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Challenger Limited ACN 106 842 371

FY17

Analyst Pack

30 June 2017

Providing our customers with financial security for retirement

challenger

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2017 Annual Report
2017 Annual Review

can be downloaded from Challenger's online Shareholder Centre

challenger.com.au/share

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Important Note

Information presented in the FY17 Analyst Pack is presented on an operational basis (rather than statutory) to reflect a management view of the business. Challenger Limited (ACN 106 842 371) also provides statutory reporting as prescribed under the Corporations Act 2001. The Challenger Limited 2017 Annual Report is available from Challenger's website at www.challenger.com.au.

The Analyst Pack is not audited. The statutory net profit after tax as disclosed in the consolidated profit and loss (page 7) has been prepared in accordance with Australian Accounting Standards and the Corporations Act 2001. Challenger's external auditors, Ernst & Young, have audited the statutory net profit after tax as disclosed in the consolidated profit and loss. Normalised profit after tax, as disclosed in the consolidated profit and loss (see page 7) has been prepared in accordance with a normalised profit framework. The normalised profit framework has been disclosed in section 2 of the Operating and Financial Review in the Challenger Limited 2017 Annual Report. The normalised profit after tax has been subject to a review performed by Ernst & Young.

Any forward looking statements included in this document are by nature subject to significant uncertainties, risks and contingencies, many of which are outside the control of, and are unknown to, Challenger, so that actual results or events may vary from those forward looking statements, and the assumptions on which they are based.

Past performance is not an indicator of future performance. While Challenger has sought to ensure that information is accurate by undertaking a review process, it makes no representation or warranty as to the accuracy or completeness of any information or statement in this document. In particular, information and statements in this document do not constitute investment advice or a recommendation on any matter, and should not be relied upon.

FY17 financial highlights

Group

- Statutory net profit after tax[1] $398m, up 21%
- Normalised net profit after tax[1] $385m, up 6%
- Normalised EPS 68.5 cents per share, up 6%
- Statutory EPS 70.7 cents per share, up 21%
- Net income $766m, up 6%
- Expenses $256m, up 3%
- Normalised cost to income ratio improved 120 bps to 33.4%
- Group assets under management $70.0bn, up 17%
- Normalised return on equity 18.3% (pre-tax), up 50 bps
- Full year dividend 34.5 cents per share (fully franked), up 6%
- Normalised dividend payout ratio 50%

Life

- Cash Operating Earnings (COE) $631m, up 7%
- COE margin 4.29%, down 20 bps
- Expenses $100m, up 8%
- EBIT $531m, up 6%
- Annuity sales $4.0bn, up 20%
- Annuity book growth $900m up $160m (or 9.4% of opening liabilities)
- Total Life sales $5.0bn, up 14%
- Total Life book growth $1,313m up $245m (or 12.1% of opening liabilities)
- Investment assets $15.7bn, up 11%
- Normalised Return on Equity 21.0% (pre-tax), up 60 bps
- Prescribed Capital Amount (PCA) ratio 1.57 times, unchanged and at the top end of the 1.3-1.6 times target
- Common Equity Tier 1 (CET1) ratio 1.01 times, down from 1.12 times

Funds Management

- Net income $134m, up 5%
- Expenses $89m, down 2%
- EBIT $45m, up 21%
- Net flows $6.2bn
- Funds Under Management $66.9bn, up 18%
- Return on Equity 24.8% (pre-tax), up 130 bps

1 Normalised net profit after tax excludes investment experience, being unrealised gains and losses on Life's investment assets and liabilities valued at fair value (refer to page 51 for more detail). In FY17, investment experience is the only difference between normalised and statutory net profit after tax.

Market overview and outlook

The Australian superannuation system is underpinned by mandatory contributions, which are scheduled to increase from 9.5% of gross salaries to 12.0% by 2025. Due to the mandated nature of Australia's superannuation system, Australia has the fourth largest pension market globally and is expected to grow strongly over the next 20 years. The superannuation system is forecasted to grow from $2.3 trillion today to over $10 trillion by 2035[1].

Both the Life and Funds Management businesses benefit from growth in Australia's superannuation system. The Funds Management business targets the retirement savings (or accumulation) phase of superannuation by providing investment products seeking to deliver superior investment returns to help build retirement savings. The Life business targets the retirement spending (or retirement) phase of superannuation by providing investment products that convert savings into safe and secure retirement incomes.

Life

The retirement spending phase of superannuation is expected to grow strongly over the next 20 years as a result of demographic changes. Over the next 20 years, the number of Australians over the age of 65, which is Life's target market, is expected to increase by 75%[1] as Australia's Baby Boomers (born 1946 to 1964) move into the retirement phase.

Reflecting the demographic changes underway, and growth in Australia's superannuation system, the annual transfer from the retirement savings phase to the retirement spending phase is expected to increase from ~$57bn per year in 2017 to ~$198 billion by 2030, representing a ~11% compound annual increase[2]. Annuities currently captured less than 5% of this annual transfer to the retirement phase.

There is growing recognition that retirees need to take a different approach to investing in retirement and there is a move toward income layering and objectives-based investing. As retirees transition from Government funded aged pensions to private pensions, retirees are demanding safe, secure retirement income products that convert savings to income and provide financial security. Annuities address these retiree needs.

There are a range of retirement income regulatory reforms currently underway (refer page 25 for more detail), which are designed to enhance the retirement phase of superannuation. These reforms provide a significant opportunity to increase the proportion of retirement savings invested in longevity products, including annuities.

The retirement phase of superannuation is a high growth market driven by ageing demographics, rising superannuation balances from mandatory contributions, and changes in retiree risk preferences. As Australia's leading annuities provider, Challenger Life Company (CLC) is expected to continue to benefit from this growth over the long-term.

CLC is diversifying its product range and expanding distribution relationships outside of Australia. In 2016, CLC commenced an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary), a leading provider of Australian dollar denominated annuity products in Japan (refer to the MS Primary section on page 23). This relationship provides CLC with access to Japan's significantly larger Australian dollar annuities market.

Japan has one of the world's most rapidly ageing populations and Japan has a low domestic interest rate environment, which is making higher returning foreign currency annuities popular. CLC is well placed to build on the MS Primary annuity relationship.

Funds Management

Challenger's Funds Management business has experienced significant FUM growth over the past five years, with $25 billion of net inflows and is growing significantly faster than the broader Australian Funds Management market.

This growth can be attributed to the strength of Challenger's retail and institutional distribution teams, a market leading Funds Management business model which focuses on investor alignment, and Australia's superannuation system growth.

Challenger's Fidante Partners' business model comprises interests in separately branded boutique fund managers, with Challenger providing the distribution, administration and business support, leaving managers to focus on managing investment portfolios. This strong investor alignment is driving superior long-term investment performance, with 97% of Fidante Partners' funds outperforming their benchmark[3]. This long-term performance track record is underpinning net flows, with over $6 billion received in FY17.

Following the success of Challenger's Fidante Partners business model in Australia, it is being replicated in Europe, providing access to the £7 trillion United Kingdom funds management market[4], and opening up global distribution opportunities for existing investment managers.

Funds Management is expected to continue to benefit from Challenger's distribution capability, superior long-term investment performance, and expansion into Europe. This provides a strong base to continue to grow the business and achieve Challenger's vision of providing customers with financial security for retirement.

1 Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2015-2035.
2 Rice Warner 2016 Super Projections – forecasted growth over next 10 years based on existing regulatory environment.
3 Represents percentage of Fidante Partners' funds meeting or exceeding performance benchmark over five years.
4 The Investment Association Annual Survey 2015-2016.

Vision and strategy

To provide our customers with financial security for retirement

Increase the Australian retirement savings pool allocation to secure and stable incomes

Be recognised as the leader and partner of choice in retirement income solutions with a broad product offering

Provide customers with relevant investment strategies exhibiting consistently superior performance

Deliver superior outcomes to customers and shareholders through a highly engaged, diverse and agile workforce committed to sustainable business practices and a strong risk and compliance culture

FY17 strategic progress

Grow allocation to secure and stable retirement incomes

Increase the Australian retirement savings pool allocation to secure and stable incomes

Annuities currently capture less than 5% of the annual transfer from the retirement savings (accumulation) to the retirement spending (retirement) phase. Challenger is focused on growing the allocation of the Australian retirement savings pool allocated to secure and stable incomes.

FY17 progress includes:

Record Life Sales:

- $4.0bn of annuity sales, up 20% on FY16;
- $1.0bn of lifetime annuity sales, up 70% on FY16; and
- $0.9bn of Life other sales, representing institutional guaranteed rate products.

Launching new income focused products:

- Launched Challenger Index Plus Fund, a new pooled institutional fixed income product;
- Developed a new Deferred Lifetime Annuity to be launched in 1H18; and
- Following new Government retirement income product rules, enhanced Liquid Lifetime (lifetime annuity) in order to increase customer options.

Tools for financial advisers:

- The market leading Challenger Retirement Illustrator was launched in order to support adviser and the para-planning process. The illustrator provides scenario modelling to demonstrate the benefits of partial annuitisation.

Superannuation reforms engagement and advocacy:

- Continued superannuation reform engagement and advocacy following new retirement income rules and development of a framework for Comprehensive Income Products for Retirement (see page 25). Challenger is playing a leading role in educating financial advisers and superannuation funds on the benefits of partial annuitisation.

Be the market leader and partner of choice in retirement income solutions

Be recognised as the leader and partner of choice in retirement income solutions with a broad product offering

Challenger is the market leader in retirement incomes with 63%[1] annuity market share. As an independent provider, Challenger's strategy includes being the partner of choice for superannuation funds and wealth managers for retirement income solutions.

FY17 progress includes:

Increased product access via investment and administration platforms:

- Challenger annuities were made available by three profit-for-member funds – caresuper, legalsuper, and Local Government Super;
- Challenger annuities launched on three retail platforms – ClearView, Colonial (CarePlus product) and Suncorp; and
- Annuity relationships formed with AMP and BT, with Challenger annuities launching on their platforms during FY18.

Following the launch on AMP and BT, two thirds of Australian financial advisers will be able to access Challenger annuities via investment and administration platforms.

New relationships:

- Annuity relationship with MS Primary, a leading Japanese insurer, announced in October 2016. Life is issuing Australian dollar fixed rate annuities with a 20-year term to support a reinsurance agreement with MS Primary. The relationship provides access to Japan's significantly larger Australian dollar annuity market. The relationship accounted for 15% of Life's FY17 annuity sales; and
- Partnership formed with Standard Life Investments to distribute the Standard Life Absolute Return Global Bond Strategies Fund in Australia under Challenger's brand.

Recognition as market leader:

- Rated number one by Wealth Insights for – Overall Adviser Satisfaction (2nd year running); BDM Team (6th consecutive year); Client Services (2nd consecutive year); Image and Reputation (2nd consecutive year); and Technical Services (2nd consecutive year); and
- Won the Financial Advisers/Plan for Life award for Annuity Provider of the Year and Long-Term Income Stream; won Chant West 2017 Super Funds award for Best Longevity Fund; and won Money Management/Lonsec award for Retirement Income Innovation.

1 Strategic Insights annuity market share as at 31 March 2017.

Provide relevant and superior investment strategies for customers

Provide customers with relevant investment strategies exhibiting consistently superior performance

Challenger is focused on providing relevant investment strategies that exhibit superior investment performance in order to help build retirement savings.

FY17 progress includes:

- Added two new boutique managers, Avenir Capital a global equities manager, and Lennox Capital Partners, an Australian small cap equities manager;
- Maintained superior investment performance with 97% of Fidante Partners' funds under management exceeding benchmark over the last five years;[1]
- Continued Fidante Partners Europe build out, including restoring business profitability; and
- Expanded the product offering for existing boutique managers, with seven new strategies launched in FY17, helping increase available manager capacity by $30 billion.

Sustainable business practices to deliver superior outcomes

Deliver superior outcomes to customers and shareholders through a highly engaged, diverse and agile workforce committed to sustainable business practices and a strong risk and compliance culture

Challenger believes maintaining a highly engaged, diverse and agile workforce committed to sustainable business practices and a strong risk and compliance culture will provide customers and shareholders with superior outcomes.

FY17 progress includes:

- 2017 staff engagement survey conducted by Willis Towers Watson, confirmed Challenger's staff are highly engaged with a score of 88%. The score was well above Willis Towers Watson's Global High Performing Norm;
- Progress made on meeting Challenger's 2020 diversity targets, with all FY17 diversity targets exceeded;
- Strong risk management culture maintained, with the latest staff engagement survey showing 88% of staff had a positive view toward Challenger's risk management culture. The score was nine percentage points above the Willis Towers Watson Australian National Norm;
- Second highest industry net promotor score (survey conducted by Wealth Insights), with peers including Australia's top 20 fund managers;
- In 2017, we have refreshed our approach to corporate sustainability, including extended discussions on matters material to our business, such as regulatory reform and ethical conduct;
- Cost management remained a priority with cost increases limited to 3% in FY17. This resulted in a record low cost to income ratio and one that is 17 percentage points[2] below industry average; and
- All financial guidance metrics set at the start of the FY17 year were achieved.

1 Represents percentage of Fidante Partners' funds meeting or exceeding performance benchmarks over five years.
2 Includes Australian and New Zealand Banking Corporation, AMP , Bank of Queensland, Bendigo and Adelaide Bank, BT Investment Management, Commonwealth Bank of Australia, IOOF, Macquarie Bank, Magellan Financial Group , National Australia Bank, Perpetual and Westpac Banking Corporation.

Key performance indicators

	FY17	FY16	FY15	2H17	1H17	2H16	1H16	2H15	1H15
Earnings									
Normalised NPAT ($m)	384.9	361.7	334.0	188.3	196.6	179.6	182.1	179.1	154.9
Statutory NPAT ($m)	397.6	327.7	299.0	196.1	201.5	93.4	234.3	168.9	130.1
Normalised EBIT ($m)	510.3	471.5	438.4	253.9	256.4	232.8	238.7	232.0	206.4
Underlying operating cash flow ($m)	299.9	297.1	287.9	131.4	168.5	149.7	147.4	194.3	93.6
Normalised cost to income ratio	33.4%	34.6%	33.8%	33.9%	32.9%	35.4%	33.8%	33.3%	34.4%
Normalised effective tax rate	23.8%	22.6%	23.1%	24.9%	22.6%	22.3%	23.0%	22.1%	24.3%
Earnings per share (cents)									
Basic – normalised	68.5	64.6	61.2	33.5	35.0	32.0	32.6	32.4	28.8
Basic – statutory	70.7	58.5	54.8	34.9	35.8	16.6	41.9	30.5	24.2
Diluted – normalised	65.8	60.9	57.2	32.1	33.3	30.3	30.5	30.0	27.0
Diluted – statutory	67.8	55.4	51.4	33.4	34.1	16.3	39.0	28.3	22.8
Return on equity (%)									
Normalised Return on Equity (RoE) – pre-tax	18.3%	17.8%	18.0%	18.0%	18.7%	17.4%	18.1%	18.6%	17.4%
Normalised Return on Equity (RoE) – post-tax	14.0%	13.7%	13.9%	13.5%	14.5%	13.6%	14.0%	14.5%	13.2%
Statutory Return on Equity (RoE) – post-tax	14.4%	12.5%	12.4%	14.0%	14.8%	7.1%	18.0%	13.7%	11.1%
Capital management									
Net assets – average[1] ($m)	2,754	2,631	2,410	2,818	2,694	2,664	2,592	2,494	2,331
Net assets – closing ($m)	2,888	2,681	2,543	2,888	2,781	2,681	2,696	2,543	2,443
Net assets per basic share ($)	5.14	4.80	4.60	5.14	4.95	4.80	4.80	4.60	4.42
Net tangible assets ($m)	2,300	2,097	1,994	2,300	2,192	2,097	2,111	1,994	1,896
Net tangible assets per basic share ($)	4.09	3.75	3.60	4.09	3.90	3.75	3.75	3.60	3.43
Dividend (cps)	34.5	32.5	30.0	17.5	17.0	16.5	16.0	15.5	14.5
Dividend franking (%)	100.0	100.0	85.5	100.0	100.0	100.0	100.0	100.0	70.0
Normalised dividend payout ratio	50.4%	50.3%	49.0%	52.2%	48.6%	51.6%	49.1%	47.8%	50.4%
Sales, net flows and assets under management									
Life annuity sales ($m)	4,011.2	3,351.2	2,753.1	1,815.1	2,196.1	1,710.1	1,641.1	1,178.3	1,574.8
Other Life sales ($m)	941.2	998.5	944.0	378.9	562.3	588.8	409.7	395.1	548.9
Total Life sales ($m)	4,952.4	4,349.7	3,697.1	2,194.0	2,758.4	2,298.9	2,050.8	1,573.4	2,123.7
Life annuity flows ($m)	900.4	740.4	738.2	451.5	448.9	469.9	270.5	177.4	560.8
Life annuity book ($m)	10,322.2	9,558.5	8,692.6	10,322.2	9,784.9	9,558.5	8,868.4	8,692.6	8,573.1
Life annuity book growth	9.4%	8.5%	9.4%	4.7%	4.7%	5.4%	3.1%	2.2%	7.2%
Total Life flows ($m)	1,312.9	1,068.3	650.9	469.5	843.4	721.2	347.1	212.5	438.4
Total Life book[2] ($m)	12,010.0	10,874.0	9,637.7	12,010.0	11,418.1	10,874.0	9,903.5	9,637.7	9,527.9
Total Life book growth	12.1%	11.1%	7.3%	4.3%	7.8%	7.5%	3.6%	2.4%	4.9%
Funds Management – net flows[3] ($m)	6,220.6	(2,517.2)	7,738.9	3,003.5	3,217.1	1,839.2	(4,356.4)	972.7	6,766.2
Total Group assets under management	69,988	60,051	59,789	69,988	64,705	60,051	57,617	59,789	57,169
Other									
Headcount – closing FTEs	655	635	560	655	632	635	618	560	563
Weighted average number of basic shares on issue (m)	562.2	560.2	545.7	562.1	562.3	561.2	559.1	553.2	538.2
Number of basic shares on issue (m)	561.9	558.8	553.4	561.9	562.3	558.8	562.2	553.4	552.9
Share price closing ($)	13.34	8.63	6.72	13.34	11.24	8.63	8.72	6.72	6.53

1 Net assets – average calculated on a monthly basis.
2 Total Life book includes the Life annuity book, Guaranteed Index Return and Challenger Index Plus Fund liabilities.
3 Funds Management 1H16 and FY16 net flows include $5.4bn derecognition of Kapstream following the sale in July 2015.

Consolidated profit and loss

$m	FY17	FY16	FY15	2H17	1H17	2H16	1H16	2H15	1H15
Cash earnings	526.4	491.9	463.4	261.1	265.3	247.4	244.5	240.1	223.3
Normalised capital growth	105.0	100.5	80.4	53.9	51.1	52.1	48.4	45.9	34.5
Normalised Cash Operating Earnings (COE)	**631.4**	**592.4**	**543.8**	**315.0**	**316.4**	**299.5**	**292.9**	**286.0**	**257.8**
Net fee income	134.0	127.7	117.5	68.7	65.3	60.6	67.1	61.4	56.1
Other income	0.8	1.0	1.3	0.4	0.4	0.4	0.6	0.6	0.7
Total net income	**766.2**	**721.1**	**662.6**	**384.1**	**382.1**	**360.5**	**360.6**	**348.0**	**314.6**
Personnel expenses	(179.3)	(172.8)	(154.8)	(91.4)	(87.9)	(89.0)	(83.8)	(78.3)	(76.5)
Other expenses	(76.6)	(76.8)	(69.4)	(38.8)	(37.8)	(38.7)	(38.1)	(37.7)	(31.7)
Total expenses	**(255.9)**	**(249.6)**	**(224.2)**	**(130.2)**	**(125.7)**	**(127.7)**	**(121.9)**	**(116.0)**	**(108.2)**
Normalised EBIT	**510.3**	**471.5**	**438.4**	**253.9**	**256.4**	**232.8**	**238.7**	**232.0**	**206.4**
Interest and borrowing costs	(5.3)	(4.1)	(3.8)	(3.0)	(2.3)	(1.8)	(2.3)	(2.1)	(1.7)
Normalised profit before tax	**505.0**	**467.4**	**434.6**	**250.9**	**254.1**	**231.0**	**236.4**	**229.9**	**204.7**
Normalised tax	(120.1)	(105.7)	(100.6)	(62.6)	(57.5)	(51.4)	(54.3)	(50.8)	(49.8)
Normalised profit after tax	**384.9**	**361.7**	**334.0**	**188.3**	**196.6**	**179.6**	**182.1**	**179.1**	**154.9**
Investment experience after tax	12.7	(56.1)	(35.0)	7.8	4.9	(86.2)	30.1	(10.2)	(24.8)
Significant items after tax[1]	–	22.1	–	–	–	–	22.1	–	–
Statutory net profit after tax	**397.6**	**327.7**	**299.0**	**196.1**	**201.5**	**93.4**	**234.3**	**168.9**	**130.1**
Performance analysis									
Normalised earnings per share – basic (cents)	68.5	64.6	61.2	33.5	35.0	32.0	32.6	32.4	28.8
Shares for basic EPS calculation	562.2	560.2	545.7	562.1	562.3	561.2	559.1	553.2	538.2
Normalised cost to income ratio	33.4%	34.6%	33.8%	33.9%	32.9%	35.4%	33.8%	33.3%	34.4%
Normalised effective tax rate	23.8%	22.6%	23.1%	24.9%	22.6%	22.3%	23.0%	22.1%	24.3%
Total net income analysis									
Cash earnings (Life)	68.7%	68.2%	69.9%	68.0%	69.4%	68.6%	67.8%	69.0%	71.0%
Normalised capital growth (Life)	13.7%	14.0%	12.1%	14.0%	13.4%	14.5%	13.4%	13.2%	11.0%
Net fee income (Funds Management)	17.5%	17.7%	17.7%	17.9%	17.1%	16.8%	18.6%	17.6%	17.8%
Other income (Corporate)	0.1%	0.1%	0.2%	0.1%	0.1%	0.1%	0.2%	0.2%	0.2%
Normalised EBIT by division									
Life	531.2	499.8	456.7	264.2	267.0	250.9	248.9	240.9	215.8
Funds Management	45.1	37.4	44.1	24.4	20.7	15.8	21.6	23.3	20.8
Corporate	(66.0)	(65.7)	(62.4)	(34.7)	(31.3)	(33.9)	(31.8)	(32.2)	(30.2)
Normalised EBIT	**510.3**	**471.5**	**438.4**	**253.9**	**256.4**	**232.8**	**238.7**	**232.0**	**206.4**

1 1H16 and FY16 significant items after tax primarily represents the gain on sale of Challenger's equity investment in Kapstream, offset by boutique impairments and office relocation costs.

Consolidated profit and loss

Normalised net profit after tax

FY17 normalised profit after tax was $385m, up $23m (6%) from $362m in FY16. The increase in normalised profit after tax includes a $39m (8%) increase in EBIT, partially offset by a $1m increase in interest and borrowing costs, and a $14m increase in normalised tax.

The increase in EBIT reflects higher Group assets under management, which increased total net income by $45m (6%), and was partially offset by a $6m (3%) increase in expenses.

Normalised earnings per share (EPS)

Normalised EPS increased by 6% from 64.6 cps in FY16 to 68.5 cps in FY17. The increase in normalised EPS reflects higher normalised profit after tax.

Net income

Net income increased by $45m (6%) in FY17 due to:

- Life Cash Operating Earnings (COE) increasing by $39m (up 7%) from higher average investment assets (up 11%), partially offset by a lower Life COE margin, reflecting a change in Life's product mix, and lower returns on shareholder capital (refer to page 19 for more detail); and
- Funds Management fee income increased $6m (up 5%), benefiting from an increase in average Funds Under Management (FUM) (up 12%), partially offset by a lower contribution from performance fees (down $5m). Excluding the impact of lower performance fees, net income increased by 9%.

Expenses

FY17 total expenses were $256m, up $6m (3%) on FY16. The increase in expenses relates to higher personnel costs, resulting from an increase in employee numbers. The number of Full Time Equivalent (FTE) employees increased by 3% to 655 in FY17.

FY17 normalised cost to income ratio decreased by 120 bps to a record low 33.4%, and is toward the lower end of Challenger's normalised cost to income ratio guidance range of between 32% and 36%.

Challenger has a highly scalable business and is one of Australia's most efficient financial services companies. Challenger's normalised cost to income ratio is 17 percentage points lower than the average for ASX100 banks and diversified financial companies.[1]

Reflecting the scale and efficiency of the business, Challenger has reset its medium-term normalised cost to income ratio guidance to a range of 30% to 34% (refer to page 10 for more detail).

Normalised EBIT

FY17 normalised EBIT was $510m, and increased by $39m (8%) from $471m in FY16. Life EBIT increased by $31m (6%) and Funds Management EBIT increased by $8m (21%). Corporate EBIT was unchanged.

The increase in Life normalised EBIT (up 6%) reflects an 11% increase in Life's average investment assets, partially offset by a 20 bps reduction in Life's COE margin (refer to page 19 for more detail).

The increase in Funds Management EBIT (up 21%) reflects higher average FUM, which increased by 12%, lower expenses (down 2%), and was partially offset by lower performance fees (down 65% or $5m).

Normalised Return on Equity (ROE)

FY17 normalised ROE was 18.3% (pre-tax) and increased by 50 bps from FY16. The increase reflects higher normalised net profit before tax (up 8%), partially offset by higher average net assets (up 5%). The increase in average net assets reflects higher retained earnings.

Challenger targets a pre-tax normalised ROE of 18% over the medium-term, and exceeded this target in FY17.

Normalised tax

Normalised tax was $120m in FY17, up $15m on FY16. Higher normalised tax reflects higher EBIT and a higher normalised effective tax rate.

The FY17 normalised effective tax rate was 23.8%, up from 22.6% in FY16. The increase in the normalised effective tax rate was partially due to interest payments for both Challenger Capital Notes and Challenger Capital Notes 2 (refer to page 14 for more details) not being tax deductible as they include a franked component as part of the distribution.

Based on current business mix, over the medium-term Challenger expects a normalised effective tax rate in the range of between 24% and 26% (previously 23% and 25%) The increase in the expected normalised effective tax rate includes the impact of interest payments on Challenger Capital Notes 2, which were issued in April 2017, not being tax deductible.

Investment experience after tax

Challenger Life is required by Australian accounting standards to value investment assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on investment assets and liabilities being recognised in the profit and loss. Challenger is generally a long-term holder of assets, due to them being held to match the term of life contract liabilities. As a result, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements.

1 Includes Australian and New Zealand Banking Corporation, AMP , Bank of Queensland, Bendigo and Adelaide Bank, BT Investment Management, Commonwealth Bank of Australia, IOOF, Macquarie Bank, Magellan Financial Group , National Australia Bank, Perpetual and Westpac Banking Corporation.

Investment experience relates to the Life business and pre-tax investment experience is disclosed as part of Life's financial results.

FY17 investment experience was a pre-tax gain of $21m (refer to page 20 for more detail), or $13m post-tax.

Significant one-off items

Significant one-off items represent non-recurring and abnormal income and expense items. There were no significant one-off items in FY17.

FY16 significant one-off items ($22m after tax) predominately relate to a gain on the sale of Kapstream Capital, a Funds Management boutique manager sold in July 2015.

Statutory net profit after tax

Statutory net profit includes after tax investment experience and significant one-off items.

Statutory net profit after tax in FY17 was $398m, up $70m (21%) from $328m in FY16. The increase in statutory net profit after tax reflects higher normalised profit after tax (up $23m), no significant one-off items in FY17 (down $22m), and higher after tax investment experience (up $69m).

Dividends

Final FY17 dividend

The Board has declared a final FY17 dividend of 17.5 cents per share, which is 6% higher than the final FY16 dividend. Dates for the final dividend are as follows:

- Ex-date: 1 September 2017;
- Record date: 4 September 2017;
- Final DRP election date: 5 September 2017; and
- Dividend payment date: 27 September 2017.

Full year divided

The FY17 dividend was 34.5 cents per share, up 6% on FY16.

The normalised dividend payout ratio for the FY17 dividend was 50%, and within Challenger's normalised dividend payout ratio guidance of between 45% and 50% of normalised profit after tax.

Challenger's franking account balance at 30 June 2017 was $39m.

Dividend Reinvestment Plan

Challenger operates a Dividend Reinvestment Plan (DRP), providing an effective way for shareholders to reinvest their dividends and increase their shareholding without incurring transaction costs.

The DRP participation rate for the FY16 final and FY17 interim dividend was 4% of issued capital, with 0.8m new Challenger shares issued. Under the terms of the DRP, new Challenger shares were issued based on a ten day Challenger share price VWAP, with no share price discount applied.

The DRP had the effect of reducing the effective cash dividend payout by approximately 2%.

For the FY17 final dividend, new Challenger shares will be issued in order to fulfil DRP requirements, and will continue to be issued based on a ten day Challenger share price VWAP, with no discount applied.

Credit ratings

In November 2016, Standard & Poor's (S&P) affirmed both Challenger Life Company (CLC) and Challenger Limited's credit ratings. The S&P ratings reflect the financial strength of Challenger Limited and CLC, with ratings reconfirmed as:

- CLC: 'A' with a stable outlook; and
- Challenger Limited: 'BBB+' with a stable outlook.

FY18 guidance

Normalised net profit before tax

In FY17 Challenger commenced an annuity relationship with MS Primary, a leading provider of Australian dollar annuity and life insurance products in Japan (see page 23 for more details). Challenger also launched a new pooled version of the institutional Guaranteed Index Return (GIR) product, Challenger Index Plus Fund (see page 23 for more details).

Life's mix of business is changing, with the proportion of institutional GIR and MS Primary annuity business representing 15% of Life's FY17 average liabilities, and increasing from 10% in FY16. GIR generates a lower COE margin, however meets Challenger's 18% ROE target as it is fully backed by high grade fixed income investments. MS Primary's COE margin includes Life's share of distribution costs, with no additional distribution costs and minimal operational costs included in Life's expense base.

Life's changing product mix, will likely reduce COE margin, but is expected to have minimal impact on Life's bottom line profitability.

Despite the different COE margin and capital requirements for each product, all products continue to target Challenger's 18% pre-tax ROE.

Given the change in product mix and in order to provide more relevant guidance, commencing in FY18 Challenger is changing its earnings guidance metric from Life COE to Group normalised net profit before tax. It also expands guidance to include Funds Management.

FY18 normalised net profit before tax guidance is $545m to $565m, representing growth of between 8% to 12%.

Normalised Return on Equity (ROE)

Challenger continues to target an 18% pre-tax normalised ROE over the medium term. FY18 will be impacted by higher levels of capital as a result of the 23 August 2017 equity placement, until the capital is fully deployed.

Life annuity book maturities

Life's annuity book growth is driven by sales and maturities. With Life's increasing focus on long-term annuity sales, maturities are expected to fall from ~33% of opening liabilities in FY17 to ~25% in FY18.

Normalised cost to income ratio

Challenger's business is highly efficient and very scalable. As a result, Challenger is one of Australia's most efficient financial services companies, with a normalised cost to income ratio that is 17 percentage points below the industry average.

In FY17, Challenger achieved a record low cost to income ratio of 33.4%, compared to its guidance range of 32% to 36%.

Reflecting confidence in continuing to extract scale benefits and operating efficiencies across the Challenger Group, Challenger has reset its medium-term normalised cost to income ratio guidance to a range of 30% to 34% (from 32% to 36%).

Dividend policy

Challenger targets a dividend payout ratio in the range of 45% to 50% of normalised profit after tax and aims to frank dividends to the maximum extent possible. Based on current forecasts, the Board expects future dividends to be fully franked.

However, the actual dividend payout ratio and franking levels will depend on prevailing market conditions and capital allocation priorities.

Capital management initiatives

On 23 August 2017, Challenger will issue 38.3m new ordinary shares to MS&AD at a price of $13.06 per share. The new shares will be issued at a 2% premium to Challenger's 14 August 2017 30 business day volume weighted average share price $12.9719, adjusted for the final FY17 dividend of 17.5 cents per share. The shares issued to MS&AD are not eligible for Challenger's final FY17 dividend.

The equity placement to MS&AD represents 6.3% of Challenger's issued capital following the placement. MS&AD intends to be a supportive Challenger shareholder and plans to increase its investment to 10% of issued capital over the next 12 months via market acquisitions, subject to market conditions, any necessary or desirable regulatory approvals and Challenger circumstances. MS&AD reserves the right to change its intentions and to acquire, dispose and vote Challenger shares as it sees fit.

The proceeds from the placement will be used to increase CLC's Common Equity Tier 1 capital. After allowing for the equity placement, and assuming the same capital intensity as at balance date, CLC's pro forma capital ratios at 30 June 2017 are as follows:

- PCA ratio of 1.75 times (from 1.57 times);
- Total Tier 1 ratio of 1.57 times (from 1.39 times); and
- Common Equity Tier 1 (CET1) ratio of 1.21 times (from 1.01 times).

Group balance sheet[1]

$m	FY17	1H17	FY16	1H16	FY15	1H15
Assets						
Life investment assets						
Fixed income and cash (net)	10,415.0	9,520.9	9,315.5	8,487.6	8,513.7	8,541.1
Property (net)	3,407.8	3,328.3	3,150.0	3,063.2	2,883.7	2,716.4
Equity and other investments	1,360.1	1,231.6	1,079.0	1,060.0	882.8	632.4
Infrastructure (net)	494.4	526.4	567.2	536.4	514.4	503.0
Life investment assets	**15,677.3**	**14,607.2**	**14,111.7**	**13,147.2**	**12,794.6**	**12,392.9**
Cash and cash equivalents (Group cash)	83.8	80.7	84.2	89.3	98.6	126.0
Receivables	135.1	121.0	120.2	148.5	175.7	217.4
Derivative assets	232.7	226.0	354.2	292.6	255.0	356.6
Investment in associates	53.5	49.1	51.5	30.2	43.4	39.4
Other assets	46.0	48.2	48.0	50.7	27.3	42.6
Fixed assets	33.7	32.9	34.9	34.3	8.4	10.9
Goodwill and intangibles	588.4	588.4	583.9	585.5	549.4	547.2
Less Group/Life eliminations[2]	(94.9)	(93.2)	(105.3)	(123.0)	(136.5)	(154.9)
Total assets	**16,755.6**	**15,660.3**	**15,283.3**	**14,255.3**	**13,815.9**	**13,578.1**
Liabilities						
Payables	245.5	219.8	228.6	184.9	181.5	195.0
Tax liabilities	199.0	177.7	162.6	182.4	155.3	150.4
Derivative liabilities	216.5	322.7	409.5	352.8	370.6	344.5
Subordinated debt	393.6	384.8	576.7	576.5	567.0	560.7
Challenger Capital Notes	789.4	339.3	338.5	337.7	336.8	336.2
Provisions	13.5	17.4	12.5	21.3	23.8	20.5
Life annuity book	10,322.2	9,784.9	9,558.5	8,868.4	8,693.0	8,573.1
Guaranteed Index Return (GIR) and Challenger Index Plus Fund	1,687.8	1,633.2	1,315.5	1,035.1	944.7	954.8
Total liabilities	**13,867.5**	**12,879.8**	**12,602.4**	**11,559.1**	**11,272.7**	**11,135.2**
Group net assets	**2,888.1**	**2,780.5**	**2,680.9**	**2,696.2**	**2,543.2**	**2,442.9**
Equity						
Contributed equity	1,554.5	1,560.1	1,546.7	1,576.8	1,527.2	1,524.3
Reserves	(16.5)	(29.9)	(7.9)	(19.7)	23.7	13.8
Retained earnings	1,350.1	1,250.3	1,142.1	1,139.1	992.3	904.8
Total equity	**2,888.1**	**2,780.5**	**2,680.9**	**2,696.2**	**2,543.2**	**2,442.9**

Change in Group net assets

$m	2H17	1H17	2H16	1H16	2H15	1H15
Opening net assets	**2,780.5**	**2,680.9**	**2,696.2**	**2,543.2**	**2,442.9**	**2,153.3**
Statutory net profit after tax	196.1	201.5	93.4	234.3	168.9	130.1
Dividends paid	(96.3)	(93.3)	(90.4)	(87.5)	(81.4)	(71.3)
New share issue	3.9	4.1	4.9	6.3	–	287.2
Reserve movements	13.4	(22.0)	11.8	(43.4)	9.9	(56.0)
CPP Trust movements	(9.5)	9.3	(35.0)	43.3	2.9	(0.4)
Closing net assets	**2,888.1**	**2,780.5**	**2,680.9**	**2,696.2**	**2,543.2**	**2,442.9**

1 Excludes consolidation of Special Purpose Vehicles (SPV's) and non-controlling interests.
2 Group/Life eliminations represent the fair value of the SPV residual income notes (i.e. NIM) held by Challenger Life Company Ltd.

Issued share capital

Number of shares (m)	**FY17**	**FY16**	**FY15**	**2H17**	**1H17**	**2H16**	**1H16**	**2H15**	**1H15**
Basic share count	561.9	558.8	553.4	561.9	562.3	558.8	562.2	553.4	552.9
CPP 'treasury' shares	10.1	12.4	16.3	10.1	9.4	12.4	8.4	16.3	16.8
Total issued shares	**572.0**	**571.2**	**569.7**	**572.0**	**571.7**	**571.2**	**570.6**	**569.7**	**569.7**
Movement in basic share count									
Opening	558.8	553.4	510.6	562.3	558.8	562.2	553.4	552.9	510.6
CPP deferred share purchase	(2.8)	(4.0)	(4.6)	(0.8)	(2.0)	(4.0)	–	–	(4.6)
Net treasury shares (acquired)/released	5.1	7.9	8.6	0.1	5.0	–	7.9	0.5	8.1
New share issues	0.8	1.5	38.8	0.3	0.5	0.6	0.9	–	38.8
Closing	561.9	558.8	553.4	561.9	562.3	558.8	562.2	553.4	552.9
Movement in CPP 'treasury' shares									
Opening	12.4	16.3	20.3	9.4	12.4	8.4	16.3	16.8	20.3
Shares vested to participants	(6.1)	(9.5)	(14.1)	(0.1)	(6.0)	(0.5)	(9.0)	(0.5)	(13.6)
CPP deferred share purchase	2.8	4.0	4.6	0.8	2.0	4.0	–	–	4.6
Shares bought into CPP Trust	1.0	1.6	5.5	–	1.0	0.5	1.1	–	5.5
Closing	10.1	12.4	16.3	10.1	9.4	12.4	8.4	16.3	16.8

Weighted average number of shares (m)	**FY17**	**FY16**	**FY15**	**2H17**	**1H17**	**2H16**	**1H16**	**2H15**	**1H15**
Basic EPS shares									
Total issued shares	571.7	570.5	562.8	571.9	571.4	570.9	570.1	569.7	556.0
Less CPP 'treasury' shares	(9.5)	(10.3)	(17.1)	(9.8)	(9.1)	(9.7)	(11.0)	(16.5)	(17.8)
Shares for basic EPS calculation	562.2	560.2	545.7	562.1	562.3	561.2	559.1	553.2	538.2
Diluted EPS shares									
Shares for basic EPS calculation	562.2	560.2	545.7	562.1	562.3	561.2	559.1	553.2	538.2
Add dilutive impact of equity awards schemes	14.4	16.8	20.7	14.1	14.7	15.7	17.7	18.6	23.0
Add dilutive impact of capital notes	34.8	39.1	37.1	43.2	31.8	39.1	41.6	51.2	25.4
Shares for dilutive EPS calculation	611.4	616.1	603.5	619.4	608.8	616.0	618.4	623.0	586.6

Summary of Share Rights (m)	**FY17**	**FY16**	**FY15**	**2H17**	**1H17**	**2H16**	**1H16**	**2H15**	**1H15**
Hurdled Performance Share Rights									
Opening	12.5	17.3	26.6	10.4	12.5	13.0	17.3	17.6	26.6
New grants	2.5	3.4	2.6	–	2.5	–	3.4	0.2	2.4
Vesting/forfeiture	(4.8)	(8.2)	(11.9)	(0.2)	(4.6)	(0.5)	(7.7)	(0.5)	(11.4)
Closing	10.2	12.5	17.3	10.2	10.4	12.5	13.0	17.3	17.6
Deferred Performance Share Rights									
Opening	3.8	3.5	3.8	3.7	3.8	3.8	3.5	3.6	3.8
New grants	1.6	2.3	2.3	–	1.6	–	2.3	–	2.3
Vesting/forfeiture	(1.7)	(2.0)	(2.6)	–	(1.7)	–	(2.0)	(0.1)	(2.5)
Closing	3.7	3.8	3.5	3.7	3.7	3.8	3.8	3.5	3.6

Issued share capital

Issued share capital and diluted share count

The number of Challenger Limited shares listed on the Australian Securities Exchange (ASX) at 30 June 2017 was 572m shares, and increased 0.8m in FY17 for new shares issued as a result of Challenger's Dividend Reinvestment Plan (DRP).

The basic share count used to determine Challenger's normalised and statutory EPS is based on requirements set out in Australian Accounting Standards.

Under Australian Accounting Standards:

- the basic share count is reduced for treasury shares;
- the dilutive share count includes unvested equity awards made to employees under the Challenger Performance Plan; and
- the dilutive share count considers convertible instruments (e.g. Challenger Capital Notes and Challenger Capital Notes 2 – refer to page 14 for more detail) with inclusion in the dilutive share count determined by a probability of vesting test.

In FY17 the basic share count increased by 3.1m shares following the net release of treasury shares in order to meet Challenger Performance Plan requirements, and 0.8m of new shares issued as part of Challenger's DRP.

Treasury shares

The Challenger Performance Plan (CPP) Trust was established to purchase shares to satisfy Challenger's employee equity obligations arising from hurdled and non-hurdled equity awards issued under employee remuneration structures.

Shares are acquired by the CPP Trust to mitigate shareholder dilution and provide a mechanism to hedge the cash cost of acquiring shares in the future to satisfy vested equity awards.

The CPP Trust typically acquires physical shares on market or via forward share purchase agreements. The use of forward share purchase agreements was implemented to increase capital efficiency. Shares held by the CPP Trust and share forward purchase agreements are classified as treasury shares.

It is expected that should equity awards vest in the future, the CPP Trust will satisfy equity requirements via a combination of treasury shares and settlement of forward purchase agreements. As such, it is not currently anticipated that new Challenger shares will be issued to meet future vesting obligations of equity awards.

Unvested equity awards

Hurdled Performance Share Rights (HPSRs)

Challenger's approach to executive remuneration includes providing Long-Term Incentive (LTI) awards to ensure alignment between key employees and shareholders.

LTI awards are delivered as HPSRs, which vest over a period of up to five years and are subject to meeting total shareholder return performance hurdles and continued employment before vesting.

Deferred Performance Share Rights (DPSRs)

A portion of Short-Term Incentive (STI) awards are deferred and vest over a period of up to three years. Deferred STI is delivered as DPSRs with vesting subject to continued employment.

Capital management initiatives August 2017

In order to broaden Challenger's relationship with the MS&AD Group (refer to page 24 for more details), and fund future growth, Challenger is undertaking a $500m equity placement to MS&AD Insurance Group Holdings Inc. (MS&AD).

On 23 August 2017, Challenger will issue 38.3m new ordinary shares to MS&AD at a price of $13.06 per share. The new shares will be issued at a 2% premium to Challenger's 14 August 2017 30 business day volume weighted average share price $12.9719, adjusted for the final FY17 dividend of 17.5 cents per share. The shares issued to MS&AD are not eligible for Challenger's final FY17 dividend.

The equity placement to MS&AD represents 6.3% of Challenger's issued capital following the placement. MS&AD intends to be a supportive Challenger shareholder and plans to increase its investment to 10% of issued capital over the next 12 months via market acquisitions, subject to market conditions, any necessary or desirable regulatory approvals and Challenger circumstances. MS&AD reserves the right to change its intentions and to acquire, dispose and vote Challenger shares as it sees fit.

The proceeds from the placement will be used to increase CLC's Common Equity Tier 1 capital. After allowing for the equity placement, and assuming the same capital intensity as at balance date, CLC's pro forma capital ratios at 30 June 2017 are as follows:

- PCA ratio of 1.75 times (from 1.57 times);
- Total Tier 1 ratio of 1.57 times (from 1.39 times); and
- Common Equity Tier 1 (CET1) ratio of 1.21 times (from 1.01 times).

Capital Notes

Challenger Life is growing strongly and over the past four years Challenger Limited has issued two separate subordinated, unsecured convertible notes, with proceeds used to fund Challenger Life Company Limited (CLC) qualifying Additional Tier 1 regulatory capital.

Challenger Capital Notes (ASX code 'CGFPA')

In October 2014, Challenger issued Challenger Capital Notes to the value of $345m, which are subordinated, unsecured convertible notes issued by Challenger Limited. Challenger Capital Notes pay a margin of 3.40% above the 90 day Bank Bill rate, with the total distribution cost reduced by available franking credits.

Challenger Capital Notes are convertible to ordinary shares at any time before May 2022 on the occurrence of certain events, and mandatorily convertible to ordinary shares thereafter, in both cases subject to meeting certain conditions.

However, Challenger retains the option to redeem or resell Challenger Capital Notes and has an outright option to redeem or resell on 25 May 2020 (both subject to certain conditions being met). If Challenger exercises its option to redeem or resell, there will be no conversion of Challenger Capital Notes to Challenger ordinary shares and no subsequent shareholder dilution.

Challenger Capital Notes 2 (ASX code 'CGFPB')

In February 2017, Challenger launched Challenger Capital Notes 2, which are subordinated, unsecured convertible notes issued by Challenger Limited. Following strong investor demand the offer was increased to $460m (from $350m) and the notes were priced at the lower end of Challenger's margin guidance range. Challenger Capital Notes 2 were issued in April 2017 and pay a margin of 4.40% above the 90 day Bank Bill rate, with the total distribution cost reduced by available franking credits.

Challenger Capital Notes 2 are convertible to ordinary shares at any time before May 2025 on the occurrence of certain events, and mandatorily convertible to ordinary shares thereafter, in both cases subject to meeting certain conditions.

However, Challenger retains the option to redeem or resell Challenger Capital Notes 2 and has an outright option to redeem or resell on 22 May 2023 (both subject to certain conditions being met). If Challenger exercises its option to redeem or resell, there will be no conversion of Challenger Capital Notes 2 to Challenger ordinary shares and no subsequent shareholder dilution.

Accounting treatment of Capital Notes

Challenger Capital Notes and Challenger Capital Notes 2 are an effective source of funding for Challenger as quarterly interest payments made to noteholders can comprise a combination of cash and franking credits, which reduce the cash cost for Challenger. The cash interest payment to noteholders is included within Life's normalised cash operating earnings framework.

Under Australian Accounting Standards, convertible debt is considered dilutive whenever the interest per ordinary share obtainable on conversion is less than the basic earnings per share. As such, a test is required to be undertaken each reporting period to determine if they are included in the dilutive share count.

Under Australian Accounting Standards, both Challenger Capital Notes and Challenger Capital Notes 2 have been considered to be dilutive at 30 June 2017 and have been included in Challenger's FY17 dilutive share count.

Consolidated operating cash flow

$m	FY17	FY16	FY15	2H17	1H17	2H16	1H16	2H15	1H15
Receipts from customers	673.0	598.4	543.0	334.0	339.0	317.2	281.2	288.8	254.2
Dividends received	66.5	56.4	77.1	30.5	36.0	24.2	32.2	43.1	34.0
Interest received	673.7	639.1	585.9	347.2	326.5	294.3	344.8	316.3	269.6
Interest paid	(527.1)	(444.8)	(438.7)	(293.6)	(233.5)	(221.0)	(223.8)	(225.3)	(213.4)
Payments to suppliers and employees	(508.1)	(488.1)	(413.7)	(246.6)	(261.5)	(231.6)	(256.5)	(206.6)	(207.1)
Income tax paid	(78.1)	(63.9)	(65.7)	(40.1)	(38.0)	(33.4)	(30.5)	(22.0)	(43.7)
Underlying operating cash flow	**299.9**	**297.1**	**287.9**	**131.4**	**168.5**	**149.7**	**147.4**	**194.3**	**93.6**
Adjust for:									
Net annuity policy capital receipts	900.4	740.4	738.2	451.5	448.9	469.9	270.5	177.4	560.8
Net other Life capital receipts / (payments)	412.5	309.0	(186.7)	67.5	345.0	230.1	78.9	(16.7)	(170.0)
Other[1]	(15.6)	(64.1)	(23.5)	(6.9)	(22.5)	(34.9)	(29.2)	(7.7)	(15.8)
Operating cash flow per financial report	**1,597.2**	**1,282.4**	**815.9**	**657.3**	**939.9**	**814.8**	**467.6**	**347.3**	**468.6**

Underlying operating cash flow excludes cash flows that are capital in nature such as annuity sales and annuity capital payments.

FY17 underlying operating cash flow was $300m, broadly consistent with FY16.

FY17 underlying operating cash flow ($300m) represents approximately 78% of FY17 normalised net profit after tax ($385m). Normalised net profit after tax includes non-cash normalised capital growth ($105m) and non-cash income tax provisions which will be paid in 1H18.

Net annuity policy capital receipts

FY17 net annuity policy capital receipts were $900m and comprise:

- Annuity sales of $4,011m; less
- Annuity capital payments of $3,111m.

Annuity capital payments are returns of capital to annuitants and exclude interest payments.

FY17 annuity net book growth was 9.4% (FY16 8.5%) and can be calculated as annuity net flows ($900m) divided by opening period Life annuity book ($9,558m – refer to page 17).

Net other Life capital receipts

FY17 net other Life capital receipts in FY17 were $412m and comprise:

- Other Life sales of $941m; less
- Other Life capital payments of $529m.

Other Life sales include existing Guaranteed Index Return (GIR) client mandate rollovers of ~$500m, a new GIR client mandate of ~$200m, and sales of the new Challenger Index Plus Fund of ~$200m.

Challenger Index Plus Fund is a pooled version of GIR, and was launched in the second quarter of FY17.

FY17 Life book growth was 12.1% (FY16 11.1%) and can be calculated as total net flows ($1,313m) divided by the sum of the opening period liabilities of $10,874m (Life annuity book, GIR and Challenger Index Plus Fund – refer to page 17).

1 Other includes net SPV operating cash flow and adjustments for classification differences between statutory operating cash flow and normalised cash operating earnings.

Life financial results

$m	FY17	FY16	FY15	2H17	1H17	2H16	1H16	2H15	1H15
Investment yield – policyholders' funds	813.5	767.5	765.8	408.5	405.0	385.1	382.4	390.2	375.6
Interest expense	(426.7)	(410.4)	(413.8)	(216.4)	(210.3)	(203.5)	(206.9)	(209.1)	(204.7)
Distribution expense	(27.8)	(24.5)	(25.5)	(11.3)	(16.5)	(14.3)	(10.2)	(11.5)	(14.0)
Other income[1]	36.4	24.4	19.8	11.9	24.5	12.8	11.6	10.8	9.0
Product cash margin	**395.4**	**357.0**	**346.3**	**192.7**	**202.7**	**180.1**	**176.9**	**180.4**	**165.9**
Investment yield – shareholders' funds	131.0	134.9	117.1	68.4	62.6	67.3	67.6	59.7	57.4
Cash earnings	**526.4**	**491.9**	**463.4**	**261.1**	**265.3**	**247.4**	**244.5**	**240.1**	**223.3**
Normalised capital growth	105.0	100.5	80.4	53.9	51.1	52.1	48.4	45.9	34.5
Normalised Cash Operating Earnings (COE)	**631.4**	**592.4**	**543.8**	**315.0**	**316.4**	**299.5**	**292.9**	**286.0**	**257.8**
Personnel expenses	(61.8)	(56.7)	(51.0)	(31.7)	(30.1)	(29.8)	(26.9)	(25.6)	(25.4)
Other expenses	(38.4)	(35.9)	(36.1)	(19.1)	(19.3)	(18.8)	(17.1)	(19.5)	(16.6)
Total expenses	**(100.2)**	**(92.6)**	**(87.1)**	**(50.8)**	**(49.4)**	**(48.6)**	**(44.0)**	**(45.1)**	**(42.0)**
Normalised EBIT	**531.2**	**499.8**	**456.7**	**264.2**	**267.0**	**250.9**	**248.9**	**240.9**	**215.8**
Investment experience	21.4	(68.4)	(50.0)	12.9	8.5	(111.4)	43.0	(14.6)	(35.4)
Net profit after investment experience before tax	**552.6**	**431.4**	**406.7**	**277.1**	**275.5**	**139.5**	**291.9**	**226.3**	**180.4**
Reconciliation of investment experience to capital growth									
Investment experience	21.4	(68.4)	(50.0)	12.9	8.5	(111.4)	43.0	(14.6)	(35.4)
Normalised capital growth	105.0	100.5	80.4	53.9	51.1	52.1	48.4	45.9	34.5
Capital growth	**126.4**	**32.1**	**30.4**	**66.8**	**59.6**	**(59.3)**	**91.4**	**31.3**	**(0.9)**
Performance analysis									
Cost to income ratio[2]	15.9%	15.6%	16.0%	16.1%	15.6%	16.2%	15.0%	15.8%	16.3%
Net assets – average[3]	2,525	2,456	2,349	2,586	2,468	2,487	2,441	2,383	2,318
Normalised RoE (pre-tax)	21.0%	20.4%	19.4%	20.6%	21.5%	20.3%	20.3%	20.4%	18.5%

1 Other income includes Accurium revenue and Life Risk revenue (premiums net of claims).
2 Cost to income ratio calculated as total expenses divided by Normalised Cash Operating Earnings.
3 Net assets – average calculated on a monthly basis. Prior comparative periods have been restated to reflect monthly average calculations.

Life financial results

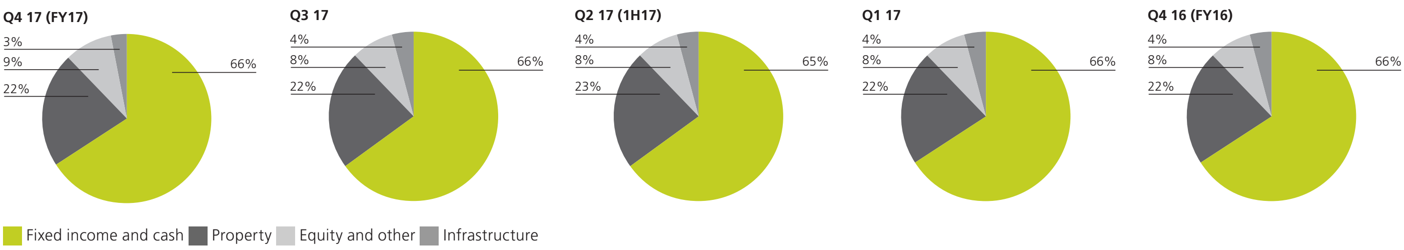
$m	FY17	FY16	FY15	2H17	1H17	2H16	1H16	2H15	1H15
Sales									
Fixed Term sales	3,024.3	2,769.8	2,273.2	1,382.4	1,641.9	1,357.4	1,412.4	1,017.6	1,255.6
Lifetime sales	986.9	581.4	479.9	432.7	554.2	352.7	228.7	160.7	319.2
Life annuity sales	**4,011.2**	**3,351.2**	**2,753.1**	**1,815.1**	**2,196.1**	**1,710.1**	**1,641.1**	**1,178.3**	**1,574.8**
Maturities and repayments	(3,110.8)	(2,610.8)	(2,014.9)	(1,363.6)	(1,747.2)	(1,240.2)	(1,370.6)	(1,000.9)	(1,014.0)
Life annuity flows	**900.4**	**740.4**	**738.2**	**451.5**	**448.9**	**469.9**	**270.5**	**177.4**	**560.8**
Life annuity book	10,322.2	9,558.5	8,692.6	10,322.2	9,784.9	9,558.5	8,868.4	8,692.6	8,573.1
Annuity book growth	**9.4%**	**8.5%**	**9.4%**	**4.7%**	**4.7%**	**5.4%**	**3.1%**	**2.2%**	**7.2%**
Other Life sales	941.2	998.5	944.0	378.9	562.3	588.8	409.7	395.1	548.9
Other maturities and repayments	(528.7)	(670.6)	(1,031.3)	(360.9)	(167.8)	(337.5)	(333.1)	(360.0)	(671.3)
Other Life flows	**412.5**	**327.9**	**(87.3)**	**18.0**	**394.5**	**251.3**	**76.6**	**35.1**	**(122.4)**
Guaranteed Index Return (GIR) and Challenger Index Plus Fund liabilities	1,687.8	1,315.5	944.7	1,687.8	1,633.2	1,315.5	1,035.1	944.7	954.8
Other Life net book growth	**31.4%**	**34.7%**	**(8.1%)**	**1.4%**	**30.0%**	**26.6%**	**8.1%**	**3.2%**	**(11.4%)**
Life net flows	1,312.9	1,068.3	650.9	469.5	843.4	721.2	347.1	212.5	438.4
Life annuity book, GIR and Challenger Index Plus Fund liabilities	12,010.0	10,874.0	9,637.3	12,010.0	11,418.1	10,874.0	9,903.5	9,637.3	9,527.9
Life book growth[1]	**12.1%**	**11.1%**	**7.3%**	**4.3%**	**7.8%**	**7.5%**	**3.6%**	**2.4%**	**4.9%**
Assets									
Closing investment assets	**15,677**	**14,112**	**12,795**	**15,677**	**14,607**	**14,112**	**13,147**	**12,795**	**12,393**
Fixed income and cash[2]	9,746	8,473	8,394	10,028	9,434	8,537	8,409	8,575	8,234
Property	3,274	3,178	2,640	3,350	3,205	3,220	3,120	2,906	2,385
Equity and other investments	1,183	988	626	1,262	1,110	1,059	928	742	511
Infrastructure	524	550	516	510	538	553	545	518	512
Average investment assets[3]	**14,727**	**13,189**	**12,176**	**15,150**	**14,287**	**13,369**	**13,002**	**12,741**	**11,642**
Liabilities									
Closing liabilities	**13,209**	**11,796**	**10,550**	**13,209**	**12,148**	**11,796**	**10,825**	**10,550**	**10,436**
Average liabilities – annuities, GIR and Challenger Index Plus Fund	11,471	9,981	9,397	11,802	11,133	10,166	9,786	9,706	9,107
Average liabilities – capital notes	451	345	239	542	345	345	345	345	148
Average liabilities – sub debt	481	579	563	392	556	574	584	582	543
Average liabilities[3]	**12,403**	**10,905**	**10,199**	**12,736**	**12,034**	**11,085**	**10,715**	**10,633**	**9,798**
Margins[4]									
Investment yield – policyholders' funds	5.52%	5.82%	6.29%	5.44%	5.62%	5.80%	5.84%	6.18%	6.40%
Interest expenses	(2.90%)	(3.11%)	(3.40%)	(2.88%)	(2.92%)	(3.06%)	(3.16%)	(3.31%)	(3.49%)
Distribution expense	(0.19%)	(0.19%)	(0.21%)	(0.16%)	(0.23%)	(0.22%)	(0.16%)	(0.18%)	(0.24%)
Other income	0.25%	0.19%	0.16%	0.16%	0.34%	0.19%	0.18%	0.17%	0.15%
Product cash margin	**2.68%**	**2.71%**	**2.84%**	**2.56%**	**2.81%**	**2.71%**	**2.70%**	**2.86%**	**2.82%**
Investment yield – shareholders' funds	0.89%	1.02%	0.97%	0.92%	0.87%	1.01%	1.03%	0.94%	0.98%
Cash earnings	**3.57%**	**3.73%**	**3.81%**	**3.48%**	**3.68%**	**3.72%**	**3.73%**	**3.80%**	**3.80%**
Normalised capital growth	0.72%	0.76%	0.66%	0.71%	0.71%	0.79%	0.74%	0.73%	0.59%
Normalised Cash Operating Earnings (COE)	**4.29%**	**4.49%**	**4.47%**	**4.19%**	**4.39%**	**4.51%**	**4.47%**	**4.53%**	**4.39%**

1 Total Life book growth represents life annuity net flows and other life net flows over the period divided by the opening Life annuity book, Guaranteed Index Return and Challenger Index Plus Fund liabilities.
2 Includes average NIM (FY17: $94m, FY16: $120m, FY15: $156m).
3 Average investment assets and average liabilities are calculated on a monthly basis.
4 Ratio of Normalised Cash Operating Earnings components divided by average investment assets.

Life quarterly sales and investment assets

$m	Q4 17	Q3 17	Q2 17	Q1 17	Q4 16
Life sales					
Fixed Term	720	662	905	737	912
Lifetime (including Care)	215	218	258	296	223
Total annuity sales	**935**	**880**	**1,163**	**1,033**	**1,135**
Other Life sales	1	378	512	50	300
Total Life sales	**936**	**1,258**	**1,675**	**1,083**	**1,435**
Life					
Fixed income and cash[1]	10,415	9,907	9,521	9,518	9,316
Property[1]	3,408	3,330	3,328	3,183	3,150
Equity and other	1,360	1,181	1,232	1,079	1,079
Infrastructure[1]	494	522	526	536	567
Total Life investment assets	**15,677**	**14,940**	**14,607**	**14,316**	**14,112**
Average Life investment assets[2]	**15,559**	**14,689**	**14,354**	**14,227**	**13,535**

Life asset allocation



1 Fixed income, property and infrastructure are reported net of debt.
2 Average Life investment assets calculated on a monthly basis.

Life financial results

Challenger Life Company Ltd (CLC) is Australia's leading provider of annuities and guaranteed retirement income products.

Life's products appeal to investors seeking the security and certainty of guaranteed cash flows with protection against market, inflation and longevity risks.

Products are distributed via financial advisers, both independent and within the major hubs. Being an independent product manufacturer, CLC's products are included on all major hub Approved Product Lists (APLs).

CLC is diversifying its product range and distribution footprint by launching new products and making products more broadly available to financial advisers and their customers through leading investment and administration platforms.

CLC has also formed an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary), a leading provider of Australian dollar denominated annuities in Japan (refer to page 23 for more detail).

CLC has won the Association of Financial Advisers/Plan for Life 'Annuity Provider of the Year' for the past eight years. CLC also won the 2017 Retirement Product Innovation award for Liquid Lifetime in the Money Management/Lonsec Fund Manager of the Year awards, and the Longevity Product Best Fund award for the fourth year running in the Chant West 2017 Super Funds awards.

The Life business includes Accurium, one of Australia's leading providers of Self-Managed Superannuation Fund (SMSF) actuarial certificates (refer to page 24 for more detail).

CLC is diversifying its capital and earnings base by participating in wholesale reinsurance longevity and mortality transactions (Life Risk). Life is experienced in managing, pricing and reinsuring longevity and mortality risk. Refer to page 24 for additional details on Life Risk.

CLC is an APRA regulated entity and its financial strength is rated by Standard & Poor's with an 'A' rating and stable outlook. CLC is strongly capitalised with significant excess capital above APRA's minimum requirements. CLC's regulatory capital base, prescribed capital amount, and excess capital position is disclosed on page 38.

Normalised EBIT and ROE

FY17 Life normalised EBIT was $531m and increased by $31m (6%) on FY16. The increase in EBIT reflects a $39m increase in Normalised Cash Operating Earnings, partly offset by a $8m increase in expenses.

FY17 Life ROE (pre-tax) was 21.0%, and increased 60 bps from 20.4% in FY16.

Normalised Cash Operating Earnings (COE) and COE margin

FY17 normalised COE was $631m and increased by $39m (7%) on FY16. The increase in normalised COE is a result of higher average AUM (up 12%), partially offset by a 20 bps reduction in Life's COE margin.

Life's FY17 COE margin was 4.29%, down 20 bps from 4.49% in FY16. The change in COE margin is a result of:

- Lower product cash margin -3 bps. The product cash margin benefited from higher other income, as a result of a one-off Life Risk fee of ~$10m (6 bps). Offsetting the higher one-off Life Risk fee was a 30 bps reduction in asset yields, partially offset by a 21 bps reduction in interest and distribution expenses reflective of the lower interest rate environment. The lower asset yields are primarily due to lower yields on the fixed income portfolio.

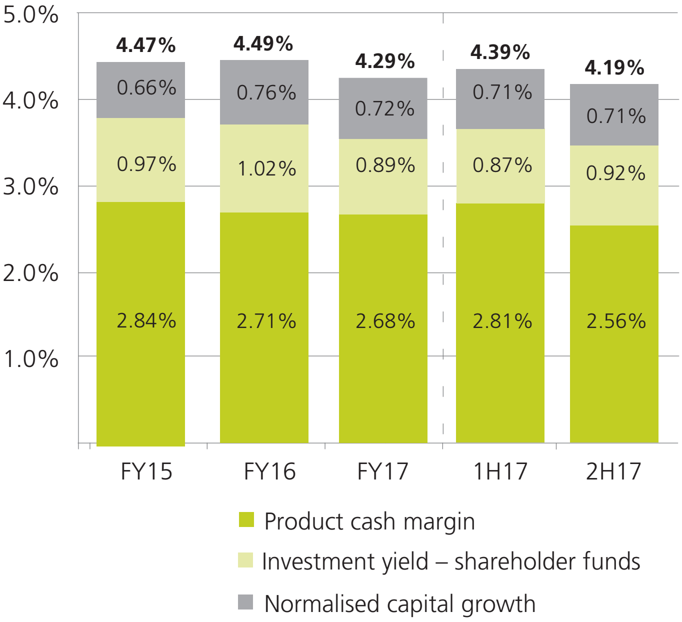
  The lower interest and distribution expenses increased Life's COE margin by 21 bps in FY17. For MS Primary annuity business, which represented 15% of Life's FY17 annuity sales, Life's share of distribution expenses is implicit within the rate provided to MS Primary or interest expense in Life's COE margin. As a result, the distribution expense fell by 7 bps in 2H17.

  The MS Primary annuity business is operationally very efficient, with minimal operational costs included in Life's direct expense base.
- Lower normalised capital growth -4 bps. Normalised capital growth was impacted by a higher allocation to fixed income, which increased from 64% of average investment assets in FY16 to 66% in FY17. The normalised capital growth assumption for fixed income is -35 bps, representing an allowance for credit defaults, whereas the return for other asset classes varies from +2.0% to +4.5%.
- Lower return on shareholder capital -13 bps. The return on shareholder capital was impacted by lower return on shareholder capital (-25 bps), partially offset by higher shareholder capital (+12 bps). The return on shareholder capital reduced as a result of lower interest rates, with shareholder capital not hedged for interest rate movements. The average BBSW rate in FY17 was 43 bps lower than in FY16.

FY17 normalised COE includes other income of $36m (25 bps), and was $12m higher than in FY16. Other income includes Accurium revenue of $9m (FY16 $9m) and Life Risk revenue of $28m (FY16 $15m).

Life Risk revenue represents premiums net of expected claims on wholesale reinsurance longevity and mortality transactions (refer to page 24 for more detail). The increase in Life Risk revenue (up $13m) predominately relates to a ~$10m one-off fee received in 1H17 as a result of restructuring a Life Risk transaction.

Life COE margin composition



Expenses

FY17 Life expenses were $100m, and increased by $8m (8%) on FY16. Personnel expenses increased by $5m in order to support Life's strategy to expand its distribution and product footprint. Other expenses increased by $3m and include costs associated with establishing the annuity relationship with MS Primary.

Reflecting the above COE and expense growth, Life's cost to income ratio increased by 30 bps to 15.9% in FY17 from 15.6% in FY16.

Investment experience overview

Challenger Life is required by Australian Accounting Standards to value investment assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on investment assets and liabilities being recognised in the profit and loss. Challenger is generally a long-term holder of assets, due to them being held to match the term of life contract liabilities. As a result, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements.

Investment experience represents the difference between actual investment gains/losses (both realised and unrealised) and expected gains/losses based on Challenger's long-term expected returns. Refer to page 50 for details on Challenger's assumed long-term expected returns by asset class.

Investment experience also includes any impact from changes in economic variables and assumptions, including changes in discount rates used to value Life's liabilities (refer to page 51 for more detail).

FY17 investment experience was a gain of $21m (pre-tax), comprising a $92m gain on Life's investment assets, partially offset by a $71m loss on Life's annuity liabilities.

Asset class ($m)	Actual capital growth	Normalised capital growth	Investment experience
Fixed income	97	34	131
Property	55	(65)	(10)
Infrastructure	(28)	(21)	(49)
Equity and other	73	(53)	20
Asset investment experience	**197**	**(105)**	**92**
Annuity liability valuation experience	(71)	–	(71)
Total investment experience	**126**	**(105)**	**21**

Asset investment experience

The gain on Life's investment assets in FY17 of $92m was primarily due to:

- gains on Life's fixed income portfolio (+$131m) – reflecting a ~55 bps contraction in credit spreads on Challenger's fixed income portfolio. As Challenger is generally a hold to maturity investor, any unrealised revaluations of Challenger's fixed income portfolio is expected to reverse over time. The credit default allowance recognised in the profit and loss in FY17 was +$7m or +7 bps (FY16 -$26m or 31 bps) representing a recovery of prior period credit defaults;
- property valuation losses (-$10m) – as a result of revaluations of Challenger's listed Australian REIT portfolio. In FY17, listed Australian REITs fell by approximately 10% and underperformed Challenger's normalised growth assumption (2% per annum). Life's direct property portfolio increased by approximately 2%, which is in line with Challenger's normalised growth assumption for property;
- losses on infrastructure (-$49m) – as a result of infrastructure underperforming Challenger's normalised growth assumption (4% per annum). Infrastructure investment experience also includes the revaluation of an asset following the repositioning and establishment of a new long-term lease in 1H17; and
- gains on Life's equity portfolio (+$20m) – as a result of equities outperforming Challenger's normalised growth assumption (4.5% per annum).

Annuity valuation investment experience

Investment experience includes the impact of changes in macroeconomic variables on the valuation of Challenger Life's policy liabilities. Economic and actuarial assumption changes include changes to bond yields and expected inflation rates, expense assumptions, losses on new business (new business strain) and other factors.

FY17 investment experience on Life's annuity liabilities was a loss of $71m, and was primarily due to:

- net new business strain (loss of $58m);
- higher illiquidity premium used to value Life's annuity liabilities (loss of $53m). The illiquidity premium increased as a result of a contraction in fixed income credit spreads; offset by
- other changes including improvements in expense and mortality assumptions (gain of $40m).

New business strain

In accordance with Australian Accounting Standards, Challenger Life values term annuities at fair value and lifetime annuities using a risk-free discount rate, both of which are based on the Australian Commonwealth Government bond curve plus an illiquidity premium.

Life tends to offer annuity rates which are higher than these rates. As a result, on writing new annuity business, a loss is recognised when issuing the annuity contract due to a lower discount rate used to value the liability.

New business strain is a non-cash item and subsequently unwinds over the period of the contract. FY17 net new business was a loss of $58m. 2H17 net new business strain was a loss of $23m and was lower than 1H17 ($35m loss) due to lower overall annuity sales volumes and a reduction in annuity rates in 2H17. Annuity rates relative to the risk-free discount rate reduced in 2H17, which has the effect of reducing the 2H17 new business strain.

Illiquidity premium

In accordance with Prudential Standards and Australian Accounting Standards, Challenger Life values term annuities at fair value and lifetime annuities using a risk-free discount rate, both of which are based on the Australian Commonwealth Government bond curve plus an illiquidity premium.

Movements in credit spreads impact the fair value of assets as well as the illiquidity premium which forms part of the discount rate used to value policy liabilities.

The illiquidity premium used to value policy liabilities is calculated in accordance with AASB 1038 Life Insurance Contracts and AASB 139 Financial Instruments: Recognition and Measurement.

Sales and AUM

Annuity sales

FY17 Life annuity sales were $4.0bn, and increased by 20% on FY16. Term annuity sales increased by 9% and lifetime annuity sales increased by 70%.

Both term and lifetime annuity sales continue to benefit from favourable demographic trends, including an ageing population and retirees taking a more conservative approach to retirement investing. These favourable demographic trends are being leveraged by Challenger's market leading retirement income brand, highly rated distribution team, thought leadership, research and product capability.

Challenger's annuity sales growth is also benefiting from new distribution relationships, allowing access to Challenger annuities via investment and administration platforms.

During FY16, Challenger annuities were made available on the Colonial First State platforms, which followed Challenger annuities being integrated with VicSuper account-based pensions to effectively create Australia's first Comprehensive Income Product for Retirement (CIPR) in June 2015.

In FY17, Challenger annuities were also made available on the ClearView Wealth Solutions platform, to members of three profit-for-member funds (caresuper, legalsuper, Local Government Super) and Suncorp commenced selling Suncorp branded annuities backed by Challenger. These initiatives are expanding Challenger's distribution footprint and making Challenger annuities more easily accessible by financial advisers and their clients. As a result of these new platform initiatives, annuity sales via investment and administration platforms increased by approximately 80% in FY17.

In October 2016 Challenger announced a new annuity relationship with AMP, who operate Australia's largest retail adviser network. Through this relationship, commencing in the second quarter of FY18, Challenger's full range of annuity products will be available via AMP's investment and administration platforms.

In February 2017, Challenger announced a new annuity relationship with BT Financial Group (BT), one of Australia's leading wealth management organisations. The annuity relationship with BT will see them work towards offering Challenger annuities through the innovative BT Panorama platform in the third quarter of FY18.

These new platform and distribution initiatives are significantly broadening access to Challenger annuities. Following the launch of Challenger annuities on the AMP and BT platforms, approximately two thirds of Australian financial advisers will be able to access Challenger annuities via investment and administration platforms.

In October 2016, Challenger announced a new annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary), a leading provider of Australian dollar annuity and life insurance products in Japan (refer to page 23 for more information on the MS Primary annuity relationship).

From 1 November 2016, Challenger commenced issuing Australian dollar fixed rate annuities with a 20 year term in order to support a reinsurance agreement with MS Primary. MS Primary sales are disclosed within term annuities, as Challenger provides a fixed return over a fixed period. MS Primary sales accounted for 15% of total FY17 annuity sales.

Term annuity sales

FY17 term annuity sales were $3.0bn and increased by 9% on FY16. FY17 term annuity sales benefited from the new MS Primary annuity relationship, which is providing the opportunity to focus on long-term business (refer below).

Lifetime annuity sales

Lifetime annuity sales were $987m in FY17, up 70% on FY16. FY17 lifetime sales comprise Liquid Lifetime of $785m (FY16 $522m) and CarePlus of $202m (FY16 $60m).

Liquid Lifetime annuity sales are benefiting from new platform distribution initiatives and being included in retirement income model portfolios.

CarePlus was launched in early FY16 and is a product designed specifically for the aged care market. CarePlus sales in 1H17 were $90m, and increased by ~25% in 2H17 to $112m. FY17 CarePlus sales were over 200% higher than in FY16.

Lifetime sales represented 25% of FY17 total annuity sales, up from 17% in FY16.

Focus on long-term annuity sales

Challenger is focused on growing its long-term annuity business as it embeds significant value for Challenger shareholders. Approximately 40% of FY17 sales were either lifetime annuities or MS Primary annuities, up from 17% in FY16. Lifetime annuities have a contracted term of up to 25 years, and MS Primary annuities have a contracted fixed term of up to 20 years.

Long-term annuity business is attractive for Challenger as it:

- lengthens the annuity book tenor;
- improves the maturity outlook;
- assists future book growth; and
- enhances overall book quality.

Strong growth in both lifetime annuities and MS Primary annuities is providing Challenger the opportunity to substitute short-term business with long-term business.

New business tenor

As a result of a larger proportion of sales being lifetime annuities and longer dated MS Primary annuity sales, new business tenor increased to 10.8 years in FY17, up from 6.5 years in FY16.

Other Life sales

Other Life sales represent Challenger's institutional Guaranteed Index Return (GIR) product and the recently launched Challenger Index Plus Fund, which is a pooled GIR product targeted at Australian superannuation funds.

FY17 other Life sales were $0.9bn and include existing GIR client mandate rollovers ($0.5bn), a new GIR client mandate ($0.2bn), and sales of the new Challenger Index Plus Fund ($0.2bn).

Net book growth

Life annuity book growth

FY17 Life annuity net flows (i.e. annuity sales less capital repayments) were $900m, representing a 22% increase on FY16 ($740m).

Based on the closing FY16 Life annuity book liability ($9,558m), FY17 annuity book growth was 9.4% (FY16 8.5%).

Other Life book growth

FY17 Other Life net flows (i.e. Other life sales less capital repayments) were $413m, representing a 26% increase on FY16 ($328m).

Total Life book growth

FY17 total Life net flows across both annuities and other products (Guaranteed Index Return and Challenger Index Plus Fund) were $1,313m, including annuity net flows of $900m and other net flows of $413m. FY17 total net flows of $1,313m were 23% higher than in FY16 ($1,068m).

Based on the closing FY16 annuity liability ($9,558m) and GIR liability ($1,316m), FY17 total Life book growth was 12.1%, up from 11.1% in FY16.

Life book liability maturity profile

Life's FY17 book growth was impacted by elevated annuity maturities. Maturities in FY17 represented 33% of the closing FY16 Life annuity book liability ($9,558m), and were elevated as a result of the maturity profile of prior period sales.

With Challenger's ongoing focus on long-term business, the annuity maturity rate is expected to reduce, which will benefit future period book growth. Maturities in FY18 are expected to be ~25% of the closing FY17 annuity book ($10,322m).

Average AUM

Life's FY17 average investment assets were $14.7bn, and increased by 12% ($1.5bn) on FY16. The increase in average investment assets is primarily due to annuity net flows, growth in other products, Life earnings (net of dividends to Group), and proceeds from Challenger Capital Notes 2.

Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary) annuity relationship

Consistent with Challenger's strategy to diversify its range of products and expand its distribution relationships, in November 2016 Challenger commenced a new annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary).

MS Primary provides annuity and life insurance products for Japanese customers and is part of MS&AD Insurance Group Holdings Inc., a Nikkei 225 company.

Japan has one of the world's most rapidly ageing populations who are looking for income from longer dated products due to the low Japanese interest rate environment. This has driven a significant increase in demand for foreign currency annuities, including Australian dollar denominated annuities. Challenger estimates sales of Australian dollar annuities in Japan to be ~$30bn per year, which is significantly larger than the annuities market in Australia.

MS Primary is a leading provider of Australian dollar annuity and life insurance products in Japan. MS Primary had ~A$28 billion of Australian dollar annuities and life insurance products in force as at 31 March 2017.

In late August 2016, MS Primary launched a new innovative Australian dollar product with a 20-year fixed rate in Japan. The product is being distributed through the Japanese bancassurance channel. Under the terms of the new product, the customer can choose an annuity payment period of 5, 10 or 20 years, with a benefit payable upon death.

In relation to this new product, from 1 November 2016, Challenger commenced issuing Australian dollar fixed rate annuities with a 20-year term in order to support a reinsurance agreement with MS Primary. Challenger provides a guaranteed interest rate and assumes the investment risk, on a portion of each new policy issued by MS Primary.

The MS Primary annuity portfolio is invested in the key asset classes that Challenger currently invests in and is accounted for under Australian Generally Accepted Accounting Principles and Challenger's normalised profit framework, consistent with Challenger's Life business.

As the product is an Australian dollar product, Challenger assumes no foreign currency risk and the product is confined to a fixed 20 year period.

MS Primary is responsible for marketing and distributing the product in Japan, including making payments to policyholders. Challenger guarantees a rate to MS Primary, which effectively includes Challenger's contribution toward marketing, distributing and administration costs in Japan. As such, for this product, Challenger will incur limited distribution and operational costs as part of its direct expense base.

The annuity relationship with MS Primary has started strongly. MS Primary sales, which commenced in November 2016, account for 15% of Challenger's FY17 total annuity sales. Challenger expects MS Primary sales to be approximately $600m in FY18.

Under the reinsurance agreement, the guaranteed interest rate on new business can be revised for changes in both interest rates and margin, and has mechanisms to regulate volumes between MS Primary and Challenger. The agreement also includes usual termination rights for both parties, including material breach, failure to make payments and events that may be triggered by changes in MS Primary's regulatory environment.

Broadening the relationship with MS&AD Group

MS&AD's subsidiary, MS Primary is a key Challenger distributor. Challenger is broadening its relationship with the MS&AD Group and both parties have identified new potential growth opportunities, including the development of new products.

In FY17 Challenger opened a Tokyo office to support future growth across both Life and Funds Management. The MS&AD relationship complements Challenger's existing Japanese footprint.

In recognition of the strategic importance of the MS&AD relationship, and to facilitate Challenger's future growth, a $500m equity placement to MS&AD Insurance Group Holdings Inc. will be completed on 23 August 2017 (refer to page 40 for more detail).

The equity placement represents 6.3% of Challenger issued capital. MS&AD intends to increase their investment in Challenger to 10% of issued capital via market acquisitions over the next 12 months, subject to market conditions any necessary or desirable regulatory approvals and Challenger circumstances. MS&AD reserves the right to change its intentions and to acquire, dispose and vote Challenger shares as it sees fit.

MS&AD's equity investment in Challenger underpins the strength of the relationship and is supportive of Challenger's ongoing growth.

Life Risk

Undertaking wholesale longevity and mortality transactions is a natural business extension for the Life business. Life is participating in established markets, has specialised expertise and is taking a disciplined approach to the wholesale Life Risk opportunity.

FY17 Life COE includes $28m of income as a result of Life Risk transactions, up from $15m in FY16. Life Risk income represents premiums net of expected claims.

The increase in Life Risk (up $13m) in FY17 includes a one-off fee (~$10m) as a result of restructuring a Life Risk transaction in 1H17.

The present value of future profits arising from the Life Risk portfolio was $263m at 30 June 2017, up from $243m at 30 June 2016. The Life Risk portfolio has an average duration of 14 years.

Accurium

Accurium is Australia's leading provider of Self-Managed Superannuation Fund (SMSF) actuarial certificates. An actuarial certificate is required by a SMSF when one (or more) members are in the retirement phase of superannuation and one (or more) are in the savings (accumulation) phase of superannuation.

Accurium's FY17 revenue was $9m (FY16 $9m) and is disclosed as part of other income within Life's normalised cash operating earnings framework.

Retirement income regulatory reforms update

The Australian Government commissioned the Financial System Inquiry (FSI) to provide a 'blueprint' for Australia's financial system over the next decade. The FSI report (released December 2014) recommended a number of retirement income reforms to enhance the retirement phase of superannuation.

These reforms included:

1. Defining and enshrining the objective of superannuation in legislation;
2. Removing impediments to longevity product development through the Retirement Income Streams Review; and
3. Creating a framework for pre-selecting retirement income products at retirement (Comprehensive Income Products for Retirement or MyRetirement).

The Government responded to the FSI recommendations in October 2015, supporting all major retirement income recommendations and is embarking on a legislative program to implement these reforms.

1. Objective of superannuation

The Government has adopted the FSI recommendation that the objective of superannuation should be to provide income in retirement to substitute or supplement the Age Pension. Making clear the objective of superannuation provides the framework for future Government policy, and also provides guidance to the superannuation industry and retirees.

2. New retirement income rules – Retirement Income Streams Review

As part of the Federal Budget in May 2016, the Government announced a new superannuation framework for retirement income products. The new product rules remove the impediments to longevity products, including Deferred Lifetime Annuities and group self-annuitisation products, and are expected to provide the building blocks for superannuation funds to develop Comprehensive Income Products for Retirement (CIPRs).

In June 2017, the Government finalised the new retirement income product rules by issuing final regulations. Challenger is well progressed on finalising the design of its Deferred Lifetime Annuity (DLA) product and expects to launch a DLA in FY18. The Department of Social Security has not yet finalised the age pension means testing treatment for retirement income products. This will be an important consideration for financial advisers in recommending DLAs.

3. Comprehensive Income Products for Retirement (CIPR) or MyRetirement

The FSI recommended trustees should pre-select for members a Comprehensive Income Product for Retirement (CIPR) to enable seamless transition to retirement and deliver on the superannuation objective to provide retirement income.

CIPRs will comprise a combination of products in order to achieve these objectives, and superannuation funds will be able to partner with Life Insurance Companies in order to provide pooled longevity products, such as annuities as part of their CIPR offering.

In order to assist with the development of a CIPR framework, the Government is specifically seeking industry feedback on: the structure and minimum requirements of CIPRs; the framework for regulating CIPRs; and the process for offering a CIPR.

Industry submissions in relation to CIPRs closed in July 2017. As part of its consultation, the Government is proposing to rename CIPRs 'MyRetirement products'. The CIPR framework is not expected to commence before mid-2018.

Life balance sheet

$m	FY17	1H17	FY16	1H16	FY15	1H15
Assets						
Life investment assets						
Cash and equivalents	1,430.1	1,172.7	1,990.6	1,631.9	728.4	1,307.3
Asset backed securities	4,416.7	4,362.8	4,138.1	4,044.5	4,340.6	4,209.5
Corporate credit	4,568.2	3,985.4	3,186.8	2,811.2	3,444.7	3,024.3
Fixed income and cash (net)	**10,415.0**	**9,520.9**	**9,315.5**	**8,487.6**	**8,513.7**	**8,541.1**
Australian – Office	1,670.6	1,563.1	1,498.4	1,385.2	1,359.0	1,138.2
Australian – Retail	941.1	921.3	962.0	986.1	818.0	721.6
Australian – Industrial	170.1	195.6	188.3	98.6	96.7	162.8
Japanese	229.3	226.9	242.4	203.6	225.1	204.3
REITS and other	396.7	421.4	258.9	389.7	384.9	489.5
Property (net)	**3,407.8**	**3,328.3**	**3,150.0**	**3,063.2**	**2,883.7**	**2,716.4**
Equity and other investments	1,360.1	1,231.6	1,079.0	1,060.0	882.8	632.4
Infrastructure (net)	494.4	526.4	567.2	536.4	514.4	503.0
Life investment assets	**15,677.3**	**14,607.2**	**14,111.7**	**13,147.2**	**12,794.6**	**12,392.9**
Other assets (including intangibles)	479.7	389.4	516.0	460.1	456.4	601.4
Total assets	**16,157.0**	**14,996.6**	**14,627.7**	**13,607.3**	**13,251.0**	**12,994.3**
Liabilities						
Life annuity book	10,322.2	9,784.9	9,558.5	8,868.4	8,693.0	8,573.1
Guaranteed Index Return (GIR) and Challenger Index Plus liabilities	1,687.8	1,633.2	1,315.5	1,035.1	944.7	954.8
Subordinated debt	393.6	384.8	576.7	576.5	567.0	560.7
Challenger Capital Notes	805.0	345.0	345.0	345.0	345.0	345.0
Other liabilities	277.4	295.3	342.6	215.2	292.3	199.8
Total liabilities	**13,486.0**	**12,443.2**	**12,138.3**	**11,040.2**	**10,842.0**	**10,633.4**
Net assets	**2,671.0**	**2,553.4**	**2,489.4**	**2,567.1**	**2,409.0**	**2,360.9**

Life balance sheet

Life maintains a high quality investment portfolio in order to generate cash flows to meet future annuity obligations.

Life investment portfolio overview

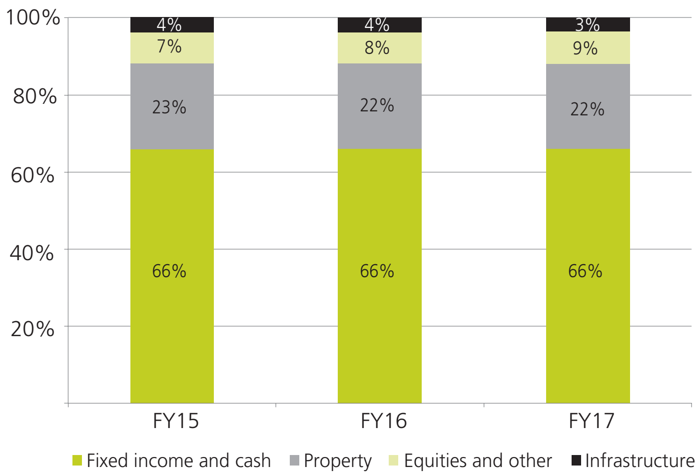
Life reviews its investment asset allocation based on the relative value of different asset classes, expected return on equity, and the tenor of annuity sales as Life maintains a cash flow matched portfolio. Accordingly, Life's investment asset allocation may vary from time to time.

Life's investment assets at 30 June 2017 comprised:

- Fixed income and cash 66%;
- Property 22%;
- Equities and other investments 9%; and
- Infrastructure 3%.

Detailed information on Life's investment assets is included on pages 28 to 36.

Life investment portfolio overview chart



Fixed income portfolio overview

Life's fixed income and cash portfolio was $10.4bn (net of debt) at 30 June 2017 up from $9.3bn at 30 June 2016. The fixed income and cash portfolio represented 66% of Life's investment assets at 30 June 2017.

Challenger manages credit risk by maintaining a high quality investment portfolio and applying a rigorous investment process. The fixed income portfolio is diversified across different industries, rating bands, asset classes and geographies.

Life's liabilities and cash flows are long-term in nature and contracted, providing the opportunity to invest in long-dated and illiquid fixed income investments, allowing Life to earn an illiquidity premium on fixed income. The average fixed income illiquidity premium generated over the last five years is between 1% and 2%.

The fixed income portfolio comprises over 1,100 different securities with 76% of the fixed income portfolio investment grade (i.e. BBB or higher), down from 81% at 30 June 2016.

A total of 78% of the fixed income portfolio is externally rated (Standard & Poor's, Fitch or Moody's) and 22% based on internal ratings calibrated to Standard & Poor's or Moody's ratings framework.

The fixed income and cash portfolio is predominately Australian focused, with approximately 70% of the fixed income portfolio invested in Australian based securities.

Approximately 25% of Life's fixed income portfolio represents fixed income investments originated by Challenger. Direct fixed income origination includes senior secured loans, asset backed securities and commercial real estate lending. Life's direct origination capability has been in place for over ten years and provides opportunities to capture relative value including illiquidity premiums.

Detailed disclosure of Life's fixed income portfolio is included on pages 28 to 31. The fixed income disclosures include the following tables.

1. Table 1 – fixed income portfolio overview;
2. Table 2 – fixed income portfolio by credit rating;
3. Table 3 – fixed income portfolio by rating type;
4. Table 4 – fixed income portfolio by industry sector; and
5. Table 5 – fixed income portfolio by geography and credit rating.

Table 1: Fixed income portfolio overview

30 June 2017		$m	% portfolio	
Liquids		1,430	14%	Includes cash and equivalents and Government Bonds (net of repurchase agreements).
Asset Backed Securities (ABS)	RMBS	2,032	20%	Residential mortgage backed securities (RMBS). RMBS expertise developed when Challenger was Australia's largest non-bank securitiser of RMBS (via Mortgage Management business sold in 2009). Also includes NIM notes.
	Other ABS	1,049	10%	Financing secured against underlying assets. Asset security includes motor vehicle, equipment and consumer finance.
	Senior Secured Bank Loans	690	7%	Senior debt secured by collateral and typically originated by Challenger.
	Aviation Finance	223	2%	Secured commercial aircraft financing.
	CMBS	423	3%	Commercial Mortgage Backed Securities (CMBS).
Corporate Credit	Banks & Financials	970	9%	Corporate loans to banks, insurance companies and fund managers.
	Infrastructure	1,295	12%	Long dated inflation linked bonds issued by Public Private Partnership projects and loans to infrastructure companies.
	Non-Financial Corporates	1,324	13%	Traded commercial loans to industrials and retailers.
	Commercial Real Estate	979	10%	Loans secured against commercial real estate assets and typically originated by Challenger.
Total		**10,415**	**100%**	

Table 2: Fixed income portfolio by credit rating

	Investment grade						Non-investment grade			Total
30 June 2017 ($m)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**$m**
Liquids										
Government Bonds[1]	1,245	–	–	–	–	**1,245**	–	–	–	**1,245**
Cash & equivalents	185	–	–	–	–	**185**	–	–	–	**185**
Asset Backed Securities (ABS)										
RMBS	–	640	372	483	325	**1,820**	111	101	**212**	**2,032**
Other ABS	–	105	89	172	189	**555**	382	112	**494**	**1,049**
Senior Secured Loans	–	139	27	116	293	**575**	103	12	**115**	**690**
Aviation Finance	–	–	–	73	90	**163**	32	28	**60**	**223**
CMBS	–	30	11	43	108	**192**	199	32	**231**	**423**
Corporate credit										
Banks & Financials	–	–	98	172	596	**866**	75	29	**104**	**970**
Infrastructure	–	6	135	238	601	**980**	146	169	**315**	**1,295**
Non-Financial Corporates	–	1	4	86	359	**450**	576	298	**874**	**1,324**
Commercial Real Estate	–	28	26	203	603	**860**	108	11	**119**	**979**
Total	**1,430**	**949**	**762**	**1,586**	**3,164**	**7,891**	**1,732**	**792**	**2,524**	**10,415**
Fixed income portfolio %	14%	9%	7%	15%	31%	**76%**	17%	8%	**24%**	**100%**
Average duration (years)	0.0	1.8	3.3	3.1	3.3	**3.0**	3.4	3.2	**3.3**	**3.1**

	Investment grade						Non-investment grade			Total
30 June 2017 (%)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**%**
Liquids										
Government Bonds[1]	100%	–	–	–	–	**100%**	–	–	**–**	**100%**
Cash & equivalents	100%	–	–	–	–	**100%**	–	–	**–**	**100%**
Asset Backed Securities (ABS)										
RMBS	–	31%	18%	24%	17%	**90%**	5%	5%	**10%**	**100%**
Other ABS	–	10%	8%	16%	19%	**53%**	36%	11%	**47%**	**100%**
Senior Secured Loans	–	20%	4%	17%	42%	**83%**	15%	2%	**17%**	**100%**
Aviation Finance	–	–	–	33%	40%	**73%**	14%	13%	**27%**	**100%**
CMBS	–	7%	3%	10%	25%	**45%**	47%	8%	**55%**	**100%**
Corporate credit										
Banks & Financials	–	–	10%	18%	61%	**89%**	8%	3%	**11%**	**100%**
Infrastructure	–	–	10%	18%	48%	**76%**	11%	13%	**24%**	**100%**
Non-Financial Corporates	–	–	–	6%	28%	**34%**	44%	22%	**66%**	**100%**
Commercial Real Estate	–	3%	3%	21%	61%	**88%**	11%	1%	**12%**	**100%**
Total	**14%**	**9%**	**7%**	**15%**	**31%**	**76%**	**17%**	**7%**	**24%**	**100%**

1 Gross Government Bonds of $5,445m are shown net of $3,287m of Government Bonds that are held via repurchase agreements. Repurchase agreements are used to hedge movements in interest rates. Refer to page 37 for more details.

Table 3: Fixed income portfolio by rating type

	Investment grade						Non-investment grade			Total
30 June 2017 ($m)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**$m**
Liquids										
Externally rated	1,430	–	–	–	–	**1,430**	–	–	–	**1,430**
Internally rated	–	–	–	–	–	**–**	–	–	**–**	**–**
Asset Backed Securities (ABS)										
Externally rated	–	877	495	678	599	**2,649**	204	79	**283**	**2,932**
Internally rated	–	37	4	209	406	**656**	624	205	**829**	**1,485**
Corporate credit										
Externally rated	–	35	263	699	1,862	**2,859**	459	397	**856**	**3,715**
Internally rated	–	–	–	–	297	**297**	445	111	**556**	**853**
Total	**1,430**	**949**	**762**	**1,586**	**3,164**	**7,891**	**1,732**	**792**	**2,524**	**10,415**
Externally rated	100%	96%	99%	87%	78%	**88%**	38%	60%	**45%**	**78%**
Internally rated	–	4%	1%	13%	22%	**12%**	62%	40%	**55%**	**22%**

	Investment grade						Non-investment grade			Total
30 June 2017 (%)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**%**
Liquids										
Externally rated	100%	–	–	–	–	**100%**	–	–	**–**	**100%**
Internally rated	–	–	–	–	–	**–**	–	–	**–**	**–**
Asset Backed Securities (ABS)										
Externally rated	–	30%	17%	23%	20%	**90%**	7%	3%	**10%**	**100%**
Internally rated	–	2%	–	14%	28%	**44%**	42%	14%	**56%**	**100%**
Corporate credit										
Externally rated	–	1%	7%	19%	50%	**77%**	12%	11%	**23%**	**100%**
Internally rated	–	–	–	–	35%	**35%**	52%	13%	**65%**	**100%**

Table 4: Fixed income portfolio by industry sector

	Investment grade						Non-investment grade			Total
30 June 2017 ($m)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**$m**
Industrials and Consumers	–	236	140	342	912	**1,630**	1,036	447	**1,483**	**3,113**
Residential Property	–	659	355	518	283	**1,815**	103	113	**216**	**2,031**
Banks, Financials & Insurance	185	13	106	267	604	**1,175**	112	29	**141**	**1,316**
Government	1,245	–	–	–	–	**1,245**	–	–	**–**	**1,245**
Commercial Property	–	33	26	178	695	**932**	305	32	**337**	**1,269**
Infrastructure & Utilities	–	6	135	238	604	**983**	148	171	**319**	**1,302**
Other	–	2	–	43	66	**111**	28	–	**28**	**139**
Total	**1,430**	**949**	**762**	**1,586**	**3,164**	**7,891**	**1,732**	**792**	**2,524**	**10,415**

	Investment grade						Non-investment grade			Total
30 June 2017 (%)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**%**
Industrials and Consumers	–	8%	4%	11%	29%	**52%**	33%	15%	**48%**	**100%**
Residential Property	–	32%	17%	26%	14%	**89%**	5%	6%	**11%**	**100%**
Banks, Financials & Insurance	14%	1%	8%	20%	46%	**89%**	9%	2%	**11%**	**100%**
Government	100%	–	–	–	–	**100%**	–	–	**–**	**100%**
Commercial Property	–	3%	2%	14%	54%	**73%**	24%	3%	**27%**	**100%**
Infrastructure & Utilities	–	–	10%	18%	47%	**75%**	11%	14%	**25%**	**100%**
Other	–	1%	–	31%	48%	**80%**	20%	–	**20%**	**100%**
Total	**14%**	**9%**	**7%**	**15%**	**31%**	**76%**	**17%**	**7%**	**24%**	**100%**

Table 5: Fixed income portfolio by geography and credit rating

	Investment grade						Non-investment grade			Total
30 June 2017 ($m)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**$m**
Australia	1,313	729	508	998	1,976	**5,524**	1,144	352	**1,496**	**7,020**
United States	27	48	51	257	569	**952**	362	297	**659**	**1,611**
Rest of World	21	130	90	93	176	**510**	56	32	**88**	**598**
United Kingdom	50	42	16	123	223	**454**	19	78	**97**	**551**
Europe	19	–	45	54	168	**286**	70	7	**77**	**363**
New Zealand	–	–	52	61	52	**165**	81	26	**107**	**272**
Total	**1,430**	**949**	**762**	**1,586**	**3,164**	**7,891**	**1,732**	**792**	**2,524**	**10,415**

	Investment grade						Non-investment grade			Total
30 June 2017 (%)	**Liquids**	**AAA**	**AA**	**A**	**BBB**	**Total**	**BB**	**B or lower**	**Total**	**%**
Australia	19%	10%	7%	14%	29%	**79%**	16%	5%	**21%**	**100%**
United States	2%	3%	3%	16%	35%	**59%**	22%	19%	**41%**	**100%**
Rest of World	4%	22%	15%	16%	28%	**85%**	9%	6%	**15%**	**100%**
United Kingdom	9%	8%	3%	22%	40%	**82%**	3%	15%	**18%**	**100%**
Europe	5%	–	12%	15%	47%	**79%**	19%	2%	**21%**	**100%**
New Zealand	–	–	19%	22%	20%	**61%**	30%	9%	**39%**	**100%**
Total	**14%**	**9%**	**7%**	**15%**	**31%**	**76%**	**17%**	**7%**	**24%**	**100%**

Property portfolio overview

Life's property portfolio of $3.4bn (net of debt) at 30 June 2017 represented 22% of Life's total investment assets, unchanged from 30 June 2016.

Life's property portfolio increased by $0.3bn (net of debt) in FY17 due to property acquisitions and partially offset by a decrease in listed REIT investments, and the disposal of four properties.

Challenger Life has a policy that all properties are independently valued each year with approximately 50% valued in June and 50% valued in December. Internal valuations are also undertaken for properties not independently valued each June and December. An independent valuation is subsequently undertaken if the internal valuation shows a significant variance to the most recent independent valuation. Independent valuations were undertaken for all of Life's direct properties in FY17.

Life's direct property valuations increased by approximately 2% in FY17, in line with the 2% normalised capital growth assumption for property. The listed Australian REITs portfolio fell by ~10% and underperformed the normalised assumption.

Property acquisitions incur stamp duty and acquisition costs. Under Australian Accounting Standards, property acquisition and transaction costs are required to initially be capitalised. When the property is subsequently revalued, there is generally no value ascribed to the acquisition costs which may result in a reduction in the property valuation and corresponding negative investment experience. During FY17, all properties acquired in FY16 were subject to either an independent valuation or directors' valuation, with $4m of transaction costs (including stamp duty) offset against property valuation gains.

During FY17 one property was acquired for approximately $60m, with property acquisition costs including stamp duty of $3m incurred. The property acquisition costs will be offset against property revaluations in 1H18.

Life's property portfolio principally comprises directly held properties and is diversified across office, retail, and industrial properties.

Property includes a net $229m exposure to Japanese property (7% of the property portfolio), consisting of suburban shopping centres that are focused on non-discretionary retailing.

Property also includes a $159m investment in listed Australian REITs.

Rental income is diversified across sectors and tenants, with 54% (by FY17 gross rental income) of tenants classified investment grade (i.e. rated BBB or higher).

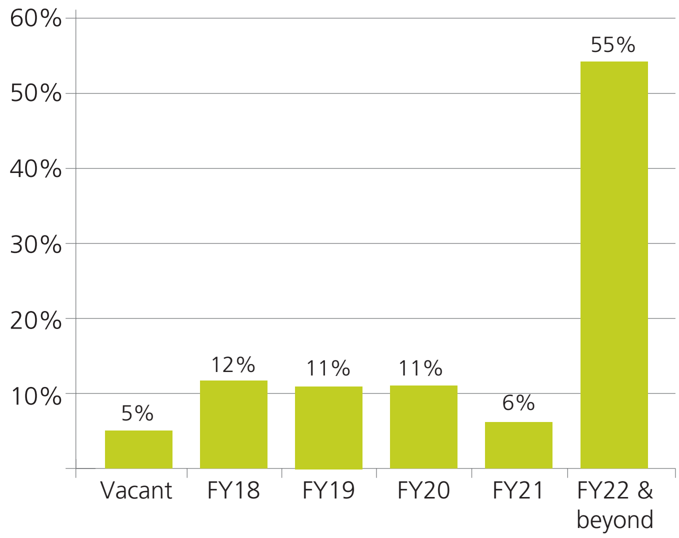
The Australian Government is a major tenant, leasing a range of commercial office buildings and accounted for approximately 32% of FY17 gross rental income[1].

Full details of Life's property portfolio are listed on pages 34 and 35.

Property portfolio summary

% of total portfolio	FY17	FY16
Australian office	49%	48%
Australian retail	28%	30%
Australian industrial	5%	6%
Australian listed REITs	5%	–
Australian unlisted REITs	3%	4%
Australian total	**90%**	**88%**
Japanese retail	7%	8%
Other (including offshore)	3%	4%
Total	**100%**	**100%**

Portfolio lease expiry overview[2]



The property portfolio generates long-term cash flows in order to match long-term liabilities. Approximately 55% of contracted leases expire in FY22 and beyond, demonstrating the long-term nature of property cash flows.

1 Represents total gross passing income attributable to the direct property portfolio.
2 Direct property portfolio and jointly held assets only and excludes Australian REITs and development assets.

Direct property portfolio overview[1]

30 June 2017		**Office**	**Retail**	**Industrial**	**Total**
Total rent (%)[2]		54%	38%	8%	100%
WALE		4.1	5.5	4.6	4.7
Tenant credit ratings					
	AAA	24%	–	–	24%
	AA	8%	1%	–	9%
	A	–	3%	1%	4%
	BBB	4%	9%	4%	17%
	BB	12%	18%	1%	31%
	B or below	1%	2%	1%	3%
	Not rated	2%	4%	1%	7%
	Vacant	4%	1%	–	5%
	Total	**54%**	**38%**	**8%**	**100%**
% of total gross rent	Investment grade	36%	13%	5%	54%
	Non-investment grade	14%	24%	3%	41%
	Vacant	4%	1%	–	5%

1 Direct property portfolio and jointly held assets only and excludes Australian REITs and development assets.
2 Includes vacant floors/suites available for lease.

Direct property investments

30 June 2017		Acquisition date[1]	Total cost $m[2]	Carrying value $m	Cap rate FY17 %[3]	Last external valuation date
Australia						
Office						
	31 Queen Street, VIC	31-Mar-11	97.4	136.8	5.75	31-Dec-16
	82 Northbourne Avenue, ACT	01-Jun-17	60.4	60.4	6.25	–
	35 Clarence Street, NSW	15-Jan-15	145.3	180.0	5.75	30-Jun-17
	53 Albert Street, QLD	12-Dec-14	222.9	216.0	6.50	30-Jun-17
	565 Bourke Street, VIC	28-Jan-15	88.1	90.1	6.00	31-Dec-16
	ABS Building, ACT	01-Jan-00	120.1	124.0	7.00	30-Jun-17
	215 Adelaide Street, QLD	31-Jul-15	242.6	230.0	6.75	30-Jun-17
	County Court, VIC	30-Jun-00	215.1	301.0	6.25	31-Dec-16
	DIBP (formerly DIAC) Building, ACT	01-Dec-01	103.3	122.5	6.75	30-Jun-17
	Discovery House, ACT	28-Apr-98	88.2	105.1	7.50	31-Dec-16
	Elder House, SA	21-Jun-02	48.3	23.0	9.00	30-Jun-17
	Executive Building, TAS	30-Mar-01	33.6	40.9	7.50	31-Dec-16
	Makerston House, QLD	14-Dec-00	67.7	68.3	8.00	31-Dec-16
Retail						
	Bunbury Forum, WA	03-Oct-13	152.8	151.0	6.25	30-Jun-17
	Century City Walk, VIC	16-Oct-06	30.2	45.0	7.00	31-Dec-16
	Channel Court, TAS	21-Aug-15	80.9	82.5	7.25	30-Jun-17
	Golden Grove, SA	31-Jul-14	141.1	146.4	6.00	30-Jun-17
	Karratha, WA	28-Jun-13	54.2	54.3	7.00	30-Jun-17
	Kings Langley, NSW	29-Jul-01	15.9	23.0	6.25	30-Jun-17
	Lennox, NSW	27-Jul-13	28.2	35.5	6.25	30-Jun-17
	Next Hotel, QLD	25-Mar-15	142.0	130.9	6.84	31-Dec-16
	North Rocks, NSW	18-Sep-15	137.6	128.0	6.50	30-Jun-17
Industrial						
	12-30 Toll Drive, Altona North, VIC	31-Dec-08	13.9	13.6	7.50	31-Dec-16
	2-10 Toll Drive, Altona North, VIC	31-Dec-08	6.3	7.0	7.00	31-Dec-16
	Cosgrave Industrial Park, Enfield, NSW	31-Dec-08	91.9	105.8	6.25	31-Dec-16
	21 O'Sullivan Circuit, NT	27-Jan-16	47.6	42.3	7.75	31-Dec-16
	31 O'Sullivan Circuit, NT	27-Jan-16	28.6	27.3	8.00	31-Dec-16
Mixed use						
	The Barracks, QLD	31-Oct-14	153.8	150.7	6.50	30-Jun-17
Total Australia			**2,658.0**	**2,841.4**		

1 Acquisition date represents the date of CLC's initial acquisition or consolidation of the investment vehicle holding the asset.
2 Total cost represents the original acquisition cost plus additions less full and partial disposals since acquisition date.
3 The capitalisation rate is the rate at which net market income is capitalised to determine the value of the property. The rate is determined with regards to market evidence.

Direct property investments

30 June 2017			Acquisition date[1]	Total cost $m[2]	Carrying value $m	Cap rate FY17 %[3]	Last external valuation date
Japan							
	Retail						
		Aeon Kushiro	31-Jan-10	30.5	32.5	5.50	30-Jun-17
		Carino Chitosedai	31-Jan-10	118.4	118.4	4.70	31-Dec-16
		Carino Tokiwadai	31-Jan-10	77.0	76.4	4.70	30-Jun-17
		DeoDeo Kure	31-Jan-10	31.9	28.8	5.60	30-Jun-17
		Fitta Natalie Hatsukaichi	28-Aug-15	11.4	13.0	5.90	31-Dec-16
		Izumiya Hakubaicho	31-Jan-10	68.9	66.9	5.00	31-Dec-16
		Kansai Super Saigo	31-Jan-10	13.1	12.6	5.50	30-Jun-17
		Kojima Nishiarai	31-Jan-10	12.2	13.3	4.60	30-Jun-17
		Life Asakusa	31-Jan-10	27.8	31.3	4.60	30-Jun-17
		Life Higashi Nakano	31-Jan-10	32.9	33.6	4.70	31-Dec-16
		Life Nagata	31-Jan-10	25.2	26.2	5.00	30-Jun-17
		MaxValu Tarumi	28-Aug-15	16.9	18.0	5.70	31-Dec-16
		Seiyu Miyagino	31-Jan-10	9.7	9.7	5.70	30-Jun-17
		Valor Takinomizu	31-Jan-10	26.8	23.3	5.70	31-Dec-16
		Valor Toda	31-Jan-10	42.5	41.4	5.50	30-Jun-17
		Yaoko Sakato Chiyoda	31-Jan-10	18.8	17.1	5.00	31-Dec-16
Total Japan				**564.0**	**562.5**		
Europe							
	Industrial						
		105 Route d'Orleans, Sully sur Loire	31-Dec-08	27.1	9.1	8.00	30-Jun-17
		Gennevilliers,140 Rue Marcel Paul	31-Dec-08	14.1	10.2	7.25	30-Jun-17
		Parcay-Meslay, ZAC Papillon	31-Dec-08	10.1	7.3	7.50	30-Jun-17
		Villeneuve les Beziers, Rue Charles Nicolle	31-Dec-08	18.4	12.9	7.25	30-Jun-17
	Retail						
		Aulnay sous Bois, Avenue de Savigny	31-Dec-08	20.3	12.0	6.25	30-Jun-17
Total Europe				**90.0**	**51.5**		
Total Overseas				**654.0**	**614.0**		
Development							
		839 Collins Street, VIC	22-Dec-16	34.6	34.6	–	–
		Gateway, NT	01-Jul-15	95.7	96.4	–	–
		TRE Data Centre site, ACT	14-Apr-10	13.1	13.1	–	–
		Maitland, NSW	06-Dec-06	49.0	29.4	–	–
Total development				**192.4**	**173.5**		
Total direct portfolio investments				**3,504.4**	**3,628.9**		

1 Acquisition date represents the date of CLC's initial acquisition or consolidation of the investment vehicle holding the asset.
2 Total cost represents the original acquisition cost plus additions less full and partial disposals since acquisition date.
3 The capitalisation rate is the rate at which net market income is capitalised to determine the value of the property. The rate is determined with regards to market evidence.

Equity and other portfolio overview

Life's equity and other portfolio of $1.4bn represented 9% of Life's total investment assets at 30 June 2017, and increased by $0.3bn in FY17. Life's equity and other portfolio consists of beta investments, alternatives and other investments.

Listed beta equity investments of $577m represent investments in long only equities, including ETFs. Unlisted beta equity investments of $273m represent investments managed by a range of third party investment managers. Beta investment returns are expected to be correlated to listed equity market returns.

Alternatives and other equity investments of $510m represent a range of investments including absolute return funds and unlisted investments. Returns are considered to generally be uncorrelated to listed equity market returns.

Equity and other portfolio

30 June 2017 ($m)	Domestic	Offshore	Total
Listed beta	134	443	577
Unlisted beta	49	224	273
Alternatives and other	183	327	510
Total	366	994	1,360

Infrastructure portfolio overview

Life's infrastructure portfolio of $0.5bn (net of debt) represented 3% of Life's investment assets at 30 June 2017, and decreased by $0.1bn in FY17.

Challenger Life seeks infrastructure assets that generate reliable and consistent cash flows, which are preferably inflation linked, giving rise to sustainable income growth over time. Infrastructure investments comprise directly held infrastructure assets and indirectly held listed and unlisted investments.

Approximately 60% of the infrastructure portfolio is unlisted.

The infrastructure portfolio is diversified across a number of geographic regions and sectors.

Infrastructure portfolio by sector

30 June 2017	$m	%
Logistics	65	13%
Utilities	76	15%
Patronage	18	4%
Airport	40	8%
Power Generation	24	5%
Renewable	104	21%
Core infrastructure	167	34%
Total	**494**	**100%**

Infrastructure portfolio by geography

30 June 2017	$m	%
Australia	325	66%
United Kingdom	66	13%
Europe	22	4%
North America	48	10%
South America	33	7%
Total	**494**	**100%**

Challenger Life Company (CLC) debt facilities

$m	FY17	1H17	FY16	1H16	FY15	1H15
Controlled property debt	534.5	535.8	572.9	652.9	566.1	679.2
Subordinated debt	393.6	384.8	576.7	576.5	567.0	560.7
Repurchase agreements	3,287.5	3,482.9	2,454.2	1,875.1	1,267.3	1,163.3
Infrastructure debt	201.1	202.9	204.3	206.0	206.0	205.0
Other finance	17.0	17.8	18.8	19.5	1.4	3.3
Total CLC debt facilities	**4,433.7**	**4,624.2**	**3,826.9**	**3,330.0**	**2,607.8**	**2,611.5**

CLC debt facilities

CLC debt facilities includes debt which is non-recourse to the Challenger Group and secured against assets held in investment vehicles by CLC, including direct properties and infrastructure investments. CLC debt facilities increased by $0.6bn during FY17, as a result of an increase in repurchase agreements used to hedge interest rate movements, partially offset by a reduction in subordinated debt and controlled property debt.

Repurchase agreements

CLC enters into repurchase agreements whereby fixed income securities are sold for cash whilst simultaneously agreeing to repurchase the fixed income security at a fixed price and fixed date in the future. The use of repurchase agreements is part of Challenger's strategy to hedge interest rate movements.

CLC uses Australian Commonwealth Government Bonds (ACGBs) with repurchase agreements, interest rate swaps and bond futures to hedge movements in interest rates on its asset portfolio, annuity policy liabilities, Guaranteed Index Return mandates, and the Challenger Index Plus Fund.

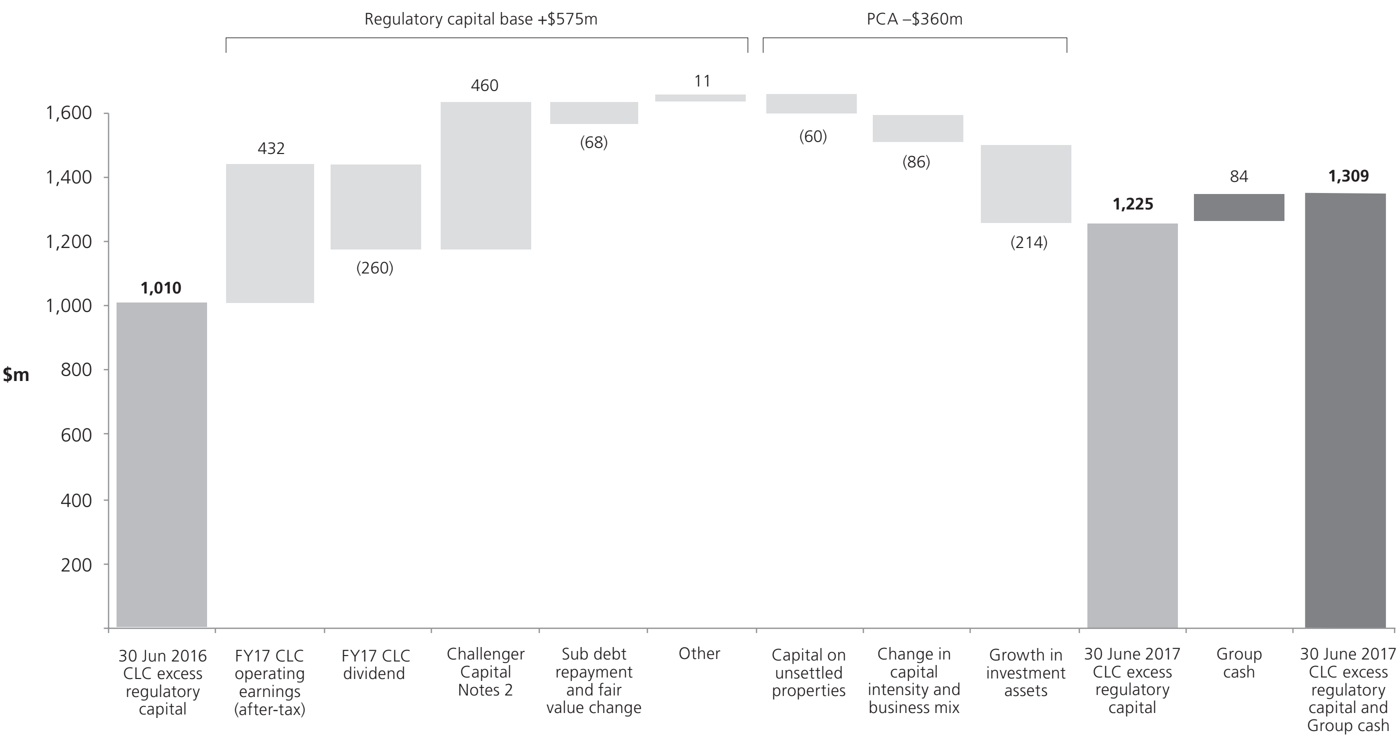
The Commonwealth Government continued to increase supply and extend the duration of the nominal bond curve in FY17. Swap spreads, being the difference in yield between interest rate swaps and Commonwealth Government Bonds remain near historical lows. As a result, bonds provide a more cost effective hedge than swaps, particularly for longer dated liabilities.

Derivatives such as interest rate swaps and bond futures are self-financing, whereas the use of bonds requires the use of repurchase agreement financing. As a consequence, outstanding repurchase agreements increased by $0.8bn for the year to $3.3bn at 30 June 2017.

Challenger Life Company (CLC) regulatory capital

$m		FY17	1H17	FY16	1H16	FY15	1H15
CLC Regulatory capital							
Common Equity Tier 1 (CET1) regulatory capital		2,169.0	2,046.0	2,003.6	1,951.8	1,907.6	1,886.7
Additional Tier 1		805.0	345.0	345.0	345.0	345.0	345.0
Tier 2 regulatory capital – subordinated debt[1]		395.4	386.7	445.5	477.5	474.0	504.7
CLC total regulatory capital base		**3,369.4**	**2,777.7**	**2,794.1**	**2,774.3**	**2,726.6**	**2,736.4**
CLC Prescribed Capital Amount (PCA)							
Asset risk charge		2,067.1	1,933.3	1,712.0	1,731.3	1,773.6	1,718.0
Insurance risk charge		157.5	152.7	168.3	132.7	120.5	143.5
Operational risk charge		38.7	34.9	28.7	22.7	22.6	23.9
Aggregation benefit		(119.2)	(115.5)	(125.3)	(100.4)	(91.9)	(108.5)
CLC prescribed capital amount – excluding transition relief		**2,144.1**	**2,005.4**	**1,783.7**	**1,786.3**	**1,824.8**	**1,776.9**
Transition relief		–	–	–	(107.6)	(107.6)	(215.2)
CLC prescribed capital amount		**2,144.1**	**2,005.4**	**1,783.7**	**1,678.7**	**1,717.2**	**1,561.7**
CLC excess over prescribed capital amount		**1,225.3**	**772.3**	**1,010.4**	**1,095.6**	**1,009.4**	**1,174.7**
PCA ratio (times)		1.57	1.39	1.57	1.65	1.59	1.75
Tier 1 ratio (times)		1.39	1.19	1.32	1.37	1.31	1.43
CET1 ratio (times)		1.01	1.02	1.12	1.16	1.11	1.21
Tier 2 regulatory capital – subordinated debt[1]							
First call date after 1 Jan 2013	**Maturity date**	**FY17**	**1H17**	**FY16**	**1H16**	**FY15**	**1H15**
7 Nov 2017	7 Nov 2037	395.4	386.7	378.0	374.7	376.6	385.4
7 Jun 2013	7 Dec 2016	–	–	33.4	67.6	63.5	88.3
7 Dec 2016	7 Dec 2026	–	–	34.1	35.2	33.9	31.0
		395.4	**386.7**	**445.5**	**477.5**	**474.0**	**504.7**

Movement in CLC excess regulatory capital and Group cash graph



1. FY17 Tier 2 regulatory capital – subordinated debt ($395m) differs to the Group balance sheet ($394m) due to accrued interest and amortised costs ($1m).

Challenger Life Company Limited (CLC) regulatory capital

Capital management

CLC holds capital in order to ensure that under a range of adverse scenarios it can continue to meet its regulatory and contractual obligations to customers. CLC is regulated by the Australian Prudential Regulation Authority (APRA) and is required to hold a minimum level of regulatory capital. CLC has an ongoing and open engagement with APRA.

CLC's regulatory capital base and prescribed capital amounts have been calculated based on APRA prudential capital standards.

CLC excess regulatory capital

CLC's excess capital above APRA's prescribed capital amount at 30 June 2017 (FY17) was $1,225m, up $0.2bn for the year. The increase in excess regulatory capital was a result of a $0.6bn increase in CLC's regulatory capital base, partially offset by a $0.4bn increase in CLC's Prescribed Capital Amount (PCA).

The regulatory capital base ($3.4bn) increased as a result of retained earnings net of CLC dividends and Additional Tier 1 equity injected following the Challenger Capital Notes 2 issue, partially offset by the repayment of subordinated debt during the year.

In April 2017 Challenger Limited issued Challenger Capital Notes 2, which are subordinated, unsecured, convertible notes. Following strong investor demand, the Challenger Capital Notes 2 offer was increased from $350m to $460m and priced at the lower end of Challenger's margin guidance range.

The proceeds from Challenger Capital Notes 2 ($460m) were used to fund CLC Additional Tier 1 regulatory capital, and increased CLC's excess regulatory capital base by $460m in 2H17.

Life's PCA increased as a result of growth in Life's annuity and other retirement products, and changes in the mix of Life's investment portfolio.

CLC's capital ratios at 30 June 2017 were as follows:

- PCA ratio of 1.57 times;
- Total Tier 1 ratio of 1.39 times; and
- Common Equity Tier 1 (CET1) ratio of 1.01 times.

APRA requires Total Tier 1 capital to be at least 80% of the PCA and CET1 capital to be at least 60% of the PCA. Both Challenger's Total Tier 1 capital ratio (1.39 times) and CET1 capital ratio (1.01 times) are well in excess of APRA's minimum requirements.

CLC maintains a target level of capital representing APRA's prescribed capital amount plus a target surplus. The target surplus is a level of excess capital that CLC seeks to carry over and above APRA's minimum requirement.

CLC's target surplus is set to ensure it provides a buffer so that CLC can continue to meet APRA's minimum requirements, with allowance for adverse market or insurance risk experience.

CLC uses internal capital models to determine its target surplus, which are risk-based and responsive to changes in CLC's asset allocation and market conditions.

While CLC does not target a specific PCA ratio, CLC's internal capital models generate a PCA ratio based upon asset allocation, business mix and economic circumstances. CLC's target PCA range is 1.3 times to 1.6 times.

Subordinated debt

CLC's total regulatory capital base includes $395m of admissible subordinated debt. Subordinated debt issued prior to 1 January 2013 (implementation date of new Life and General Insurance Capital (LAGIC) capital standards) will continue to be fully eligible as Tier 2 regulatory capital under LAGIC until each tranche's first call date after 1 January 2013, and will then amortise over four years.

CLC repaid $190m of subordinated debt in December 2016, with $68m qualifying as regulatory capital.

CLC's remaining $395m of subordinated debt has a call date in November 2017. As such, it will continue to be fully eligible as Tier 2 regulatory capital until its call date in November 2017 and will continue to be partially eligible until November 2021.

Group cash

In addition to CLC's excess regulatory capital, Challenger maintains cash at a Group level, which can be utilised to meet regulatory requirements. Group cash at 30 June 2017 was $84m, and was unchanged from 30 June 2016.

Challenger also maintains an undrawn Group banking facility of $400m, which is maintained to provide additional financial flexibility. The banking facility was undrawn at 30 June 2017.

APRA's Level 3 (conglomerate) capital proposals

APRA has developed a supervisory framework for Level 3 (conglomerate) groups, which was originally due to be effective from 1 January 2015. Level 3 groups perform material activities across more than one APRA regulated industry.

In March 2016, APRA announced it would defer the Level 3 capital framework until finalisation of other domestic and international capital policy initiatives. Based on draft Level 3 capital standards, Challenger does not expect a material impact on its regulatory capital base should these capital standards be implemented.

Capital management initiatives August 2017

In order to broaden Challenger's relationship with the MS&AD Group (refer to page 24 for more details), and fund future growth, Challenger is undertaking a $500m equity placement to MS&AD Insurance Group Holdings Inc. (MS&AD).

On 23 August 2017, Challenger will issue 38.3m new ordinary shares to MS&AD at a price of $13.06 per share (refer to page 13 for further details). The proceeds from the placement will be used to increase CLC's Common Equity Tier 1 capital. After allowing for the equity placement, and assuming the same capital intensity as at balance date, CLC's pro forma capital ratios at 30 June 2017 are as follows:

- PCA ratio of 1.75 times (from 1.57 times);
- Total Tier 1 ratio of 1.57 times (from 1.39 times); and
- Common Equity Tier 1 (CET1) ratio of 1.21 times (from 1.01 times).

Profit and equity sensitivities

$m	Change in variable	Profit/(loss) after tax FY17	Change in equity FY17	Profit/(loss) after tax FY16	Change in equity FY16
Credit risk					
Fixed Income assets (change in credit spreads)	+50 bps	(98.9)	(98.9)	(71.3)	(71.3)
	-50 bps	98.9	98.9	71.3	71.3
Property risk					
Direct Property	+1%	24.2	24.2	24.1	24.1
	-1%	(24.2)	(24.2)	(24.1)	(24.1)
Australian listed property securities	+10%	11.1	11.1	–	–
	-10%	(11.1)	(11.1)	–	–
Other property securities	+10%	10.1	10.1	10.0	10.0
	-10%	(10.1)	(10.1)	(10.0)	(10.0)
Total		45.4	45.4	34.1	34.1
		(45.4)	(45.4)	(34.1)	(34.1)
Infrastructure and equity risk					
Infrastructure investments	+10%	22.7	22.7	23.8	23.8
	-10%	(22.7)	(22.7)	(23.8)	(23.8)
Equity investments	+10%	95.2	95.2	75.5	75.5
	-10%	(95.2)	(95.2)	(75.5)	(75.5)
Total	+10%	117.9	117.9	99.3	99.3
	-10%	(117.9)	(117.9)	(99.3)	(99.3)
Life insurance risk					
Mortality, morbidity and longevity[1]					
Life insurance contract liabilities	+50%	(18.2)	(18.2)	(15.1)	(15.1)
	-50%	18.2	18.2	15.1	15.1
Interest rate risk					
Change in interest rates	+100 bps	1.4	1.4	4.1	4.1
	-100 bps	(1.4)	(1.4)	(4.1)	(4.1)
Foreign exchange risk					
British Pound	+10%	0.1	0.1	0.7	0.7
	-10%	(0.1)	(0.1)	(0.7)	(0.7)
US Dollar	+10%	(0.1)	(0.1)	7.0	7.0
	-10%	0.1	0.1	(7.0)	(7.0)
Euro	+10%	(0.1)	(0.1)	(0.3)	(0.3)
	-10%	0.1	0.1	0.3	0.3
Japanese Yen	+10%	–	0.2	–	0.8
	-10%	–	(0.2)	–	(0.8)
Other	+10%	(0.1)	(0.1)	0.4	0.4
	-10%	0.1	0.1	(0.4)	(0.4)

1 Mortality, morbidity and longevity life insurance contract liabilities sensitivity is net of any reinsurance with third parties.

Profit and equity sensitivities

Profit and equity sensitivities set out the expected impact from changes in a range of economic and investment market variables on Challenger's earnings and balance sheet. These sensitivities represent the after tax impact, assuming a tax rate of 30%.

The sensitivities are not forward looking and make no allowance for events occurring after 30 June 2017.

If using these sensitivities as forward looking, an allowance for changes post 30 June 2017, such as sales and asset growth, should be made.

These sensitivities assess the risk of changes in economic and investment markets on the valuation of assets, which in turn impact earnings. The earnings impact is included in investment experience and does not take into consideration the impact of any under or over performance of normalised growth assumptions for each asset category. Refer to page 50 for normalised growth assumptions.

These sensitivities do not include the indirect impact on fees for the Funds Management business.

Refer to the Risk Management Framework below for additional detail on how to apply the profit and equity sensitivities.

Risk Management Framework

Challenger is exposed to a variety of financial risks, including market risk (currency risk, interest rate risk, equity risk), credit default risk and liquidity risk.

The management of these risks is fundamental to Challenger's business and building long-term shareholder value.

The Challenger Limited Board is responsible, in conjunction with senior management, for understanding risks associated with the business and implementing structures and policies to adequately monitor and manage these risks.

The Board has established the Group Risk Committee (GRC) and Group Audit Committee (GAC) to assist in discharging certain responsibilities. In particular, these committees assist the Board in setting the risk appetite and ensuring Challenger has an effective Risk Management Framework, incorporating management, operational and financial controls.

The Executive Risk Management Committee (ERMC) is an executive committee, chaired by the Chief Risk Officer (CRO), which assists the GRC, GAC and Board in discharging their risk management obligations by implementing the Board approved Risk Management Framework.

The Group's Risk Management division has day-to-day responsibility for monitoring the implementation of the framework with oversight, analysis, monitoring and reporting of risks. The CRO provides regular reporting to the GRC, and the Board.

Risk appetite

Challenger's risk appetite requires a range of financial risks, including foreign exchange, interest rate, and inflation risk to be minimised. As a result Challenger takes an active approach to hedging and limiting these financial risks.

Challenger's risk appetite statement provides that, subject to acceptable returns, Challenger can retain exposure to credit risk, property risk, equity and infrastructure risk and Life insurance risk.

Accept exposure (subject to appropriate returns)	**Minimise exposure**
✓ Credit risk	✗ Foreign exchange risk
✓ Property risk	✗ Interest rate risk
✓ Equity & infrastructure risk	✗ Inflation risk
✓ Life insurance risk	✗ Liquidity risk
	✗ Licence risk
	✗ Operational risk

Credit default risk

Credit default risk is the risk of loss in value of an investment due to a counterparty failing to discharge an obligation.

Challenger's approach to credit management utilises a credit risk framework to ensure that the following principles are adhered to:

- credit risk management teams separation from risk originators;
- recognition of the different risks in the various businesses;
- credit exposures being systematically controlled and monitored;
- credit exposures being regularly reviewed in accordance with existing credit procedures; and
- ensuring credit exposures include the impact from derivative transactions.

Challenger makes use of external ratings agencies (Standard & Poor's, Fitch, Moody's) to determine credit ratings.

Where a counterparty or debt obligation is rated by multiple external rating agencies, Challenger will use Standard & Poor's ratings where available.

All credit exposures with an external rating are also reviewed internally and cross-referenced to the external rating, if applicable.

Where external credit ratings are not available, internal credit ratings are assigned by appropriately qualified and experienced credit personnel who operate separately from the risk originators.

Credit spread risk sensitivity

Challenger is exposed to price movements resulting from credit spread fluctuations through its fixed income securities net of subordinated debt. As at 30 June 2017, a 50 basis point increase/decrease in credit spreads results in an unrealised loss/gain of $99m (after tax).

Property risk

Property risk is the potential impact of movements in the market value of property investments on Challenger's profit and includes leasing risk which may impact the potential cash flow from these investments.

Property risk sensitivity

Challenger is exposed to movements in the market value of property investments, both directly held investment properties and property securities.

The direct property sensitivities included on page 41 show the impact of a change in property valuations on balance date and are based on Life's gross direct property investments of $3.6bn (net investments of $3.1bn plus debt of $0.5bn).

Equity risk

Equity risk is the potential impact of movements in the market value of listed and unlisted equities on Challenger's profit.

Challenger holds equities as part of its investment portfolio in order to provide diversification across the investment portfolio.

Equity risk sensitivity

Challenger is exposed to movements in the market value of listed and unlisted equity investments with a 10% move in equity markets at 30 June 2017 resulting in $95m (after tax) movement in the valuation of equity investments.

Liquidity risk

Liquidity risk is the risk that Challenger will encounter difficulty in raising funds to meet cash commitments associated with financial instruments and contracted payment obligations to annuitants. This may result from either the inability to sell financial assets at face value, a counterparty failing on repayment of a contractual obligation, or the inability to generate cash inflows as anticipated.

Challenger's liquidity policy aims to ensure that it has sufficient liquidity to meet its obligations on a short, medium and long-term basis. In setting the level of sufficient liquidity, Challenger considers new business activities in addition to current contracted obligations. In determining the required levels of liquidity, Challenger considers:

- minimum cash requirements;
- collateral and margin call buffers;
- Australian Financial Services License requirements;
- cash flow forecasts;
- associated reporting requirements;
- other liquidity risks; and
- contingency plans.

Required annuity cash outflows are met from contracted investment cash flows together with assets in Challenger's liquidity pool. As a result, cash flows are well-matched and continue to be rebalanced through time.

Life insurance risk

Lifetime annuities provide guaranteed payments to customers for life. Through selling lifetime annuities and assuming wholesale reinsurance agreements, CLC is assuming longevity risk, which is the risk annuitant customers live longer, in aggregate, than expected. This is in contrast to mortality risk, which is the risk that people die earlier than expected. CLC is exposed to mortality risk on the wholesale mortality reinsurance business.

CLC is required under APRA Prudential Standards to maintain regulatory capital in relation to the longevity, mortality and morbidity risks it carries. CLC manages some of its longevity risk exposure by using reinsurance for closed lifetime annuity portfolios as well as regularly reviewing the portfolio for longevity experience to ensure longevity assumptions remain appropriate.

Mortality and morbidity rates are based on industry standards which are adjusted for CLC's own recent experience, and include an allowance for future rates of mortality improvement.

CLC assumes future mortality rates for individual lifetime annuities will improve by between 0% and 2.6% per annum (FY16 0% and 2.8% per annum) depending on different age cohorts. This has the impact of increasing the life expectancy of a male aged 65 from 22 years (per the base mortality rates) to 24 years.

Mortality, morbidity and longevity sensitivities

The mortality sensitivities on page 41 set out the expected impact of an improvement in mortality. This is in addition to the mortality improvements Challenger already assumes.

A 50% increase in mortality improvement rates would increase the life expectancy of a male aged 65 from 24 years to 26 years.

Foreign exchange risk

It is Challenger's policy to seek to hedge the exposure of all balance sheet items for movements in foreign exchange rates.

Currency exposure arises primarily as a result of Life's investments in Europe (including the United Kingdom), Japan and the United States. As a result, currency risk arises from fluctuations in the value of the Euro, British Pound, Japanese Yen and US Dollar against the Australian Dollar.

In order to protect against foreign currency exchange rate movements, Challenger enters into foreign currency derivatives which limit Challenger's exposure to currency movements.

Foreign exchange sensitivity

The impact of movements in foreign currencies on Challenger's profit and loss and balance sheet are set out on page 41. As a result of foreign currency derivatives in place, Challenger's profit and loss is not materially sensitive to movements in foreign currency rates.

Interest rate risk

Interest rate risk is the risk of fluctuations in Challenger's earnings arising from movements in market interest rates, including changes in the absolute level of interest rates, the shape of the yield curve, the margin between the different yield curves and the volatility of interest rates.

CLC's market risk policy sets out the relevant risk limits for interest rate exposure. It is CLC's policy to minimise the impact of interest rate movements on its projected future cash flows.

Interest rate sensitivity

The impact of movements in interest rates on Challenger's profit and loss and balance sheet are set out on page 41.

The sensitivities assume the change in variable occurs on 30 June 2017, and are based on assets and liabilities held at that date. It is Challenger's policy to minimise the impact of movements in interest rates via the use of interest rate swaps, Australian Commonwealth Government bonds and bond futures. As a result the interest rate sensitivities on page 41 show Challenger's profit is not materially sensitive to changes in base interest rates.

Funds Management financial results

$m	FY17	FY16	FY15	2H17	1H17	2H16	1H16	2H15	1H15
Fidante Partners									
Fidante Partners income[1]	77.6	71.3	53.3	38.1	39.5	33.8	37.5	25.6	27.7
Performance fees	2.4	6.9	9.0	1.3	1.1	3.1	3.8	4.6	4.4
Net income	**80.0**	**78.2**	**62.3**	**39.4**	**40.6**	**36.9**	**41.3**	**30.2**	**32.1**
Challenger Investment Partners (CIP)									
CIP Income[2]	54.0	49.5	47.2	29.3	24.7	23.7	25.8	23.2	24.0
Performance fees	–	–	8.0	–	–	–	–	8.0	–
Net income	**54.0**	**49.5**	**55.2**	**29.3**	**24.7**	**23.7**	**25.8**	**31.2**	**24.0**
Total net fee income	**134.0**	**127.7**	**117.5**	**68.7**	**65.3**	**60.6**	**67.1**	**61.4**	**56.1**
Personnel expenses	(62.6)	(62.4)	(50.2)	(30.7)	(31.9)	(31.5)	(30.9)	(25.4)	(24.8)
Other expenses	(26.3)	(27.9)	(23.2)	(13.6)	(12.7)	(13.3)	(14.6)	(12.7)	(10.5)
Total expenses	**(88.9)**	**(90.3)**	**(73.4)**	**(44.3)**	**(44.6)**	**(44.8)**	**(45.5)**	**(38.1)**	**(35.3)**
EBIT	**45.1**	**37.4**	**44.1**	**24.4**	**20.7**	**15.8**	**21.6**	**23.3**	**20.8**
Performance analysis									
Fidante Partners – income margin (bps)[3]	17	19	15	16	18	18	20	14	16
Challenger Investment Partners – income margin (bps)[3]	36	37	43	38	34	36	39	47	39
Cost to income ratio	66.4%	70.7%	62.5%	64.5%	68.3%	73.9%	67.8%	62.1%	62.9%
Net assets – average[4]	181.4	159.2	124.3	185.4	176.9	165.9	151.3	121.7	127.1
RoE (pre-tax)	24.8%	23.5%	35.5%	26.5%	23.2%	19.2%	28.4%	38.6%	32.5%
Fidante Partners	50,960	43,012	44,667	50,960	46,958	43,012	41,605	44,667	42,503
Challenger Investment Partners	15,945	13,650	13,235	15,945	15,155	13,650	13,093	13,235	12,709
Closing FUM – Total	**66,905**	**56,662**	**57,902**	**66,905**	**62,113**	**56,662**	**54,698**	**57,902**	**55,212**
Fidante Partners	46,791	41,860	42,433	48,791	44,815	41,973	41,710	44,382	40,494
Challenger Investment Partners	15,006	13,248	12,713	15,725	14,308	13,346	13,128	13,358	12,0667
Average FUM – Total[5]	**61,797**	**55,108**	**55,146**	**64,516**	**59,123**	**55,319**	**54,838**	**57,740**	**52,561**
FUM and net flows analysis									
Fidante Partners[6]	4,125.8	(2,609.7)	6,104.4	2,384.8	1,741.0	1,332.1	(3,941.8)	678.3	5,426.1
Challenger Investment Partners	2,094.8	92.5	1,634.5	618.7	1,476.1	507.1	(414.6)	294.4	1,340.1
Net flows	6,220.6	(2,517.2)	7,738.9	3,003.5	3,217.1	1,839.2	(4,356.4)	972.7	6,766.2
Distributions	(504.2)	(541.1)	(261.7)	(248.2)	(256.0)	(203.1)	(338.0)	(97.2)	(164.5)
Market linked movement	4,527.4	1,817.6	3,298.7	2,037.1	2,490.3	327.6	1,490.0	1,815.0	1,483.7
Total FUM movement	**10,243.8**	**(1,240.7)**	**10,775.9**	**4,792.4**	**5,451.4**	**1,963.7**	**(3,204.4)**	**2,690.5**	**8,085.4**

1 Fidante Partners income includes equity accounted profits, distribution fees, administration fees and Fidante Partners Europe transaction fees.
2 CIP income includes asset based management fees and other income. Other income includes leasing fees, asset acquisition and disposal fees, development and placement fees.
3 Income margin represents net income divided by average FUM.
4 Net assets – average calculated on a monthly basis.
5 Average FUM calculated on a monthly basis.
6 Funds Management 1H16 and FY16 net flows include $5.4bn derecognition of Kapstream following the sale in July 2015.

Assets and Funds Under Management and net flows

$m	Q4 17	Q3 17	Q2 17	Q1 17	Q4 16
Funds Management					
Fidante Partners					
Equities	22,365	21,576	20,833	19,124	18,317
Fixed income	21,808	20,393	19,726	19,065	18,364
Alternatives	6,787	6,426	6,399	6,332	6,331
Total Fidante Partners	50,960	48,395	46,958	44,521	43,012
Challenger Investment Partners					
Fixed income	11,051	11,068	10,357	9,703	9,059
Property	4,895	4,808	4,798	4,669	4,591
Total Challenger Investment Partners	15,946	15,876	15,155	14,372	13,650
Total funds under management	**66,906**	**64,271**	**62,113**	**58,893**	**56,662**
Average Fidante Partners	50,046	47,438	45,516	44,041	42,539
Average Challenger Investment Partners	15,998	15,490	14,632	14,000	13,506
Average total funds under management[1]	**66,044**	**62,928**	**60,148**	**58,041**	**56,045**
Analysis of flows					
Funds Management net flows					
Equities	809	(157)	936	(56)	(51)
Fixed Income	1,161	446	573	369	360
Alternatives	31	95	(50)	(31)	434
Total Fidante Partners	**2,001**	**384**	**1,459**	**282**	**743**
Challenger Investment Partners	(32)	650	835	641	338
Net flows	**1,969**	**1,034**	**2,294**	**923**	**1,081**

Reconciliation of Total Group Assets Under Management

$m	Q4 17	Q3 17	Q2 17	Q1 17	Q4 16
Funds Management (FUM)	66,906	64,271	62,113	58,893	56,662
Life investment assets	15,677	14,940	14,607	14,316	14,112
Adjustments to remove double counting of cross holdings	(12,595)	(12,640)	(12,015)	(11,215)	(10,723)
Total Assets Under Management	**69,988**	**66,571**	**64,705**	**61,994**	**60,051**

1 Average total funds under management calculated on a monthly basis.

Funds Management financial results

Challenger's Funds Management business is Australia's seventh largest investment manager and one of the fastest growing[1]. Over the past five years FUM has increased from $31bn to $67bn, and is growing significantly faster than the broader Australian funds management market.

The Funds Management business benefits from a clear business strategy focused on investor alignment.

Fidante Partners' multi-boutique platform comprises separately branded investment management businesses investing in equities, fixed income and alternatives. The model aligns the interests of investors, boutique investment managers and Fidante Partners.

In July 2015, as part of Fidante Partner's international distribution and product expansion strategy, the business was expanded into Europe.

Funds Management also includes Challenger Investment Partners (CIP), comprising fixed income and property investment teams investing on behalf of third party institutional clients including Challenger Life.

EBIT and ROE

Funds Management EBIT was $45m and increased by $8m (21%) on FY16. The increase in Funds Management EBIT, was due to a $6m (5%) increase in net income and a $1m reduction in expenses.

Funds Management net income increased as a result higher average FUM (up 12%), a rebound in Fidante Europe income (up $8m), partially offset by lower performance fees (down $5m). Excluding the impact of lower Fidante Partners performance fees, EBIT would have increased by 40%.

FY17 Funds Management ROE was 24.8%, and increased by 130 bps from 23.5% in FY16. FY17 ROE benefitted from an increase in EBIT.

Total net fee income

FY17 net income was $134m and increased by $6m (5%) on FY16. Fee income benefited from higher average FUM, which increased by 12%, and an improvement in Fidante Partners Europe profitability (refer to page 48 for more detail), partially offset by lower performance fees (down $5m). Excluding the impact of lower performance fees, net fee income increased by 9%.

Expenses

FY17 Funds Management expenses were $89m, and decreased by $1m (down 2%) on FY16. Expenses reduced as a result of lower Fidante Partners Europe operating expenses.

Funds Management FY17 cost to income ratio was 66.4%, down 430 bps from 70.7% in FY16.

Fidante Partners net income

Fidante Partners' net fee income includes distribution fees, administration fees, transaction fees from Fidante Partners Europe, performance fees and a share in the equity accounted profits of boutique investment managers.

Fidante Partners' net income was $80m in FY17, up $2m (2%) from FY16. Fidante Partners' net income increased as a result of higher average FUM (up 12%), partially offset by lower performance fees.

Fidante Partners' FY17 income margin (net income to average FUM) was 17 bps, down 2 bps from FY16. The decrease in net income margin was due to:

- lower performance fees (-1 bps); and
- lower contribution from Australian boutiques due to a change in FUM mix (-2 bps), partially offset by an increased contribution from Fidante Partners Europe (+1 bps).

Fidante Partners FUM and net flows

Fidante Partners' FUM at 30 June 2017 (FY17) was $51.0bn, and increased by $7.9bn (18%) in FY17. The increase in Fidante Partners FUM for the year was due to:

- $4.1bn of net flows; and
- $3.8bn of positive market movements net of distributions.

Approximately 44% of Fidante Partners' FY17 FUM is invested in equities, 43% in fixed income and 13% in alternatives (e.g. infrastructure) products.

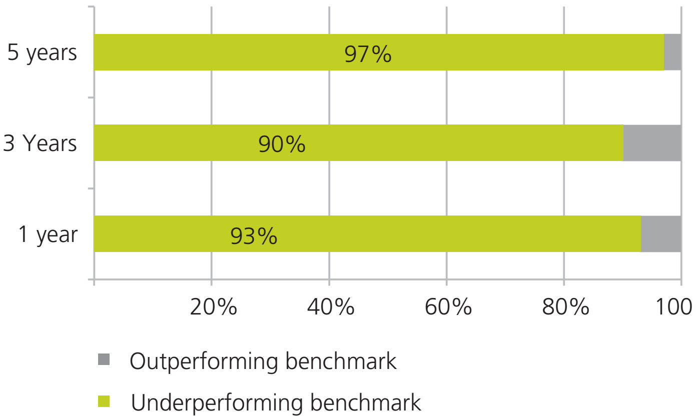
FY17 net flows of $4.1bn include $1.5bn of equity product inflows; $2.5bn of fixed income product inflows, and $0.1bn of alternative product inflows.

Fidante Partners net flows for the fourth quarter of FY17 were very strong, with $2.0bn on net flows achieved, predominately across equity and fixed income boutiques. As a result of the strong net flows in the fourth quarter, Fidante Partners closing FY17 FUM is 9% higher than the FY17 average, providing FY18 earnings momentum.

1. Consolidated FUM for Australian fund managers – Rainmaker Roundup March 2017.
2. Australian fixed income investment managers – Rainmaker Roundup March 2017.
3. Rainmaker Roundup March 2017

Fidante Partners investment performance

Fidante Partners investment performance represents the percentage of FUM meeting or exceeding performance benchmarks. Total investment performance is weighted by boutique FUM.



Fidante Partners investment performance has remained strong. Over a one year period, 93% of FUM has exceeded benchmark and over five years, 97% has exceeded benchmark.

Fidante Partners Europe

In July 2015 Fidante Partners acquired 100% of Dexion Capital Holdings Limited (rebranded to Fidante Partners Europe), a European alternative investments group comprising economic interests in three specialist fund managers, as well as a capital raising business serving the needs of listed, closed-end alternative investment companies. The acquisition provided Fidante Partners with established distribution to UK and European alternative asset focused investors.

Due to market uncertainty in the UK in the lead up to the Brexit vote (June 2016), UK transaction activity stalled, affecting the raising of capital for closed-end listed alternative investment managers. As a result, Funds Management's FY16 EBIT included a ~$10m loss in relation to Fidante Partners Europe.

Following the Brexit vote, transaction activity in the United Kingdom has recovered, and as a result, Fidante Partners Europe profitability has recovered, contributing $3m to Funds Management's FY17 EBIT.

Challenger Investment Partners net income

Challenger Investment Partners' net income was $54m in FY17, up $4m (9%) on FY16. Challenger Investment Partners' net income benefitted from higher average FUM, which increased by 13%, partially offset by a lower net income margin.

Challenger Investment Partners' FY17 income margin (net income to average FUM) was 36 bps, down 1 bps from FY16. The decrease in net income margin was due to a change in FUM mix. Fixed income accounted for 69% of Challenger Investment Partners average FUM in FY17, up from 66% in FY16.

Challenger Investment Partners' (CIP) FUM and net flows

Challenger Investment Partners' FUM at 30 June 2017 was $15.9bn, and increased by $2.3bn (17%) in FY17.

The increase in Challenger Investment Partners' FUM for the year was due to:

- $1.8bn of Life net flows; and
- $0.3bn of third party client net flows; and
- $0.2bn of positive market movements.

Approximately 69% of Challenger Investment Partners' FY17 FUM is invested in fixed income and approximately 31% is invested in property.

Third party clients account for 24% of Challenger Investment Partners' FY17 closing FUM, down from 26% in FY16.

Corporate financial results

$m	FY17	FY16	FY15	2H17	1H17	2H16	1H16	2H15	1H15
Other income	**0.8**	**1.0**	**1.3**	**0.4**	**0.4**	**0.4**	**0.6**	**0.6**	**0.7**
Personnel expenses	(38.5)	(37.1)	(36.8)	(20.7)	(17.8)	(19.1)	(18.0)	(18.5)	(18.3)
Other expenses	(11.9)	(13.0)	(10.1)	(6.1)	(5.8)	(6.6)	(6.4)	(5.5)	(4.6)
Total expenses (excluding LTI)	**(50.4)**	**(50.1)**	**(46.9)**	**(26.8)**	**(23.6)**	**(25.7)**	**(24.4)**	**(24.0)**	**(22.9)**
Long-term incentives (LTI)	(16.4)	(16.6)	(16.8)	(8.3)	(8.1)	(8.6)	(8.0)	(8.8)	(8.0)
Total expenses	**(66.8)**	**(66.7)**	**(63.7)**	**(35.1)**	**(31.7)**	**(34.3)**	**(32.4)**	**(32.8)**	**(30.9)**
Normalised EBIT	**(66.0)**	**(65.7)**	**(62.4)**	**(34.7)**	**(31.3)**	**(33.9)**	**(31.8)**	**(32.2)**	**(30.2)**
Interest and borrowing costs	(5.3)	(4.1)	(3.8)	(3.0)	(2.3)	(1.8)	(2.3)	(2.1)	(1.7)
Normalised loss before tax	**(71.3)**	**(69.8)**	**(66.2)**	**(37.7)**	**(33.6)**	**(35.7)**	**(34.1)**	**(34.3)**	**(31.9)**

The Corporate division comprises central functions such as group executives, finance, treasury, legal, human resources, risk management and strategy.

Corporate also includes interest received on Group cash balances and any interest and borrowing costs associated with Group debt facilities.

Normalised EBIT

FY17 Corporate normalised EBIT was a $66m loss, unchanged from FY16.

Other income

FY17 other income was $1m and is unchanged from FY16. Other income includes interest received on Group cash balances. Group cash at 30 June 2017 was $84m and is unchanged from 30 June 2016.

Total expenses

FY17 total expenses were $67m, and was unchanged from FY16.

FY17 total expenses include personnel costs of $39m, other expenses of $12m and long-term incentive costs of $16m. Long term incentive costs relate to the non-cash amortisation of equity grants and were unchanged from FY16.

Interest and borrowing costs

FY17 interest and borrowing costs were $5m and increased by $1m from FY16. The increase in interest costs relates to Group banking facility costs.

The Group maintains a $400m banking facility in order to provide additional financial flexibility. The Group banking facility was undrawn as at 30 June 2017, with interest and borrowing costs reflecting debt facility fees.

Normalised cash operating earnings framework

Life normalised cash operating earnings is Challenger's preferred profitability measure for the Life business, as it aims to reflect the underlying performance trends of the Life business.

The Life normalised cash operating earnings framework was introduced in June 2008 and has been applied consistently since.

The framework removes the impact of market and economic variables, which are generally non-cash and a result of external market factors. The normalised profit framework is subject to a review performed by Ernst & Young each half year.

Life normalised cash operating earnings includes cash earnings plus normalised capital growth, but excludes investment experience (refer below).

Cash earnings

Cash earnings represents investment yield, less interest expenses and distribution expenses.

Investment yield

Represents the investment return on assets held to match annuities and the return on shareholder investment assets.

Investment yield includes net rental income, dividends received, infrastructure distributions, accrued interest on fixed income and cash, and discounts/premiums on fixed income assets amortised on a straight line basis.

Interest expense

Represents interest accrued at contracted rates to annuitants and Life subordinated debt holders and other debt holders.

Distribution expenses

Represents payments made for the acquisition and management of Life products, including annuities and commissions to third party mortgage brokers on term funded residential mortgage assets (NIM).

Other income

Other income includes revenue from Accurium and profits on Life Risk wholesale longevity and mortality transactions (refer to page 24).

Normalised capital growth

Normalised capital growth represents the expected capital growth for each asset class through the investment cycle and is based on Challenger's long-term expected investment returns for each asset class.

Normalised capital growth can be determined by multiplying the normalised capital growth assumption (see below) by each asset class average balance for the period (net of debt).

Normalised capital growth assumptions for FY17 are as follows:

- Fixed income and cash – negative 0.35% representing an allowance for credit defaults;
- Property – 2.00%;
- Infrastructure – 4.00%; and
- Equity and alternative asset classes – 4.50%.

Normalised capital growth assumptions have been set with reference to long-term market growth rates and are reviewed regularly to ensure consistency with prevailing medium to long term market returns.

Investment experience

Challenger Life is required by accounting standards and prudential standards to value all assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on assets and liabilities being recognised in the profit and loss, particularly during periods of market volatility. As Challenger is generally a long-term holder of assets, due to them being held to match the term of life liabilities, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements.

Investment experience is a mechanism employed to remove the volatility arising from asset and liability valuation movements from Life business earnings so as to more accurately reflect the underlying performance of the Life business.

The asset and liability valuation movements are reported as investment experience. These movements are generally non-cash, and by separating them from the Life business result, Life's reported earnings more closely represent the cash earnings of the business.

Impact from economic variables

Investment experience also includes the impact of changes in macroeconomic variables on the valuation of Life's assets and liabilities. Economic and actuarial assumption changes include changes to bond yields and inflation factors, expense assumptions, losses on new business and other factors applied in the valuation of life contract liabilities.

Investment experience is calculated as the difference between actual investment gains/losses (both realised and unrealised) and the normalised capital growth plus any economic and actuarial assumption changes for the period.

Glossary of terms

Terms	Definitions
Additional Tier 1 regulatory capital	High quality capital that provides a permanent and unrestricted commitment and is freely available to absorb losses but does not satisfy all the criteria to be included in Common Equity Tier 1 regulatory capital.
Cash earnings (Life)	Investment yield and other income less interest and distribution expenses.
CET1 ratio	Common Equity Tier 1 regulatory capital divided by prescribed capital amount.
CIP income	CIP income includes asset based management fees, and other income such as leasing fees, acquisition and disposal fees, development and placement fees.
Common Equity Tier 1 regulatory capital	The highest quality capital comprising items such as paid-up ordinary shares and retained earnings. Common equity tier 1 capital is subject to certain regulatory adjustments in respect of intangibles and adjusting policy liabilities.
Earnings per share	Net profit after tax divided by weighted average number of shares in the period.
Distribution expenses (Life)	Payments made for the acquisition and management of annuities and other Life products.
Fidante Partners' income (FM)	Distribution and administration fees; Fidante Partners share of boutique manager profits; and other income from boutique investment managers.
Funds under management (FUM)	Total value of listed and unlisted funds/mandates managed by the Funds Management business.
Group assets under management	Total value of Life's investment assets and Funds Management FUM.
Group cash	Cash available to Group excluding cash held by Challenger Life Company Limited.
Interest and borrowing costs (Corporate)	Interest and borrowing costs associated with group debt and group debt facilities.
Interest expenses (Life)	Interest accrued and paid to annuitants, subordinated debt note holders and other debt providers (inducing Challenger Capital Notes).
Investment experience (Life)	The difference between actual investment gains/losses (both unrealised and realised) and the normalised capital growth assumption plus any economic and actuarial assumption changes for the period.
Investment yield (Life)	Net rental income, dividends received and accrued interest and discounts/premiums on fixed income securities amortised on a straight line basis.
Investment yield – shareholder funds (Life)	Represents the return on shareholder capital held by the Life business.
Life investment assets	Total value of investment assets that are managed by the Life business.
Life annuity book growth	Net annuity policy capital receipts over the period divided by the opening policy liabilities (Life annuity book).
Life book growth	Net annuity and other policy capital receipts over the period divided by the opening policy liabilities (Life annuity book, Guaranteed Index Return liabilities and Challenger Index Plus Fund liabilities).
Net annuity policy receipts	Life retail annuity sales less annuity capital payments.
Net assets – average (Group)	Average net assets over the period (excluding non-controlling interests) calculated on a monthly basis.
Net fee income (FM)	Fidante Partners' income, performance fees (FM), Challenger Investment Partners' income and performance fees.
Net management fees (FM)	Management fees for managing investments.
Net tangible assets	Consolidated net assets less goodwill and intangibles.
Net Interest Margin (NIM)	Net interest margin on term funded prime mortgages and included as part of Life's investment assets.

Glossary of terms

Terms	Definitions
New business tenor	Represents the maximum product maturity of new business sales. These products may amortise over this period.
Normalised capital growth	Long-term expected capital growth based on long-term return assumptions calculated as long-term capital growth assumption multiplied by average investment assets.
Normalised Cash Operating Earnings (NCOE) (Life)	Cash earnings plus normalised capital growth.
Normalised cost to income ratio	Total expenses divided by total net income.
Normalised dividend payout ratio	Dividend per share divided by normalised earnings per share (basic).
Normalised EBIT (Life)	Normalised cash operating earnings less total Life expenses.
Normalised EBIT (FM)	Net income less total expenses.
Normalised effective tax rate	Normalised tax divided by normalised profit before tax.
Normalised Return on Equity (ROE) – pre-tax	Normalised Life EBIT and FM EBIT or Normalised NPBT (Group) divided by average net assets.
Normalised Return on Equity (ROE) – post-tax	Group's normalised NPAT divided by average net assets.
Other expenses	Non-employee expenses, including external professional services, occupancy costs, marketing and advertising, travel, technology and communications costs.
Other income (Corporate)	Includes interest received on Group cash balances.
Other income (Life)	Relates to Accurium revenue and Life Risk. Refer to page 24 for more detail.
Performance fees (FM)	Fees earned for outperforming benchmarks.
Personnel expenses	Includes fixed and short-term variable incentive components of remuneration structures. The amortisation of long-term incentive plans is reported separately within the Corporate results.
PCA ratio	The ratio of the total CLC Tier 1 and Tier 2 regulatory capital base divided by the prescribed capital amount.
Prescribed capital amount (PCA)	Amount of capital that a life company must hold which is intended to be sufficient to withstand a 1 in 200 year shock and still meet adjusted policy liabilities and other liabilities. For further details refer to APRA's LPS110 Capital Adequacy.
Product cash margin (Life)	Represents the return on assets backing annuities and other income, less interest and distribution expenses.
Significant items	Non-recurring or abnormal income or expense items.
Statutory Return on Equity (ROE) – post-tax	Statutory NPAT divided by average net assets.
Tier 1 regulatory capital	Tier 1 regulatory capital comprises Common Equity Tier 1 regulatory capital and Additional Tier 1 regulatory capital.
Tier 2 regulatory capital	Tier 2 capital contributes to the overall strength of a Life company and its capacity to absorb losses but does not satisfy all the criteria to be included as Tier 1 regulatory capital.
Total expenses	Personnel expenses plus other expenses.
Total net income	Normalised Cash Operating Earnings (Life) plus net fee income (FM) plus other income (Corporate).

Key dates

Challenger Limited (CGF)

Q118 Sales and AUM	17 October 2017
2017 Annual General Meeting	26 October 2017
2018 Half year results and interim dividend	13 February 2018
Q318 Sales and AUM	19 April 2018
2018 Full year results and final dividend	14 August 2018

Challenger (CGF) Final dividend 2017

Ex-dividend date	1 September 2017
Record date	4 September 2017
DRP election date	5 September 2017
Payment date	27 September 2017

Challenger (CGF) Interim dividend 2018

Ex-dividend date	27 February 2018
Record date	28 February 2018
DRP election date	1 March 2018
Payment date	27 March 2018

Challenger Capital Notes (CGFPA) Distributions

Ex-date quarterly distribution	16 August 2017
Record date quarterly distribution	17 August 2017
Payment date quarterly distribution	25 August 2017
Ex-date quarterly distribution	16 November 2017
Record date quarterly distribution	17 November 2017
Payment date quarterly distribution	27 November 2017
Ex-date quarterly distribution	15 February 2018
Record date quarterly distribution	16 February 2018
Payment date quarterly distribution	26 February 2018
Ex-date quarterly distribution	16 May 2018
Record date quarterly distribution	17 May 2018
Payment date quarterly distribution	25 May 2018

Challenger Capital Notes 2 (CGFPB) Distributions

Ex-date quarterly distribution	11 August 2017
Record date quarterly distribution	14 August 2017
Payment date quarterly distribution	22 August 2017
Ex-date quarterly distribution	13 November 2017
Record date quarterly distribution	14 November 2017
Payment date quarterly distribution	22 November 2017
Ex-date quarterly distribution	13 February 2018
Record date quarterly distribution	14 February 2018
Payment date quarterly distribution	22 February 2018
Ex-date quarterly distribution	11 May 2018
Record date quarterly distribution	14 May 2018
Payment date quarterly distribution	22 May 2018

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