Market release

Challenger Limited

02 May 2019

MACQUARIE AUSTRALIA CONFERENCE 2019 SPEAKING NOTES

Challenger Limited (ASX:CGF) attaches a copy of the speaking notes for the presentation Managing Director and Chief Executive Officer Richard Howes will deliver at 11.15am today at the Macquarie Australia Conference 2019 in Sydney.

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About Challenger

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

Challenger operates two core investment businesses, a fiduciary Funds Management division and an APRA-regulated Life division. Challenger Life Company Limited (Challenger Life) is Australia's largest provider of annuities.

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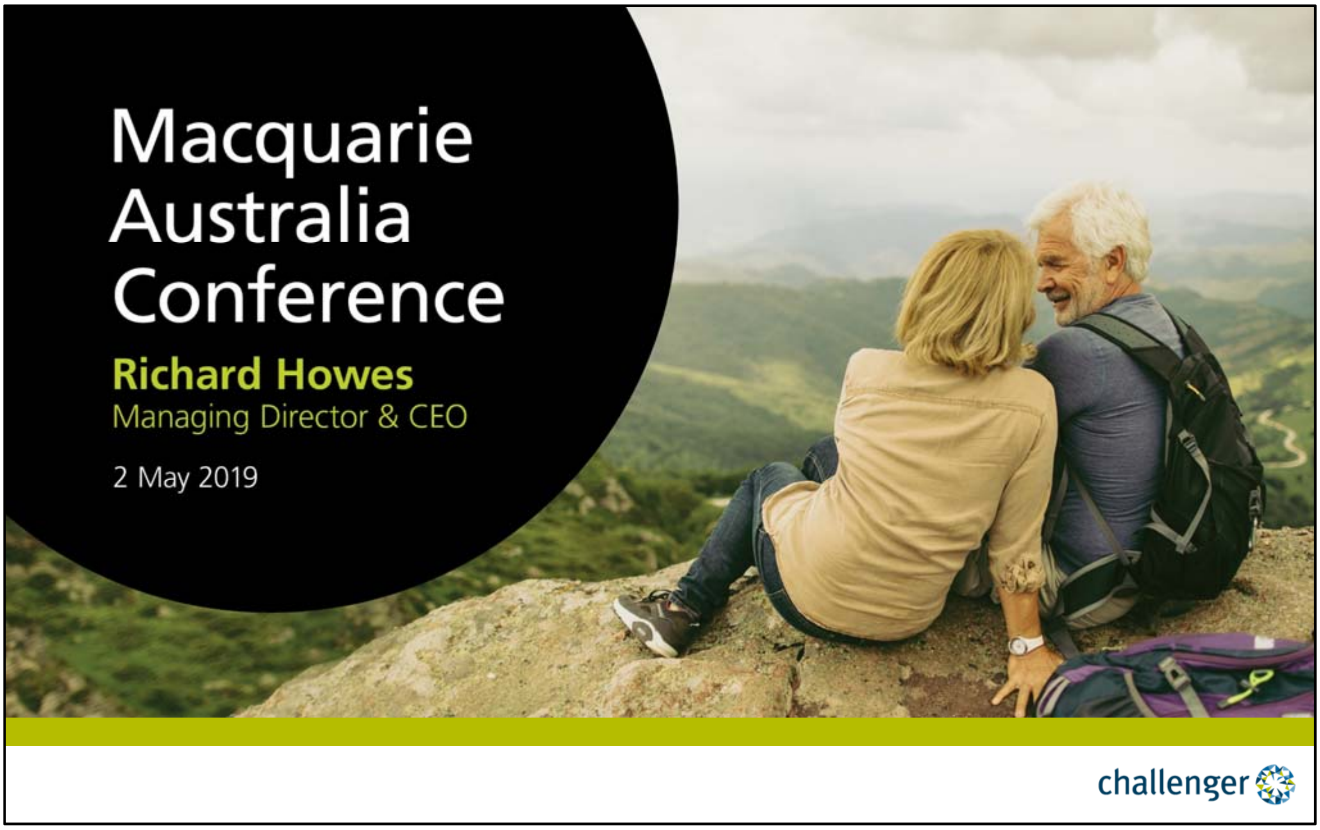

Good morning everyone. It is a pleasure to be here with you today and to have an opportunity to talk about our business, our strategy for future growth and the importance of developing the retirement phase of our superannuation system.

Challenger is a company that has a clear vision: to provide our customers with financial security for retirement. This is a vision in which we deeply believe and it is embedded in everything we do. In fact, having spent more than half my career at Challenger, I often joke that it's almost embedded in my DNA.

After four months in my new role, I can report that I'm as proud of Challenger and as excited as to our future prospects as I have ever been. That optimism reflects a strong belief in our underlying fundamentals – our target market is growing rapidly; we have a strong capital position; we have a long track record of delivering high quality products; we have the leading brand in retirement; and we have an exceptional team with capabilities to deliver on our strategy.

We fulfil our vision through a corporate strategy, which is underpinned by four pillars. Today, I want to talk about the progress we are making on executing this strategy to make our business resilient in a challenging environment and to position us well for future growth.

Expanding strategic relationship with MS&AD

Diversifying and increasing access to Japanese market

MS Primary annuity relationship

- Currently Australian dollar product reinsurance
  - commenced November 2016
- Expanding reinsurance to include US dollar product[1]
  - commences 1 July 2019[2]
  - at least ¥50 billion (~A$640 million) in total A$ and US$ sales per year for minimum of five years[3]
  - provides reliable and diversified sales contribution

MS&AD strategic relationship

- Intention to increase Challenger ownership above 15%[4]
- Representative to join Challenger Board[4]
- Growth opportunities for both companies

MS&AD

MS&AD Insurance Group

~A$27bn market cap
Total assets ~A$280bn

41,733 employees
5 business domains

(as at 30 September 2018)

1 Japanese general insurer
#1 market share
MS&AD Mitsui Sumitomo Insurance
MS&AD Aioi Nissay Dowa Insurance
MS&AD Mitsui Direct General Insurance

2 Japanese life insurer
#7 market share
#1 foreign currency annuity provider
MS&AD Mitsui Sumitomo Aioi Life Insurance
MS&AD Mitsui Sumitomo Primary Life Insurance

3 International operations
operations in 45 countries
#1 ASEAN general insurer

MS Amlin A Member of MS&AD INSURANCE GROUP
MSIG Box Innovation

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1. Challenger Life has entered into a new agreement with MS Primary to commence reinsuring the US dollar version of the 20-year term product. Challenger will provide a guaranteed interest rate and assume the investment risk in relation to those policies issued by MS Primary and reinsured by Challenger.
2. Subject to necessary approvals including regulatory, compliance and contractual requirements.
3. Subject to review in the event of a material adverse change for either MS Primary or Challenger Life.
4. Subject to necessary regulatory approvals, including the Australian Prudential Regulation Authority and Treasurer's approval under the Finance Sector (Shareholdings) Act.

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I want to start with the second pillar, which is to be the leader and partner of choice in retirement income.

Earlier this year, we announced a significant expansion of our strategic relationship with the MS&AD Group, which diversifies our access to the Japanese annuities market, and delivers certainty by underpinning and increasing the sales of our annuities into Japan.

The MS&AD group is a global insurance and financial services group with operations in 45 different countries. MS&AD is a leading player in the general insurance market and MSP is the leading provider of foreign currency annuities in Japan.

The foreign currency annuity market is something we have long been interested in and I commenced discussions with MSP in 2012.

The relationship formally got underway in November 2016 with an agreement under which Challenger reinsured, under a quota share arrangement, the Australian dollar annuity sales of MSP in Japan. Since that time, Australian dollar interest rates have weakened relative to US dollar interest rates and that has significantly reduced our volume of Japanese annuity sales.

The expanded relationship will deliver certainty by delivering a minimum 50 billion yen (or approximately $640 million Australian dollar) across both Australian and US dollar products each year. MS&AD also intends to increase its share in Challenger above 15 per cent, which I consider to be a vote of confidence in our business and our strategy. It will also see MS&AD seek representation on the Challenger Board, which will give opportunities for an even closer working relationship between our two businesses.

Overall I see the expanded partnership as leveraging the comparative strengths of each business, and delivering long-term benefits to us.

Highly engaged workforce

With a strong risk and compliance culture

Employee engagement[1]

84% Sustainable engagement

Category	Total favourable score	Australian National norm	Global Financial Services norm	Global High Performance norm
Sustainable engagement	84%	✓	✓	–
Diversity and flexibility	94%	✓	✓	✓
Risk culture	85%	✓	✓	✓

✓ Exceeds
– No material difference

Strong risk and compliance culture

- Risk management entrenched in corporate culture
- Significant investment in risk infrastructure

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1. Willis Towers Watson – March 2019.

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I'd like to jump to the fourth pillar of our strategy, which is to deliver superior outcomes to customers and shareholders by maintaining a highly engaged, workforce with a strong risk and compliance culture.

Challenger has one of the highest employee engagement scores in the industry. Our recent employee survey conducted by Willis Towers Watson, showed a sustainable engagement score of 84 per cent. Our employees report a strong connection with our vision and our brand; report being willing to go above and beyond in order to ensure success for Challenger; and they report that Challenger is a great place to work.

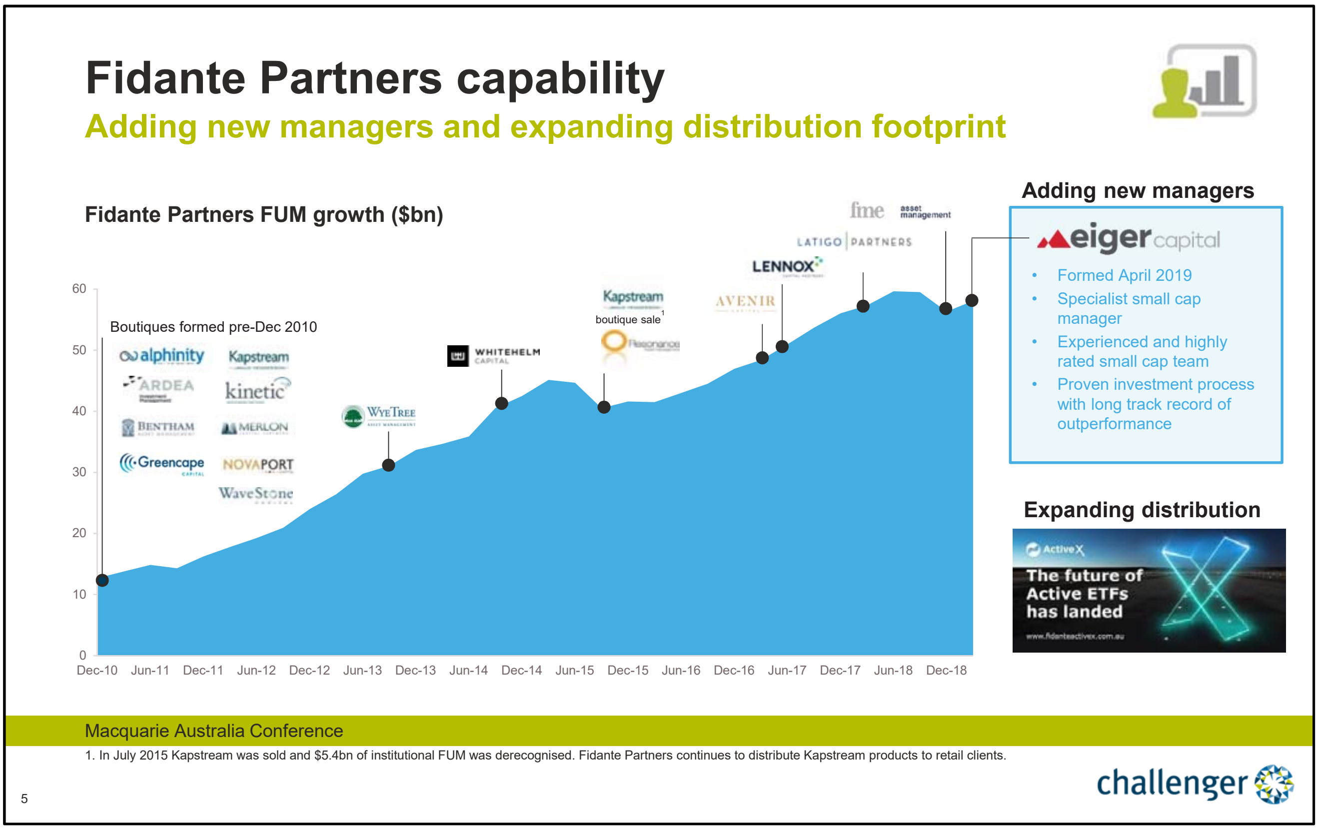
Our sustainable engagement score significantly outperforms the Australian national norm and the global financial services norm, as measured by Willis Towers Watson.

In terms of the detail there's two areas I'd like to call out. Diversity of thought is something that I've always been a big believer in simply because it's good for business, so I was really pleased that we scored 94 per cent in the categories of diversity and flexibility. Our staff report that Challenger is accepting of different cultures and lifestyles and provides flexibility to balance work and lifestyle.

Perhaps most importantly, the survey highlighted our strong risk and compliance culture, with 85 per cent of staff reporting a strong risk culture.

This reflects in many ways the broader commitment we have made to risk over the last few years including a significant investment in risk infrastructure. It is also compatible with the approach to risk across the business and is reflected in our strong prudent capital levels.

In a post-Hayne world, this is more important than ever to customers and to shareholders, and I am pleased that our engagement survey results suggest that our investment is paying off with risk management well and truly entrenched in our corporate culture.



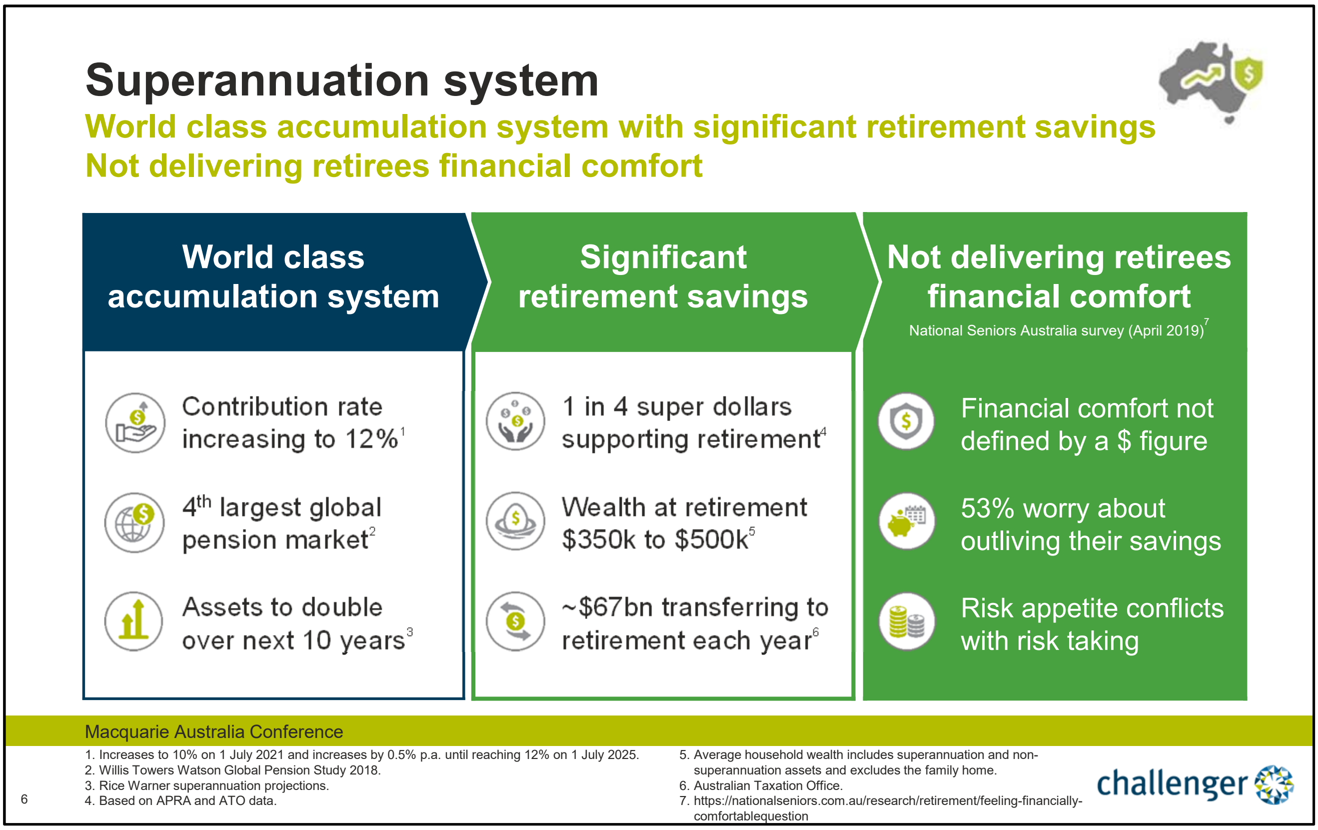
Providing our customers with relevant investment strategies exhibiting consistently superior performance is the third pillar of our strategy. We do this in a number of ways but today I want to focus on how we are growing our multi-boutique business, Fidante Partners.

Today we have 17 boutique partnerships, managing a combined $59.3 billion in funds under management. This is up from $10 billion eight years ago making Fidante one of the fastest growing fund managers in the country.

Last month, Fidante welcomed Eiger Capital to the stable. Eiger is a specialist small cap team with a combined experience of 60 years and a strong track record of delivering superior performance. We're looking forward to providing this small cap capability to the retail and institutional market here in Australia.

The exchange traded fund market has been growing in popularity in recent times, reflecting a demand from retail investors for different types of investment strategies in a convenient and simple form via the ASX.

In December, we announced the launch of ActiveX, which is Fidante's active ETF platform, and was launched with a fixed income actively managed ETF from Ardea. We are expecting in coming months that we will be launching new funds from additional managers as we move forward.



Increasing the allocation to secure and stable incomes is fundamental to our vision and forms the first pillar in our strategy.

Australia has a world-class superannuation system. On a population of 25 million people, we have the fourth biggest pension system in the world with some $2.7 trillion in assets. Moreover this system is growing strongly and is expected to double over the next 10 years, reflecting among other things, an increase in the contribution rate to 12 per cent.

There is no doubt that the system is delivering in terms of assisting Australians save for their retirement, however it's not doing as good of a job in the retirement phase itself. And with $67 billion moving from accumulation to retirement each year this issue is more important than ever.

National Seniors Australia, which is the peak body for the ageing in Australia, in a recent survey they conducted with Challenger, reported that over 50 per cent of their survey respondents were worried about running out of money in retirement.

They also reported that of the survey respondents who reported they could not tolerate a loss of more than five per cent, 25 per cent of those respondents were 100 per cent invested in shares, and 43 per cent of those respondents had some exposure to the share market. So there's a clear mismatch between reported risk appetite and portfolio construction.

Retirees are overexposed to the risks in retirement and they are clearly in need of more options to convert their savings into reliable income that lasts a lifetime. I would say in conclusion that our system is not delivering for older Australians.

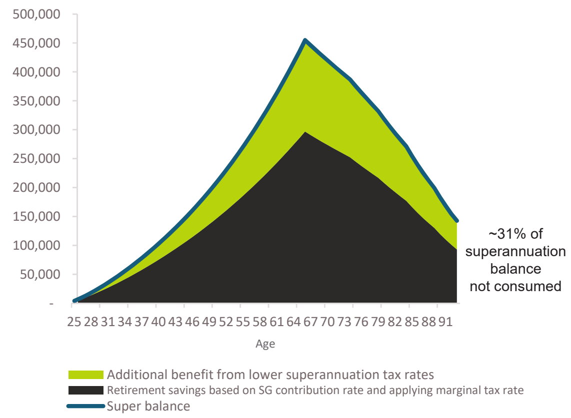
Twenty five per cent of the super system is currently in the retirement phase. This is no small amount of money. It's clear that increasing the allocation of retirement savings to secure incomes will improve outcomes both for retirees, and for the system overall.

Ongoing public policy enhancing retirement

Currently underdeveloped – longevity pooling part of the solution

- Retirees self insuring longevity risk
  - under consuming capital
  - ~31%[1] of super balance not consumed
  - inefficient application of tax concessions
- Successive governments reforming retirement phase
  - reforms to improve retiree outcomes
  - encouraging take up of longevity protection
  - making retirement system more sustainable
- New lifetime income means test rules[2]
  - simplified means test from 1 July 2019
  - support lifetime income streams

Average superannuation balance and drawdown[3]
For illustrative purposes only



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1. Australian Government Actuary 2014, *Towards more efficient retirement income products*: Paper prepared for the Financial System Inquiry, November 2014. On average 31% of initial balance at retirement will be left at death (in NPV terms).
2. Refer to Appendix for more information on new means test rules for lifetime income products.
3. Based on a 25-year-old in 2019 earning $50k with 1.0% wage inflation above CPI and a pre-tax investment return of 3% above inflation. Drawdown based on minimum drawdown rates.

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It has been widely recognised by both sides of government that the retirement phase of superannuation is underdeveloped and more needs to be done to deliver good outcomes for retirees.

Risks in retirement, which are perhaps somewhat unique to retirement, include inflation risk and market sequencing risk, and most importantly include longevity risk, which is the risk that a retiree will outlive their savings.

Most retirees self insure against longevity risk by underspending their retirement savings, thereby living a standard of living short of what they could have enjoyed if they had fully consumed their retirement savings. This graph illustrates this problem.

Here we show a 25 year old in 2019 on an income of $50,000, will accumulate a superannuation balance of $450,000 in real terms at retirement. Notably a third of these accumulated savings represent tax concessions, and very importantly, more than 30 per cent of these superannuation savings are not consumed if a popular strategy of consuming the minimum drawdown amount is followed.

In fact, the Australian Government Actuary confirms that over 30 per cent of accumulated superannuation savings leak out in the form of inheritances due to overly frugal consumption patterns of retirees who simply don’t know when they are going to pass away.

This is an inefficient application of superannuation concessions and it’s clear that more options are needed to assist retirees in managing this longevity risk.

The account based pension alone represents a “one size fits all” approach, which is failing elderly Australians in retirement and falls short of what Australian retirees need.

In terms of public policy, it has long been recognised that pooled products have an increased role to play. Pooled retirement income products effectively use the yield from capital belonging to those who predecease the projected life expectancy of the pool, to offset longevity outcomes and enhance the rate of return for surviving members of the pool.

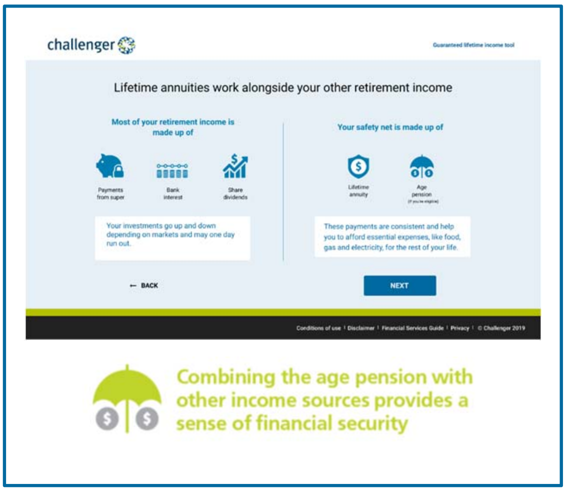
Good progress has been made from a public policy point of view in this area. For example, in 2017 impediments to innovative retirement income streams were removed, and on 1 July this year, new means test rules will come into effect.

But there is more to do to ensure the success in accumulating savings within our system translates to good retirement income outcomes for Australians.

Lifetime annuity is a compelling product

Simple and good value product

- Provides regular and reliable retirement income addressing the needs of retirees
- Provides protection from retirement risks
  - longevity
  - market
  - sequencing
  - inflation
- Lifetime annuity IRR ~120 bps[1] above Australian government bond
  - return includes mortality credits
  - better the longer you live
  - sharing risk premiums with customers
  - compares well to bond fund index[2]
- Works alongside other retirement income



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1. Challenger Flexible Liquid Lifetime. Annuity pricing and Australian government bond rate as at 29 April 2019 and IRR based on Challenger's assumed life expectancy. IRR increases the longer you live.
2. Running yield on Bloomberg Credit Index is 97 bps above Australian government bond (as at 29 April 2019).

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Beyond public policy considerations, I want to focus on the compelling nature of our product offering.

Challenger annuities are compelling in assisting retirees manage longevity risk, inflation risk and sequencing risk, but they are also compelling in delivering good value.

If we take an example of a 65 year old female, were she is to die precisely on her median cohort life expectancy, she will lock in a realised IRR on the Challenger lifetime annuity of approximately 120 basis points over government bonds. This reflects both the mortality credits that she would earn inside the product, and also reflects a sharing of risk and liquidity premiums from within our investment portfolio with our policy holders.

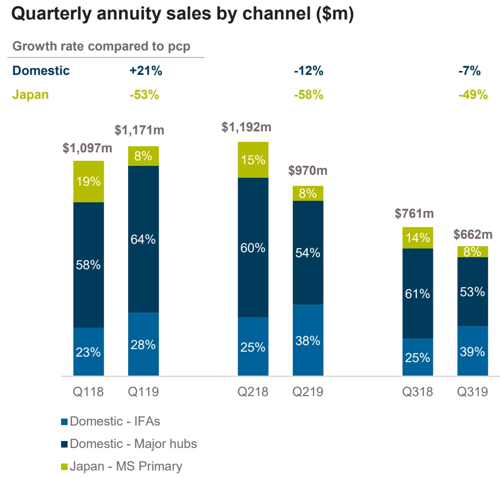
This compares favourably on an after fee basis to what a retiree could reasonably expect from most defensive assets in their account based pension, and therefore represents the logical choice for the defensive component of the retirement portfolio. Bear in mind that you would typically see a retiree allocating between 20 to 30 per cent, so it's only part of the retirement portfolio and it's the part of the portfolio used to cover the essential needs in retirement.

In fact good advisers, who are adopting what you would describe as outcomes based advice, are asking the question, "what are the basic living needs, that level of income the retiree can't live without in retirement" and making sure those needs are met through a combination of the age pension, and guaranteed lifetime income streams.

Significant financial advice market disruption

Impacting Challenger annuity sales

- Challenger sales impacted by
  - lower third-party adviser new client acquisitions
  - adviser churn
- FY19 Q2 and Q3 domestic annuity sales
  - major hub sales -25%[1] on pcp
  - IFA sales +26%[1] on pcp
- Connecting to new platforms
  - Hub24 and Netwealth go live Q4[2]



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1. Major hubs include AMP, IOOF and the wealth management operations of major Australian banks. Represents combined FY19 Q2 & FY19 Q3 annuity sales compared to prior period.
2. Challenger annuities expected to launch on Hub24 and Netwealth platforms in FY19 Q4.

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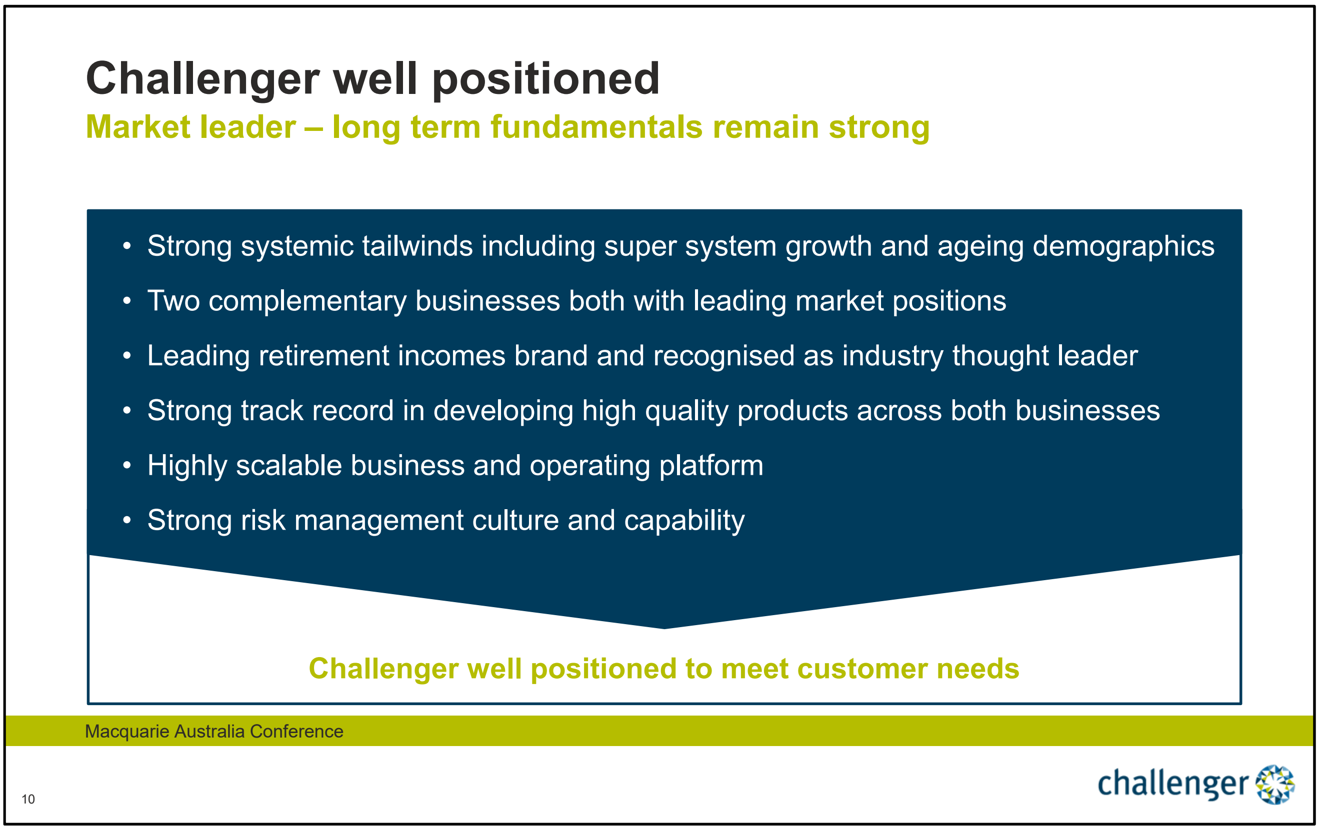
Of course, this picture of advice is undergoing significant disruption at the moment. Some of this disruption is temporary, with dealer groups attending to fixing compliance problems within their business; with advisers moving from one firm to another; and with sales processes in relation to several of these businesses underway.

Some of the disruption is more structural and there’s a reasonable expectation given higher education standards and different business models going forward that there will be fewer advisers, and advice will be more expensive.

This disruption is impacting our business because advice remains a very important channel through which our annuities are made available to retirees. This disruption is impacting the onboarding of new customers, and it’s through the onboarding of those new customers that a great majority of our annuities are effectively sold.

You can see this turning up in our quarterly sales numbers. At the major hubs for example, the combined quarter two and quarter three sales volumes were down 25 per cent on the prior corresponding period. Pleasingly on the other side of that, the IFA channel is proving quite resilient, with an increase of 26 per cent over the same period.

This underscores the merit in our strategy to grow the availability of our annuities on various platforms. With the addition of Hub24 and Netwealth, which we still expect to go live this financial year, in combination with Colonial First State, AMP and BT Panorama, our annuities will be available on the platforms used by 70 per cent of advisers.



There is no doubt we have entered a more challenging period. However, I remain confident in the long-term fundamentals of our business and the strong systemic tailwinds that will drive our business forward over the longer term. As I said at the start, we have a strong business with an exceptional team focused on delivering our strategy.

The retirement income market is only going to grow as our population ages and our system matures. I believe we are well positioned in relation to those changes and indeed that has underscored the exceptional growth we have had over the past decade. Our annuity sales have increased 10 fold over the last 11 years.

We have two complementary businesses with leading positions in each of their markets.

While trust is challenged among advice in particular in this market, we have the leading retirement brand, which positions us in a resilient way in this market.

We are the thought leader in retirement incomes, a position we take seriously, and advocate strongly for a sustainable retirement income system for all Australians.

We have a scalable business with a long track record in producing compelling product offerings for our customers.

And finally, we have a strong risk and compliance culture, which is at the heart of everything we do.

On that basis I am confident in Challenger's ability to navigate the current environment toward continued strong growth into the future.

I am happy to take your questions.

Appendix

Additional background information

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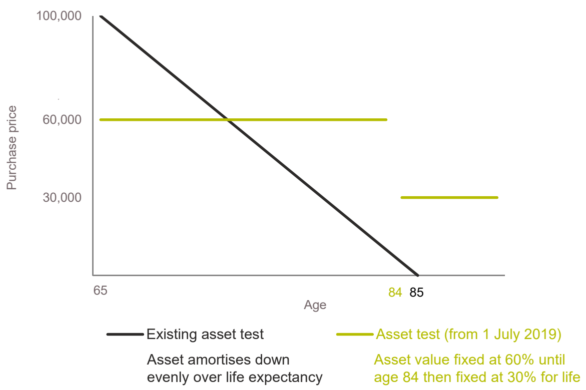
Government enhancing post-retirement phase

New means test rules for lifetime income products from 1 July 2019

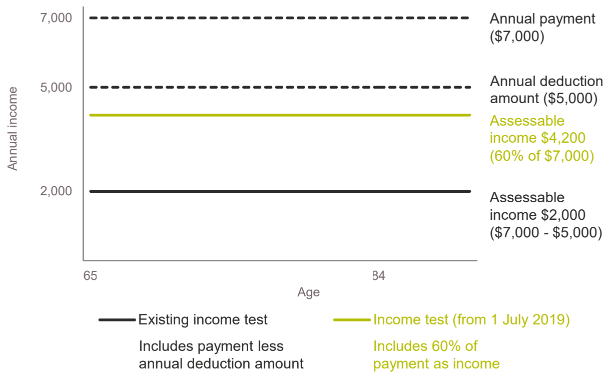
Assets pension test

Example - $100,000 lifetime income stream purchase price at age 65



Income pension test

Example - $100,000 lifetime income stream paying $7,000 per year



Important note

This presentation was prepared for the purpose of a briefing to equity analysts and certain wholesale investors on 2 May 2019.

The material in this presentation is general background information about Challenger Limited 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.

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