Challenger – capturing growth in the retirement income market

Brian Benari

Group Chief Financial Officer & Group Chief Operating Officer

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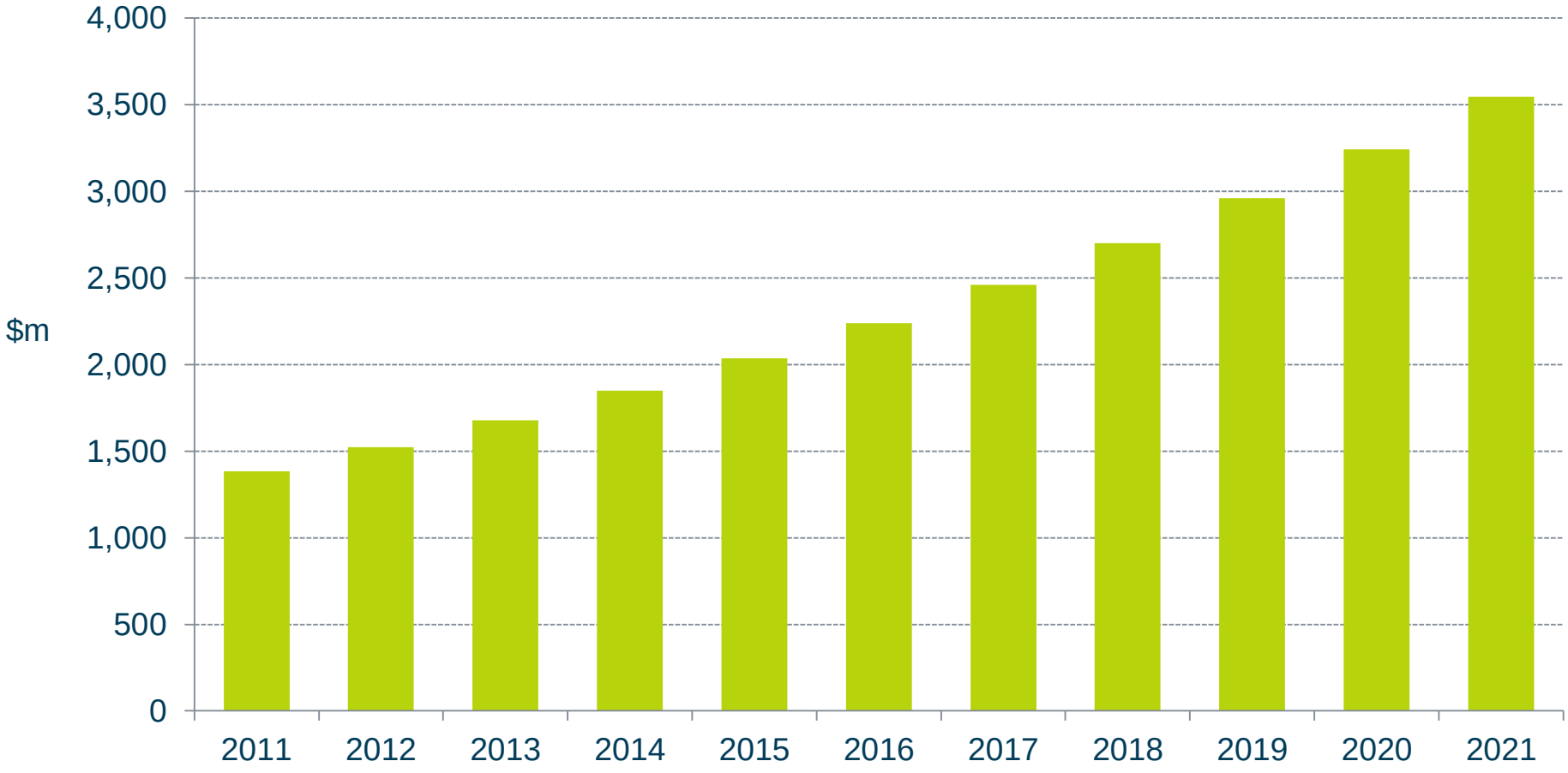
Macro drivers of annuity sales growth

Growth in underlying superannuation funds

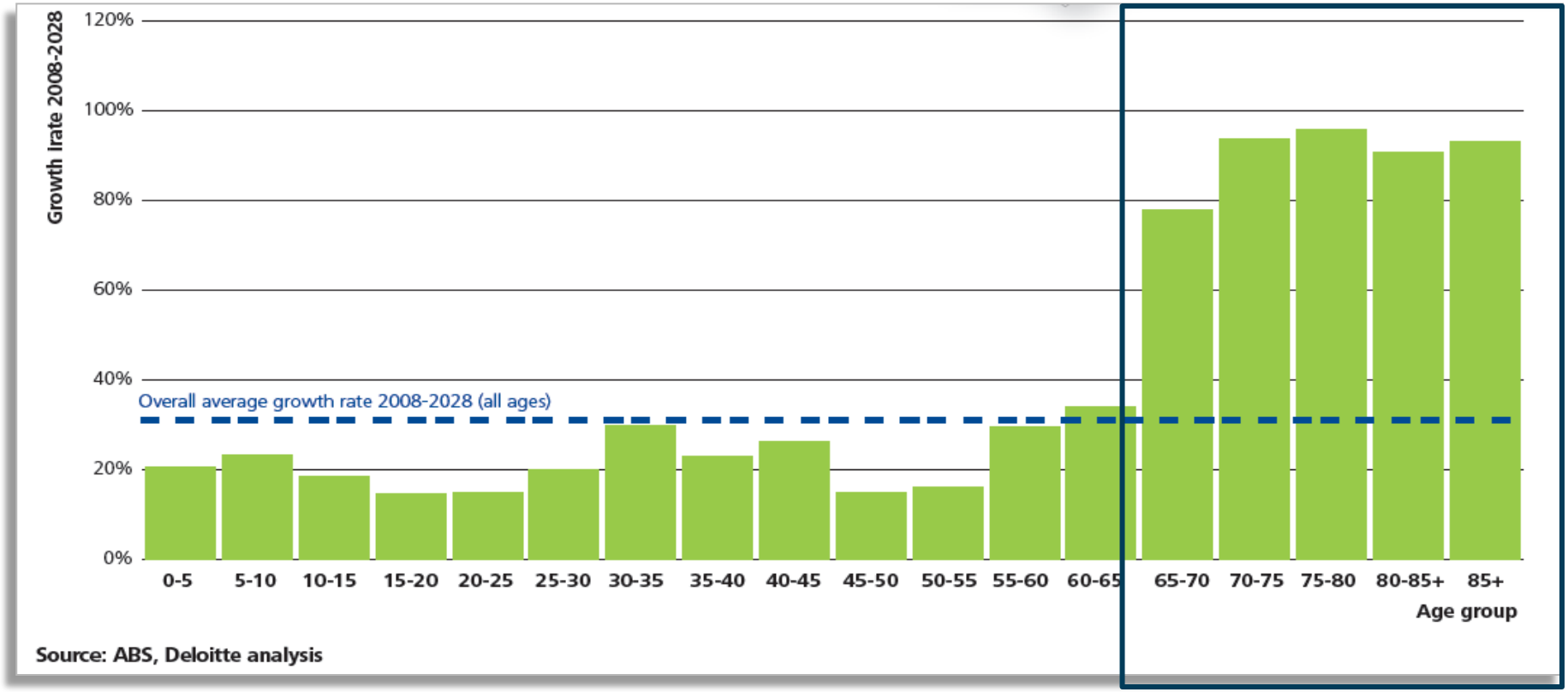


Source: Rainmaker Superannuation FUM Projections 2011-2021 (Dec 2010).

Macro drivers of annuity sales growth

Ageing population

Australian population growth 2008 - 2028



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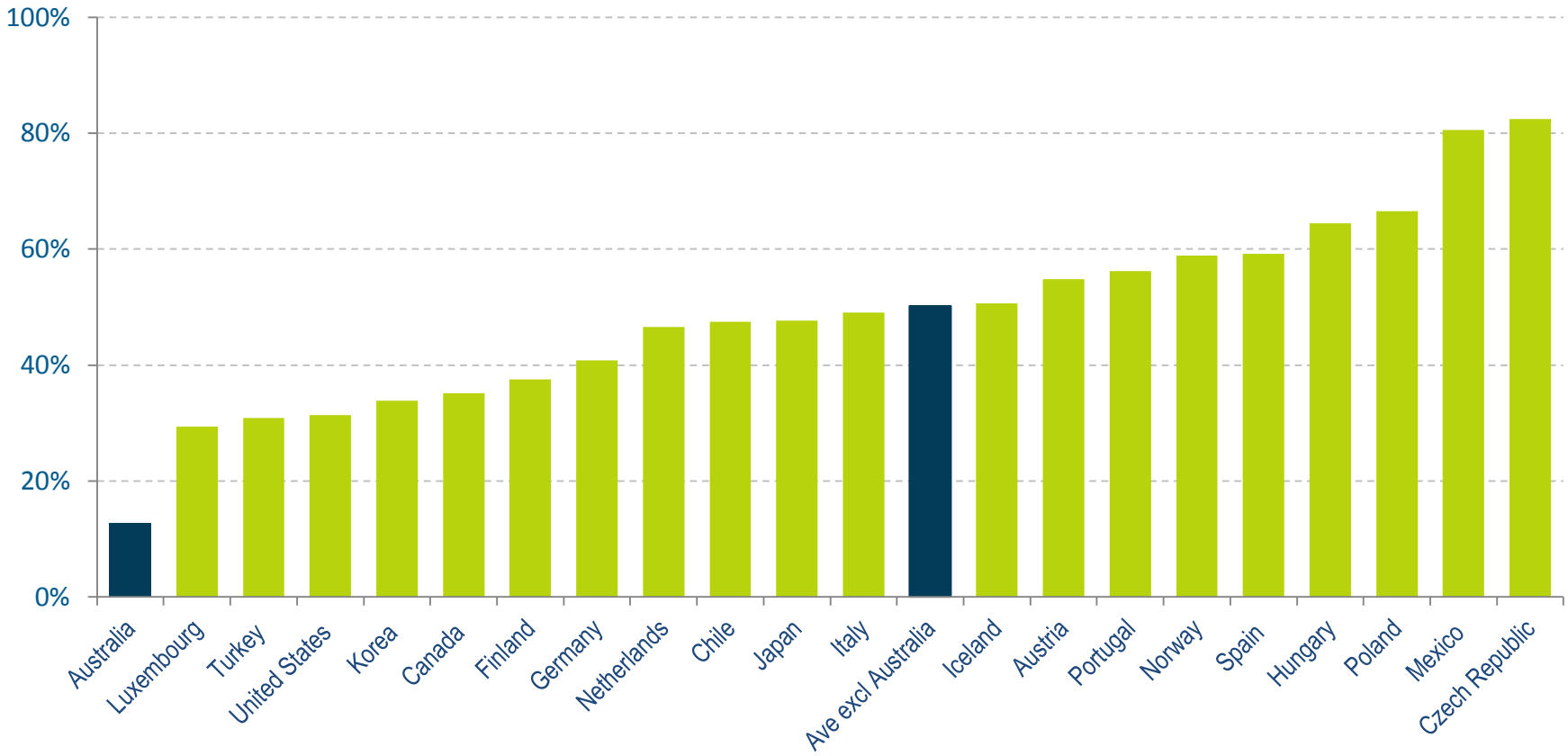
Macro drivers of annuity sales growth

Under allocation to defensive assets in Australia relative to OECD



[1]Source: OECD Global Pension Statistics (2009 data) July 2010, Issue 7

Annuities – as part of a retirees portfolio

short term

- defensive asset in portfolio
- short-term cash vehicle
- education expenses

medium term

- defensive asset in portfolio
- cash flow management in SMSF's
- aged care strategies

long term

- 'bedrock' of a retiree's income
- explicit inflation and longevity protection
- complete implemented retirement income solution

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New product opportunities

- Guarantee projects in progress:
  - RCV0 GIF series based on feedback from advisers
    - Evolution of the existing RCV100 GIF product for investment management platforms
    - Greater flexibility for customers who use platforms
  - Deferred lifetime annuities (DLAs)
    - Require minor legislative changes to SIS and Income Tax Act to put the product on an equal footing with other superannuation products
    - Positive outcomes from recent Tax Forum in October 2011
    - "*Bill Shorten and I have had a bit of a discussion about the drawdown phase that was discussed here today on the options like annuities and deferred annuities and we certainly are prepared to work with the industry to do more in this area*." - Wayne Swan – AFR 6 October 2011

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Deferred lifetime annuities

- Increased understanding of longevity risk by individuals
- Deferred lifetime annuities offer pure longevity protection
  - Low single premium to mitigate the risk of sole reliance on the age pension
    - A premium of ~$25k today:
      - will double the age pension in real terms from life expectancy onwards; and
      - meet the Westpac-AFSA comfortable living standard
  - Enables financial advisers to focus on defined period between retirement and life expectancy
  - Removes need for overly conservative retirement spending plans
  - Insurance separated from investments - no mortality impacts on balance of savings

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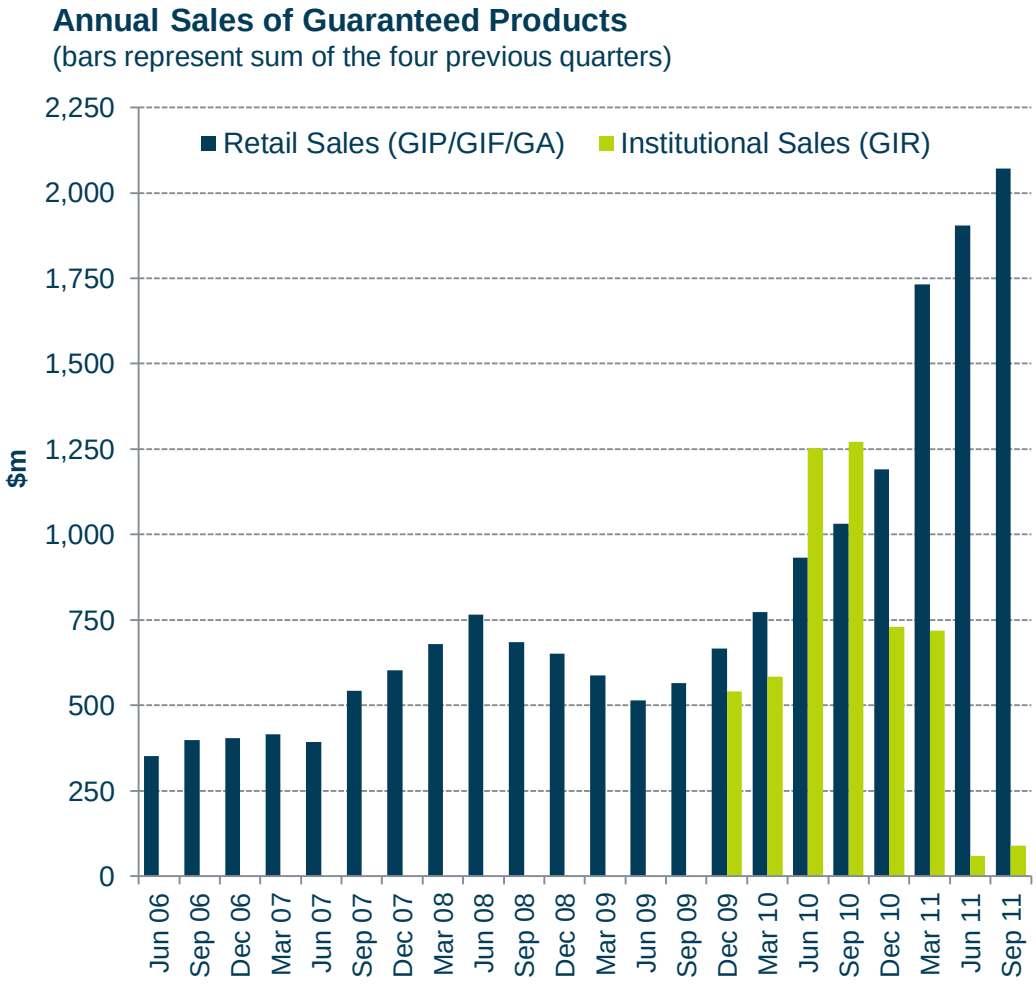
Trends evident - 1Q12 annuity sales accelerating

- Record 1Q12 retail annuity sales of $509m – up 48% on pcp and 13% on prior quarter
- Total Life sales for the quarter of $558m
- Continued lift in longer term product +6 years
- New products introduced account for ~35% of sales
- Growth in sales supported by underlying demographic, regulatory and change in risk preference trends



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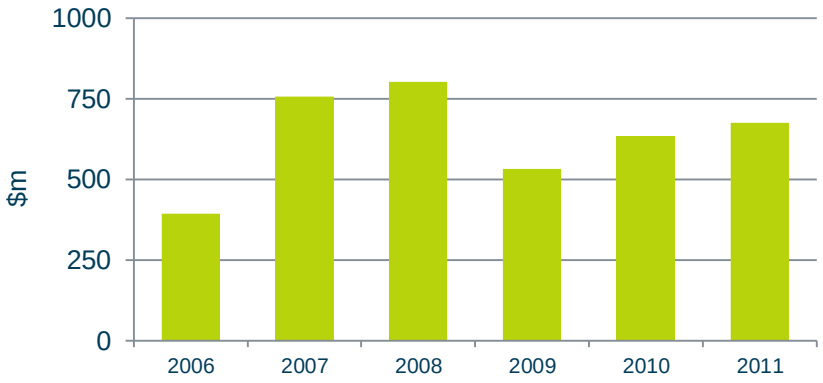
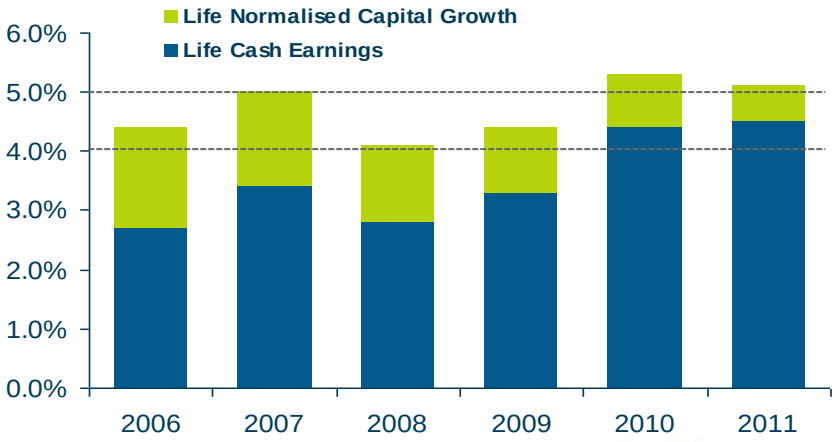
New growth supported by organic capital generation

- Capital strength
  - Strong excess to regulatory minimum maintained
  - Excess capital buffers impacts of variable market conditions
  - Cash earnings accreting resulting in steady organic capital generation
  - Proceeds from CPH option exercise further enhance financial flexibility for Challenger Group
- COE margin
  - Overall margin remains broadly within long term range of 4-5% (with asset spread between 2-3%)
  - Current market turmoil supports reinvestment of existing assets and new growth

Capital excess to regulatory requirements



Life COE Margin



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Sustainable margin

	Illustrative Margin	
Investment Yield	8.5%	9.5%
Annuity Funding	(6.5)%	(6.5)%
Asset Spread	**2.0%**	**3.0%**
Capital	1.3%	1.3%
Normalised Growth	0.7%	0.7%
Net Margin *(normalised COE)*	4.0%	5.0%

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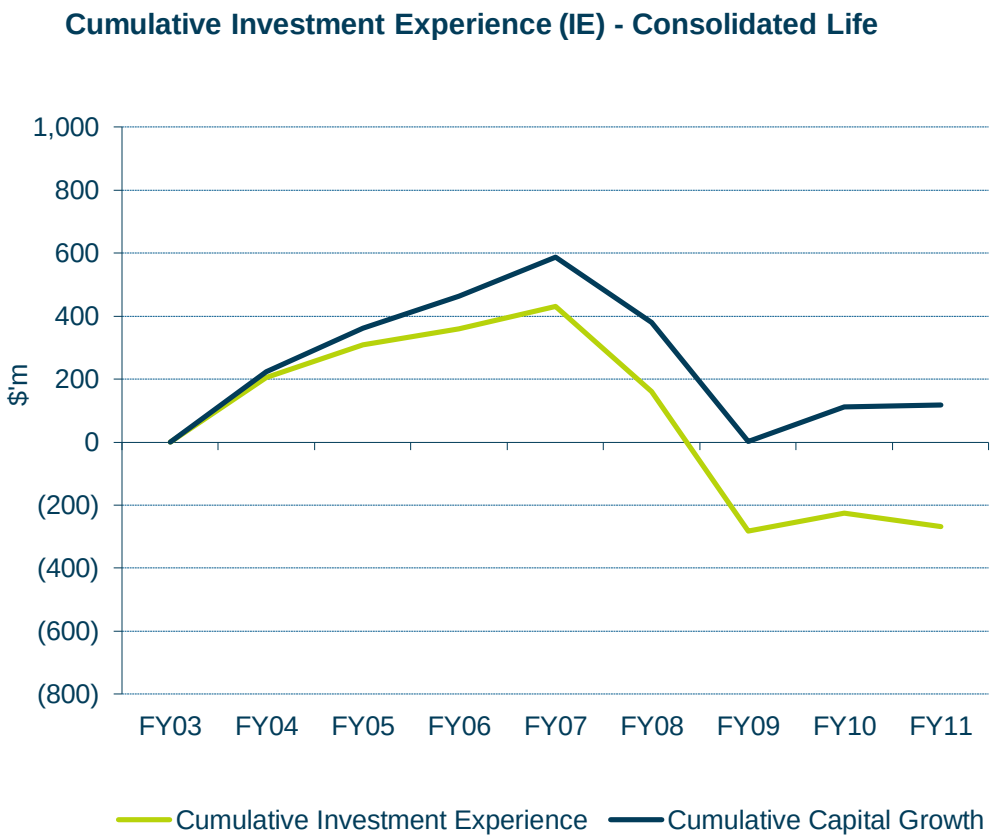
Normalised growth assumptions

- Life cash operating earnings comprise:
  - Cash spread earnings (e.g. fixed income coupons, lease cash flows)
  - Normalised growth assumptions (medium term capital growth expectations through the cycle):
    - Property 2%
    - Infrastructure 4%
    - Equity & Alternate 6%
    - Fixed income (0.35%)
- Investment experience comprises mark to market on assets <u>and</u> liabilities, normalised growth assumptions not achieved and actuarial assumptions

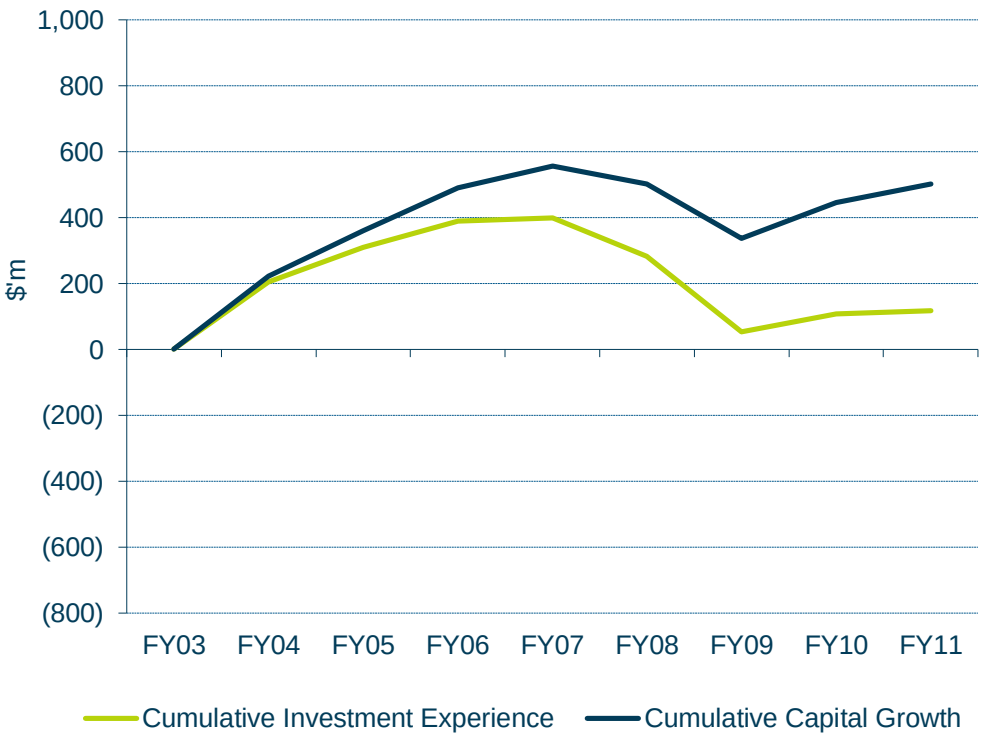


[1] Cumulative investment experience from 2003 to 2011. Note that IFRS Accounting Standards replaced Margin on Service Accounting Standards in FY 2006. As such for consistency, fiscal years 2004 and 2005 have also been calculated on the basis of IFRS accounting.

Normalised growth assumptions

- Since 2003 property and fixed income assets (representing 91% of assets) performed inline with medium term capital growth expectations
- Infrastructure and equity/alternate assets (representing 9% of assets) have underperformed expectations
- Infrastructure principally impacted by unit price performance of Challenger Infrastructure Fund (CIF)

Cumulative Investment Experience - Consolidated Life (Excluding CIF impact)



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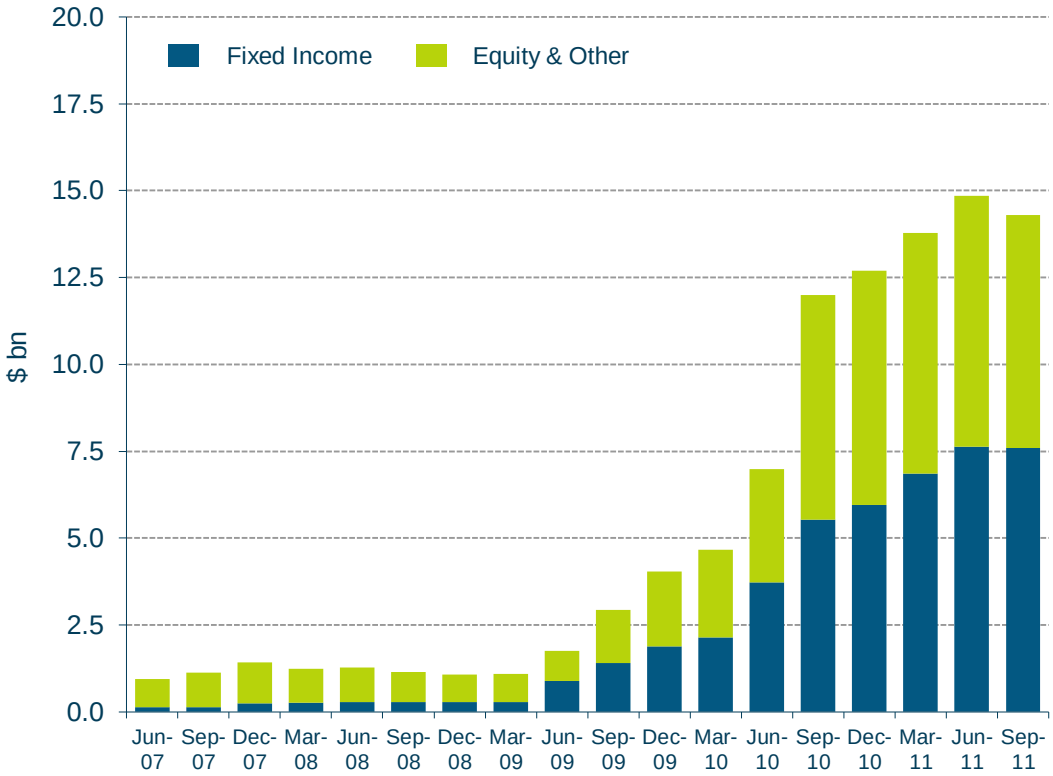
Growth in boutique FUM

- Strong performance continuing across ten boutique partnerships
- FUM up 19% in the last 12 months – due to strong net inflows offset by some negative market movement in the last quarter
- Medium term focus on growing FUM for existing boutique partnerships – delivering increased operational leverage and profitability

Boutique Partnerships Funds Under Management



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Summary

- Boutique FUM pipeline growing - underpinned by strong performance
- Structural wealth management and demographic trends continue
  - Awareness of the need for less risk in retirement has gained significant momentum
  - Need for longevity protection in retirement resonating with consumers, industry and government
- Life COE margin sustainable
- Increased demand for fixed income and guaranteed returns to drive annuity sales
  - Record 1Q12 life sales of $558m
  - On track to meet FY12 Life retail sales growth ~25% underpinning FY12 Life COE guidance of $430m

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Disclaimer: The material in this presentation is general background information about Challenger Limited activities and is current at the date of the 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 or without professional advice when deciding if an investment is appropriate.

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