

UPDATE ON CHALLENGER LIFE CAPITAL POSITION AND INVESTMENT PORTFOLIO

Challenger Limited (ASX:CGF) today confirmed it remains strongly capitalised and maintains its normalised profit guidance for FY20 despite continued significant investment market volatility as a result of the Coronavirus pandemic.

Challenger Life Company Limited (Challenger Life) continues to actively manage its investment portfolio, reducing its capital intensity and maintaining a strong capital position.

Challenger Life's Prescribed Capital Amount (PCA) ratio¹ is currently estimated at 1.55 times² and is toward the top end of Challenger's target range of 1.3 times to 1.6 times APRA's minimum requirement.

Challenger has additional financial flexibility and liquidity, including a group banking facility of \$400 million, which has been fully drawn and is being held in cash outside of Challenger Life. Challenger has the capacity to inject \$250 million of this facility into Challenger Life as Common Equity Tier 1 regulatory capital, and APRA has confirmed no objection to this.

Managing Director and Chief Executive Officer, Richard Howes said: "Challenger Life has successfully adjusted its investment portfolio given the significant market sell-off in order to maintain capital strength well in excess of APRA's requirements. While conditions remain extremely volatile, we have the capability and flexibility to successfully navigate through this period.

"We have positioned our portfolio defensively for the current conditions with a high weighting to investment grade fixed income.

"Our business is well placed to manage through this volatility with capital strength, robust risk management and leading investment capability.

"We continue to reposition the portfolio so we can be ready to benefit when conditions do ultimately begin to stabilise and relative value opportunities emerge.

"In the meantime, our customers are able to face this uncertain time with the confidence of knowing their annuity income is guaranteed, regardless of market performance."

¹ PCA ratio represents Challenger Life's regulatory capital base divided by the Prescribed Capital Amount (PCA).

² As at 27 March 2020.

Challenger Life PCA ratio¹

In order to maintain a strong capital position within Challenger Life's target PCA ratio range, Challenger is actively managing its investment portfolio by lowering exposure to certain asset classes (outlined in the Challenger Life investment portfolio update below).

Following the changes to Challenger Life's investment portfolio, Challenger has reduced the capital intensity ratio³ from 13.3% at 31 December 2019 to 10.9%⁴, which has supported Challenger Life's excess regulatory capital position and PCA ratio.

Challenger Life is required to value all assets and liabilities supporting the Life business at fair value. Following the continued and significant investment market sell-off during March, Challenger has reduced the carrying value of its fixed income, property, equities and infrastructure investments. This has the effect of reducing Challenger Life's excess regulatory capital, however has no material direct impact on FY20 normalised net profit after tax.

Following the investment portfolio and valuation changes, Challenger Life's PCA ratio is currently estimated at 1.55 times and is toward the top end of Challenger's target PCA ratio range.

Challenger Capital Notes (Additional Tier 1 instrument) replacement

Challenger Life's regulatory capital base includes \$345 million of Additional Tier 1 regulatory capital in the form of Challenger Capital Notes (ASX:CGFPA), which are subordinated, unsecured convertible notes (hybrid debt) issued by Challenger Limited.

Challenger Capital Notes convert into ordinary Challenger shares on 25 May 2022⁵, unless Challenger exercises its option to repurchase the notes on the optional exchange date on 25 May 2020. It was Challenger's intention to repurchase the Challenger Capital Notes utilising proceeds of a replacement capital notes offer which was to launch in March 2020.

The recent investment market volatility has, however, significantly impacted the listed hybrid debt market and launching a replacement capital notes offer at this time is not feasible. Challenger has requested, and APRA has confirmed no objection to, Challenger having the right to repurchase Challenger Capital Notes on any distribution payment date after the optional exchange date of 25 May 2020 up to 25 May 2022⁶. Any repurchase in the future remains subject APRA approval⁷ as is ordinarily the case.

³ Capital intensity ratio calculated as Challenger Life Prescribed Capital Amount (PCA) divided by Life closing investment assets.

⁴ As at 27 March 2020.

⁵ Conversion to ordinary Challenger shares subject to certain conditions. These conditions are intended to help protect noteholders against receiving ordinary shares worth significantly less than \$101 per Challenger Capital Notes and ensure that the ordinary shares are capable of being sold on ASX

⁶ Up to but not including 25 May 2022.

⁷ The terms of Challenger Capital Notes remain unchanged and are not required to be amended to facilitate these arrangements.

Subject to market conditions normalising, this provides Challenger further opportunities to launch a replacement capital notes offer over the next two years⁸. In the interim, Challenger Capital Notes will continue to fully qualify as Additional Tier 1 capital in Challenger Life’s regulatory capital base.

Challenger Life investment portfolio update

Challenger continues to actively manage its portfolio to reduce capital intensity and risk. Life has reduced exposure to higher capital-intensive assets, including sub-investment grade fixed income, equities and infrastructure, with the proceeds held in cash and liquid fixed income.

Following changes to the investment portfolio, 83% of the fixed income portfolio is investment grade, up from 75% at 31 December 2019.

Challenger Life is currently holding in excess of \$3 billion in cash and liquid fixed income, which can be redeployed as markets stabilise and relative value opportunities emerge. As a result, it is anticipated Life’s asset allocation and composition may change materially by 30 June 2020.

Challenger Life’s asset allocation is currently as follows –

Asset class	27 March 2020	31 December 2019
Fixed income – investment grade ¹	64%	50%
Fixed income – sub-investment grade	13%	16%
Property	17%	17%
Equity & other ¹	5%	13%
Infrastructure	1%	4%
Total	100%	100%

1. Includes impact of absolute return fund redemptions currently underway, which are expected to be completed by 31 March 2020.

S&P ratings update

On 27 March 2020 S&P Global Ratings (S&P) affirmed Challenger Life Company Limited’s A rating and Challenger Limited’s BBB+ rating. Reflecting the significant market volatility from the Coronavirus pandemic, S&P has removed the positive outlook and reverted to a stable outlook.

Challenger’s S&P ratings are as follows:

- Challenger Life Company Limited – A rating with a stable outlook; and
- Challenger Limited – BBB+ rating with a stable outlook.

⁸ There can be no guarantee that on a further distribution payment date that APRA will give its approval for the repurchase of some or all of the Challenger Capital Notes.

Normalised net profit before tax guidance

Challenger remains on track to achieve its Normalised Net Profit Before Tax guidance of between \$500 million and \$550 million for FY20. The guidance fully reflects the impact of changes to Life's investment portfolio and lower Funds Management earnings from lower funds under management following the equity market sell-off.

Disclaimer

The forward-looking statements, estimates and projections contained in this release are not representations as to future performance and nothing in this release should be relied upon as guarantees or representations of future performance.

ENDS

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 is Australia's largest provider of annuities.

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