Market release

Challenger Limited

Wednesday, 2 May 2018

MACQUARIE AUSTRALIA CONFERENCE 2018 PRESENTATION AND SPEAKING NOTES

Challenger Limited (ASX:CGF) attaches a copy of the presentation and speaking notes that will be delivered today at the Macquarie Australia Conference 2018.

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About Challenger

Challenger Limited (Challenger) is an investment management firm managing $79* billion in assets. It is focused 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 afternoon.

It’s great to have the opportunity to talk to you today about Challenger – who we are, the strategy we’re implementing to deliver growth now and into the future, and the significant opportunity we see ahead for retirement income products in Australia.

Business overview

Two core businesses benefiting from superannuation system growth

Challenger Limited (ASX:CGF)

Life

#1 market share in annuities[1]

Life
Leading provider of annuities and guaranteed retirement income solutions in Australia. Partnering with the leading provider of Australian dollar annuities in Japan. Products offer certainty of guaranteed cash flows with protection against market, inflation and longevity risks

Funds Management

One of the fastest growing fund managers[2]

Fidante Partners
Co-owned, separately branded, active fixed income, equity and alternative boutique investment managers, including Fidante Partners Europe.

Challenger Investment Partners
Originates and manages assets for Life and 3rd party investors

Distribution, Product and Marketing (DPM)

Central functions
Operations, Finance, IT, Risk Management, HR, Treasury, Legal and Strategy

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1. Annuity market share – Strategic Insights.
2. Consolidated FUM for Australian Fund Managers – Rainmaker Roundup September 2017.

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Challenger is one of those businesses that most people know something of, but less people know the full story. Our brand recognition is extremely strong. It's something we've worked hard to build over many years and it's now a key advantage for our business. We're most likely to be known as a large financial services organisation, and among our target market, a leader in retirement incomes.

We're the leading provider of annuities in Australia – that includes term annuities, lifetime annuities and our fastest growing product, CarePlus for those moving into aged care. But we also do much more. Our Life business is diversified, with institutional products such as the Challenger Index Plus Fund, and a successful partnership in Japan.

In addition to this, Challenger is one of the fastest growing fund managers in the country. Funds Management includes our Fidante Partners stable of boutique managers, both domestic and international, and our Challenger Investment Partners business that originates and manages assets for Life and third party investors.

Life and Funds Management are two complementary businesses. Both contribute to creating financial security for retirement for our customers. Funds Management helps customers build wealth for retirement, and our Life business helps convert retirement savings into reliable income for life.

And both businesses are supported by exceptional distribution, product development, marketing and back office functions, all operating with a cost to income ratio 17 percentage points below the industry average.

It's a highly differentiated business model in Australia. It would be extremely hard to replicate, and it gives us considerable resilience and competitive advantage in a high growth market.

This competitive advantage is captured through the diligent implementation of our strategy.

I'm sure many of you have seen this slide before. Our strategy has remained consistent for many years. Some of the tactics change – and we pride ourselves on being highly agile and adaptable – but the core pillars of our strategy have remained the same and guide the actions we take.

Together, the pillars of our strategy enable us to fulfil our vision – to provide our customers with financial security for retirement. This is not a vague piece of corporate speak. This is a tangible and driving purpose. It is the foundation of everything we do. It energises our people, who feel passionate about the contribution they make to the lives of our customers.

At each of our results presentations I provide an update on how we're delivering on this strategy and where we are focusing for the future.

Rather than repeating that today, I'd like to focus in more detail on the first pillar – increasing the Australian retirement savings pool allocation to secure and stable incomes.

Put simply, this is about growing the size of the whole pie – not just our share of it.
We firmly believe that Australian retirees are overexposed to risks in retirement. If a global financial crisis was to happen today, on average it would wipe $65,000 off the average super savings of those who had just retired. These are people who cannot afford to stop spending and wait for a market recovery. They likely have a very long retirement ahead of them – they are living on average nine years longer than they were when our superannuation system was first built.

Increasing the allocation of retirement savings to secure and stable incomes will improve the outcome for Australian retirees and also support the fiscal sustainability of the age pension system.

And it's happening now. Industry is increasingly seeing the benefits of including pooled lifetime income products in the retirement mix, and Government is moving to ensure the system is set up to support the use of these products in retirement.

Australian superannuation system

Very effective in accumulating assets for retirement

High growth market supported by

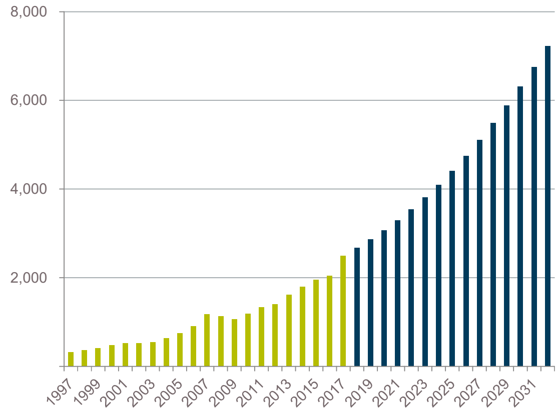
- Mandatory and increasing contributions
- Earnings compounding
- Population growth

Resulting in

- 8% CAGR growth over last 10 years
- 4th largest global pension market[1]
- Assets expected to double in next 10 years[2]

Super system doing first part of the job

Australian superannuation growth[3] ($bn)



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1. Willis Towers Watson Global Pension Study 2017.
2. Rice Warner 2017 superannuation projections.
3. 1997 to 2017: APRA data. 2018 – 2032: Based on Rice Warner 2017 superannuation projections applied to 2017 APRA superannuation assets.

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The biggest driver of this focus is, of course, the extraordinary growth in the Australian superannuation system.

It's worth around $2.6 trillion today thanks to mandatory contributions, which have increased over time, the earnings on those contributions, and the impact of a growing population.

Over the last 10 years the pool of superannuation savings in Australia has grown at a compound annual rate of 8%. Today we have the fourth largest pension market in the world.

And superannuation assets are expected to double in the next 10 years.

This is the very definition of a growth market. It's clear why Challenger's strategy is to position ourselves squarely in this space.

What these numbers tell us is that the super system is working. It is highly successful at what is essentially the first part of its job – helping Australians build savings for their retirement.

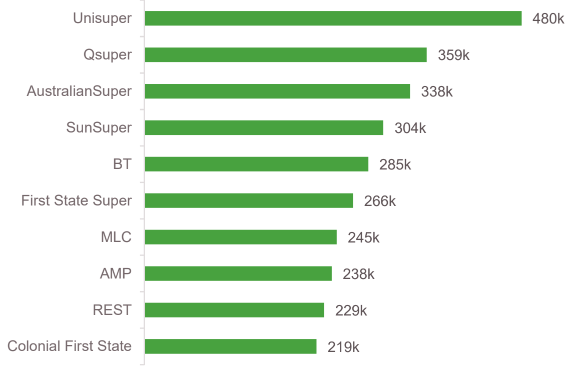
Super funds now have significant retirement assets

Australians now have meaningful balances in retirement

- Superannuation guarantee system not fully mature – established 26 years ago
- Operating for only half the working life of today's retiree
- New APRA data debunks low retirement balances myth
- One in four superannuation dollars now supporting retirement[1]

Super system starting to make a significant contribution to the lives of Australian retirees

10 largest super funds – average retiree member balance[2] ($'000)



1. Based on APRA and ATO data.
2. APRA's Annual Superannuation Bulletin June 2017 edition and Annual Fund-level Superannuation Statistics report June 2017 edition.

The best evidence for this is the most recent data released by APRA. This data shows that the retirement phase of superannuation is already reaching scale.

Across the large APRA-regulated funds, there are now more than 1.6 million retired members with an average balance of more than $250,000. The average annual retirement benefit from each account is just under $21,000, not much less than the age pension, suggesting that super is already making a significant contribution to the lives of many retired Australians.

The weight of money in the retirement phase has now reached a level where large funds could spin-off their retired members into a separate fund, and this new fund would still be a major super fund in its own right.

To put this into context, this is where we are today, in a system that is not yet fully mature. The Superannuation Guarantee system was established just 26 years ago – well short of the average working life. Indeed, that means that today's retirees, those represented in this data, did not have the full benefit of compulsory super contributions across all of their working years. It will be another 20 years before this system is mature. That means we can expect balances at retirement to grow significantly from here.

The reason this data is so important is that it demonstrates that the retirement phase of superannuation matters now.

I often hear the argument that we will definitely need to improve the retirement phase of the superannuation system, but it's not a priority yet because balances are too low. If people are retiring with very small super savings they will rely on the age pension for income and that's the end of the story.

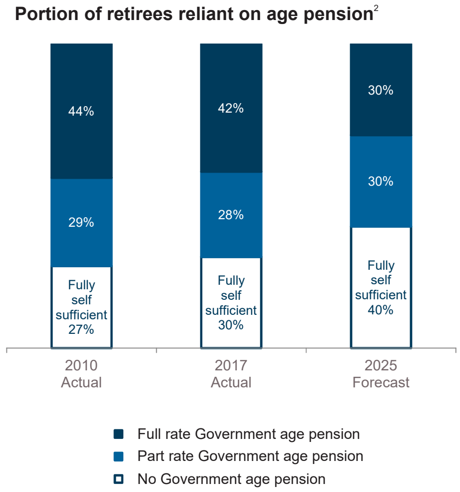
What this data shows is that those very low average super balances often quoted, include members still in accumulation. In fact, they include those who have only just started accumulating super savings. Most super members who have reached retirement actually have significant balances. Balances that can make a material difference to their quality of life in retirement. Balances that need to be recognised as serving a different purpose to those in accumulation. They are not there to build up, confident they won't be called on. They are there to be converted to a regular reliable income stream when the retiree is no longer receiving the pay packet they have relied on during their working life.

Reducing reliance on age pension

Super system starting to make a difference

- Average household wealth at retirement now $350k to $500k range[1]
- Age pension subject to asset and income tests
- 2.5m Australians receiving some age pension support
- Portion of retirees on full age pension expected to reduce from 42% to 30% over next 8 years
- However
  - number of retirees receiving support increasing
  - Government cost increasing

Super system increasingly supplementing or substituting age pension



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1. Average household wealth includes superannuation and non-superannuation assets and excludes the family home.
2. Source – 2010 and 2017 Actual: Department of Social Services and Department of Veteran Affairs; 2025 Forecast: The Association of Superannuation Funds of Australia (ASFA) projection.

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In this way super delivers on its objective – to supplement or substitute the age pension. And when we look at it through this lens, we can see that is exactly what is happening.

Today more than half of retirees provide for themselves, either fully or in part. Super is moving from supplementing the age pension to replacing it completely for an increasing proportion of retirees.

While the age pension remains essential for most Australians in retirement, it is forecast that only 30% will rely on it fully by 2025. That's only seven years from now.

This increasing ability to self-provide in retirement is critically important from a fiscal perspective. Thanks to our ageing population, while the percentage of retirees relying on the age pension is decreasing, the actual number of people accessing it continues to grow. It costs the government approximately $50 billion every year and that cost is not reducing.

Superannuation is working

With focus shifting to retirement incomes

700 new Australian retirees per day - what matters most

(2017 National Seniors Australia Survey[1])

84% *regular and constant income*

77% *money to last a lifetime*

48% *concerns with outliving savings*

Retirement is different – retirement phase of super system needs enhancing

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1. Conducted by National Seniors Australia and includes responses from 5,770 Australians over the age of 50.

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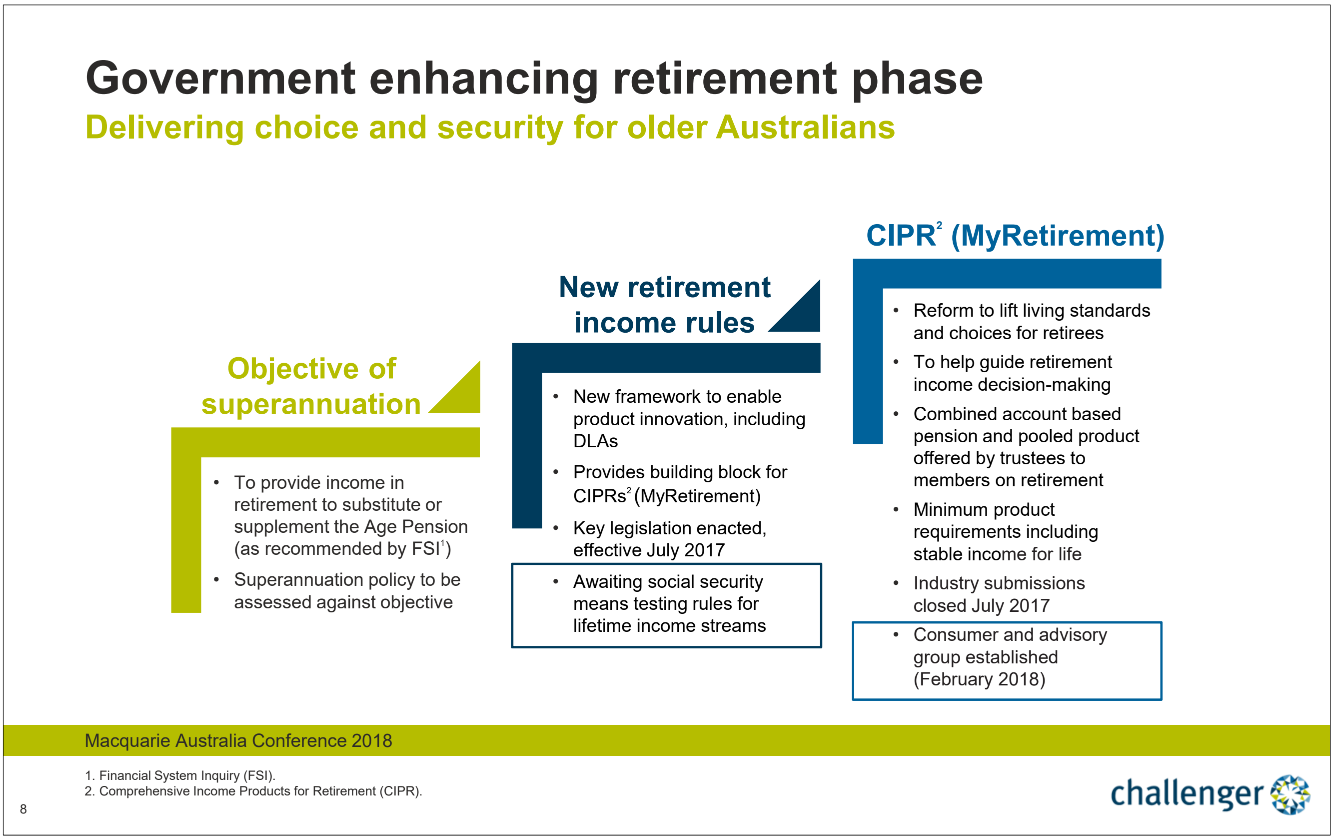
While we've got the first part right, as you can clearly see from the data I've shared so far, the system has reached a stage where we now need to also get the next part right - retirement.

At the moment, when you reach retirement you suddenly need to figure out what to do with these savings you've worked so hard to build. You need to work out how much you can spend and for how long. After a lifetime of, for most people, living around a monthly paycheque, you're confronted with a world of unknowns.

Each year National Seniors Australia conducts a major survey of Australians aged over 50. Last year, consistent with previous surveys, when asked about their financial priorities for retirement, 84% said regular and constant income was very important to them. Astoundingly, this is something our system is not set up to deliver.

77% said it is very important that their money lasts as long as they do, with 48% of over 50s who are still working, worried about outliving their savings.

It's clear that the superannuation system is an unfinished bridge, taking people part of the way but not safely getting them to the other side.



The government is clearly alive to this challenge.

In late 2014 the Financial System Inquiry recommended development of Comprehensive Income Products for Retirement, or CIPRs. The FSI found that a pre-determined combination of products designed to deliver a regular and stable income stream, longevity risk management, and flexibility, would simplify decisions at retirement and, most importantly, deliver better outcomes for retirees.

The availability of lifetime income streams in retirement is critical to ensuring savings accumulated through super can meet retiree consumption needs.

In response the government has been pursuing an agenda of reforms to improve outcomes for Australians in retirement.

The Retirement Incomes Review concluded last year with new rules to enable the creation of a wider range of retirement income products.

At Challenger we showed our support for this important reform with the introduction of deferred lifetime annuities – a product only possible thanks to the new rules.

Deferred lifetime annuities, or DLAs, are a great tool to add to the retirement planning kit box. They enable retirees to confidently spend in their active years of retirement, knowing their deferred lifetime annuity will provide a reliable income later in life.

Of course, there was one more step needed to complete this reform, and make new lifetime products including DLAs easier for all retirees to consider, including those who receive some age pension – that is the setting of means test rules for these new products. That process is now almost complete.

As well as making more products available for retirees today, the new retirement income legislation was also an essential enabling step on the way to CIPRs.

The CIPR process kicked off in earnest in late 2016 with the release of a detailed discussion paper. The paper set out the objectives of CIPRs – the key one being to lift the standard of living for retirees. The reform is intended to provide choices for retirees while also reducing the decision-making burden currently placed on them when they reach retirement, and throughout retirement.

So where are these reforms up to now?

Government enhancing retirement phase

Delivering choice and security for older Australians

New retirement income rules

Means testing of lifetime income streams

- No change for term annuities (80% of sales)
- DSS[1] seeking simplicity
- Provides clarity for product innovation
- Enable DLAs and new product opportunities
- Supports retirement income reforms
- Expect announcement soon

CIPR[2] (MyRetirement)

Consumer and advisory group

- Providing feedback and advice to Treasury on retirement framework design
- Scoping SIS[3] Act retirement covenant
- Require super trustees to design and offer appropriate retirement income solutions
- Further industry consultation expected

1. Department of Social Services (DSS).
2. Comprehensive Income Products for Retirement (CIPR).
3. Superannuation Industry (Supervision) Act 1993.

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As I mentioned, the final stage of the new retirement income rules, means testing, is close to complete. To ensure there is a consistent approach, the new rules will also apply to existing lifetime retirement income products.

Earlier this year the Department of Social Services released a position paper outlining proposed new means testing rules. They have undertaken substantial engagement to test these proposals and have indicated they expect to announce the new rules soon, possibly as early as the Federal Budget on 8 May.

Throughout this process they have expressed a strong commitment to ensuring the rules support the government's retirement income reform agenda and are simple for retirees to understand and apply.

This is an approach we support.

In terms of how the change of rules will affect Challenger, firstly it's important to understand the scope of our business.

Annuities currently represent around two-thirds of our total Life sales. Of our annuity sales, around 80% are term annuities, which are not affected by the new rules.

Following the introduction of the new rules, we will be able to broaden our offering, as the rules intend, with DLAs and other new products.

How our lifetime annuities will be affected will depend on the final rules that are announced. It's important to remember that most annuities are purchased in a blended portfolio providing a valuable and complementary part of the asset mix for retirees.

The core benefits of using lifetime annuities continue – guaranteed income for life, regardless of how markets perform, or how long you live. Only the interaction with the age pension will change, and how this impacts the total outcome across retirement will be different for every individual.

We'll update you further on this when the new rules are announced.

As for the CIPR reforms, this process is continuing to progress well. In February this year the Government convened a consumer and advisory group tasked with helping move forward the development of a retirement framework. The group was asked to scope a retirement covenant for inclusion in the relevant act – the Superannuation Industry (Supervision) Act.

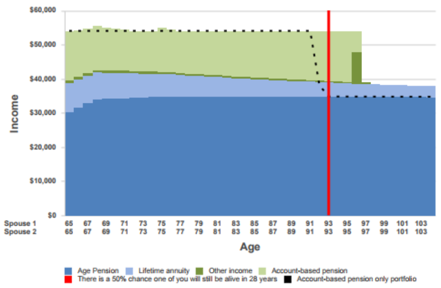
It's extraordinary to think that currently this Act, which sets out what is required of superannuation trustees, doesn't include consideration of the needs of members in retirement.

Following the work of this advisory group, there's expected to be further industry consultation and we look forward to actively participating to help ensure the success of these reforms.

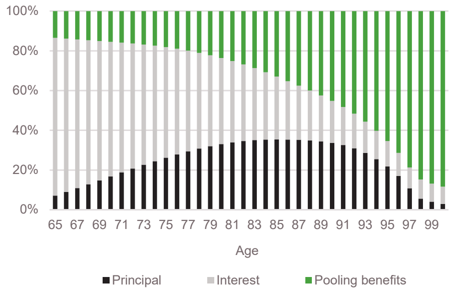
Industry moving ahead of regulation

Combining pooled products with ABPs[1] often provide superior outcomes[2]

Retirement income enhanced by combining products[3]



Pooling longevity risk helps create lifetime income
(illustrative example)



Retirement income models emerging – delivering what matters most to retirees[4]

84% *regular and constant income*

77% *money to last a lifetime*

48% *concerns with outliving savings*

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1. Account Based Pension (ABP).
2. 'Optimal solution to the retirement riddle' Actuaries Summit May 2015.
3. Example of couple with $400,000 retirement balance and 25% allocated to a lifetime annuity and 75% allocated to an Account Based Pensions (ABP).
4. 2017 National Seniors Australia survey - Conducted by National Seniors Australia and includes responses from 5,770 Australians over the age of 50.

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While it's certainly vital that we get the public policy settings right for Australia's retirees, industry is already working to improve the outcomes for older Australians.

The total outcome for a retiree will often be enhanced by including a pooled income stream, such as a lifetime annuity, in combination with other retirement assets that they hold in what is termed an account based pension. This is sometimes called a blended portfolio or comprehensive lifetime portfolio. You might have also heard us talk about this as income layering.

The chart on the left demonstrates how this works using an example of a retiree couple with $400,000 of superannuation. The coloured blocks show the income by source the couple could expect to receive if they allocated 25% of their superannuation to a lifetime annuity and 75% to an account based pension. The dotted line compares this with the income they would receive if they were 100% invested in a traditional account based pension. You can see in this example the blended portfolio should provide a higher level of income for a longer period of time, materially improving the quality of life of these retirees.

The chart on the right helps explain how lifetime annuities enable retirees to benefit from a concept known as pooling. It shows that the income the retiree receives from a lifetime annuity is made up of three parts – the earnings on their investment, their principal or capital being returned to them, and the increasing share of the pooled money they receive the longer they survive.

Because this pooled product provides a guaranteed income, when it is held in conjunctionwith an account based pension it enables the funds left in the account based pension to be invested in higher growth assets. The benefits of blending products, and the benefits of pooling, together help create higher and more reliable income throughout retirement.

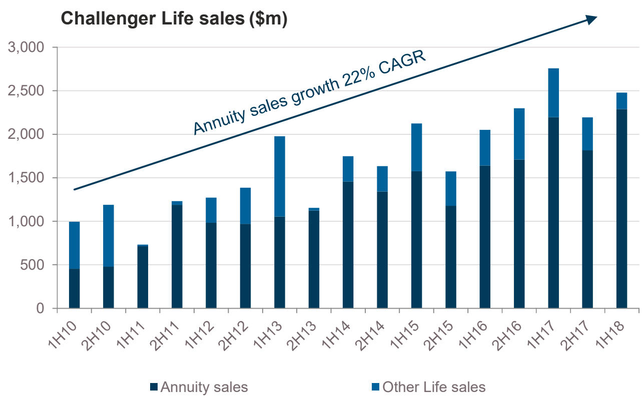
This solution delivers on the priorities identified by retirees in the National Seniors survey.

And it’s something we can, and do, deliver today.

Challenger

Leader in growing retirement incomes market

To provide our customers with financial security for retirement



Implementing a clear strategy to achieve growth

- Industry leading research
- Enabling technology
- Technical expertise
- Adviser education and support
- Product innovation

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In fact, meeting the needs of retirees in this way has seen Challenger more than quadruple annuity sales over the last eight years.

We've implemented a clear strategy to achieve this growth with:
- Industry leading research
- Enabling technology
- Technical expertise
- Adviser education and support, and
- Product innovation

In the last three years alone, we've built new partnerships to deliver annuities with nine major superannuation providers.

Beyond our shores we've built a successful relationship in Japan that has already contributed more than $1 billion in sales, and is on track to deliver our target of $600 million for this financial year. As I said when announcing our strategic relationship, it's only early days and it's off to a very strong start. These types of connections are highly desirable and take time to build. Our businesses are very complementary and we can see great potential to deliver further benefits for both groups in the future.

Of all of these important initiatives that have driven our growth, I'd like to spend a moment talking about one in particular – product innovation.

This is an area where we have a very strong track record and it's been a key driver of reinvigorating the annuity market in Australia. It's also an area where we see a lot of opportunity once the final stage of the retirement income review process is complete.

Over the years we've introduced a range of new features to our annuities to meet the needs of our customers and to help overcome their concerns. Many of the upticks you can see on the chart correlate with the introduction of new products.

Nothing demonstrates our product development capability better than our CarePlus product. The product was conceived in January 2015. Four months later we had a product design and just three months after that, in August that year, we had the relevant approvals and documentation. That same month we were in the market, operating initially with manual processes in the background while we finalised the systems.

That's agility. Today CarePlus is our fastest growing product. Last financial year it eclipsed $200 million of sales, from $60 million just 12 months earlier.

This is true product development capability and it's a capability we're looking forward to putting to work when the retirement income reform process is finalised.

I hope today I've painted a clear picture of the pivotal point our superannuation system has reached, and the incredible opportunity this presents.

Superannuation savings are growing at a very healthy pace. Although our system is still far from mature, we have already reached a stage where Australians are entering retirement with meaningful superannuation balances. Retirees are increasingly able to provide for themselves in retirement, reducing their reliance on the age pension and improving their quality of life.

But, our superannuation system needs to catch up. It's been rightly focused on accumulation – helping Australians build their savings for retirement. Now is the moment we need to make sure it is also built for the rest of its job – helping retirees convert those savings into reliable income for life.

It's a challenge the government is meeting head on, with retirement income reforms to enable and encourage the development of new products, and a program to develop Comprehensive Income Products for Retirement.

At the same time industry is also stepping up to meet the challenge.

All of this gives me great confidence in our ability to meet the needs of the fast-growing number of increasingly self-reliant retirees in Australia.

I am happy to take your questions.

Important note

This presentation was prepared for the purpose of a briefing to equity analysts and certain wholesale investors on 2 May 2018.

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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