability with movements in current rates	• Discount rate for CSM is fixed at contract inception • RA and FCF are discounted at current rates • Mismatch in discount rates drives variability when current rates move • When assumptions change, the CSM movement does not exactly offset RA & FCF movement – it can be higher or lower depending on relative levels of interest rates between contract inception and date of assumption change
Assumptions	Timing of profit recognition for non-onerous contracts	• For **onerous** contracts there is no change. Impact of non-financial assumption changes are recognised in the current year under both AASB 17 and AASB 1038 • For **non-onerous** contracts, impact of non-financial assumption changes will be recognised in current year as well as future years under AASB 17. Under AASB 1038, the impact would only be recognised in future years
Experience adjustments	Timing of profit recognition	• For **onerous** contracts there is no change. Impact of experience adjustment are recognised in the current year under both AASB 17 and AASB 1038 • For **non-onerous** contracts, impact of experience adjustment will be recognised in current year as well as future years under AASB 17. Under AASB 1038, the impact would only be recognised in the current year

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Case study – Life Risk business

Some statutory profit anomalies can arise due to new treatments and concepts introduced by AASB 17

Example

- Life Risk contracts entered into at times of low UK interest rates (CSM discount rate locked-in at low levels)
- Current UK interest rates are higher than average locked-in rates[1]
- UK mortality rates increasing relative to assumptions
  - Higher expected deaths result in lower expected payments for the Life Risk portfolio and higher projected net cash inflows / future profits

AASB 17 requirement

- Future cash flows valued at current rates (present value is an asset due to future expected premiums exceeding future claims and expenses)
- Future profits or CSM valued at locked-in rates (present value is a liability)
  - Expected future profits capitalised and released over time
- Assumption change results in offsetting cash flows within future cash flows (asset) and CSM (liability)

Impact

- Increase in liability greater than increase in asset (due to discount rate mismatch)
- Overall reduction to current year statutory profit rather than an expected increase to profit from higher mortality rates

1. UK 10-year yield curve ~2% higher as at 30 June 2023 compared to prior comparable year.

Key messages

Business Strategy

No change to how business operates

APRA Capital

No change to regulatory capital calculations[1]

Cash and Dividend

No impact to dividend policy or cash generation[2]

Profits

No impact on normalised profits, but statutory profit may be more sensitive to interest rate changes[3] driving increased variability

1. During APRA's consultation period on impacts arising from the implementation of AASB 17, APRA had an overall objective of keeping capital levels across the industry broadly unchanged. However, there may be second order impacts on the capital position from tax timing effects. Initially adopted tax treatments are subject to ATO review.
2. Other than tax timing effects.
3. Due to mismatch between locked-in discount rates used for Contractual Service Margin and current discount rates used for Fulfilment Cash Flow comprised of Risk Adjustment and Best Estimate of Liability.

Appendix

Glossary

Term	Description
AASB 17	Australian Accounting Standard AASB17 Insurance Contracts, which incorporates IFRS 17 Insurance Contracts as issued and amended by the International Accounting Standards Board (IASB). The Standard applies to annual periods beginning on or after 1 January 2023
BEL	Best estimate liability under Margin on Services (MoS) basis as required by AASB 1038
Contractual Service Margin (CSM)	A component of the carrying amount of the liability (or asset) for a group of insurance contracts representing the unearned profit the entity will recognise as it provides insurance contract services under the insurance contracts in the group
Fulfilment Cash Flows (FCF)	An explicit, unbiased and probability-weighted estimate (i.e. expected value) of the present value of the future cash outflows minus the present value of the future cash inflows that will arise as the entity fulfils insurance contracts, including a risk adjustment for non-financial risk
General Measurement Model (GMM)	The general measurement model is the default measurement approach for insurance contracts under AASB 17 and measures a group of insurance contracts as the sum of the fulfilment cash flows and a contractual service margin
MoS PVFP	Present value of future profits under Margin on Services (MoS) basis as required by AASB 1038
Risk adjustment (RA)	The compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils insurance contracts

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Disclaimer

The material in this presentation is general background information about Challenger Limited group's activities and is current at the date of this presentation. It is information given in summary form and does not purport to be complete. It is not intended to be relied upon as advice to investors or potential investors and does not take into account the investment objectives, financial situation or needs of any particular investor. These should be considered with professional advice when deciding if an investment is appropriate.

Challenger also provides statutory reporting as prescribed under the Corporations Act 2001.

The 2023 Annual Report is available from Challenger's website at www.challenger.com.au/shareholder.

This presentation is not audited. Any restatement of prior period results to AASB 17 results has not been subject to external review and is subject to change following a review by Challenger's external auditors, Ernst & Young. In addition, there is inherent uncertainty surrounding the interaction between tax laws and the implementation of AASB 17. The information in this presentation may be subject to change as tax laws are legislated and new regulations are issued. The statutory net profit after tax has been prepared in accordance with Australian Accounting Standards and the Corporations Act 2001. Normalised net profit after tax has been prepared in accordance with a normalised profit framework. The normalised profit framework has been disclosed in the Operating and Financial Review section of the Directors' Report in the Challenger Limited 2023 Annual Report. Any additional financial information in this presentation which is not included in the Challenger Limited 2023 Annual Report has not been subject to independent review by Ernst & Young.

This document may contain certain 'forward-looking statements'. The words 'forecast', 'expect', 'guidance', 'intend', 'will' and other similar expressions are intended to identify forward-looking statements. Forecasts or indications of, and guidance on, future earnings and financial position and performance are also forward-looking statements. You are cautioned not to place undue reliance on forward looking statements. While due care and attention has been used in the preparation of forward-looking statements, forward-looking statements, opinions and estimates provided in this announcement are based on assumptions and contingencies which are subject to change without notice, as are statements about market and industry trends, which are based on interpretations of current market conditions. Forward-looking statements including projections, guidance on future earnings and estimates are provided as a general guide only and should not be relied upon as an indication or guarantee of future performance and may involve known and unknown risks, uncertainties and other factors, many of which are outside the control of Challenger. Actual results, performance or achievements may vary materially from any forward-looking statements and the assumptions on which statements are based. Challenger disclaims any intent or obligation to update publicly any forward-looking statements, whether as a result of new information, future events or results or otherwise.

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Unless otherwise indicated, all numerical comparisons are to the prior corresponding period.

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