challenger

2022 Interim Financial Report

Providing our customers with financial security for a better retirement

challenger.com.au

Challenger Limited ACN 106 842 371

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Interim dividend payment date

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27 October 2022
2022 Annual General Meeting

Full listing of key dates available at:

> **challenger.com.au/shareholder/shareholder-information/key-dates**

Dates may be subject to change. Any change in dates will be advised to the Australian Securities Exchange.

About this Interim Financial Report

The 2022 Interim Financial Report can be downloaded from Challenger's online Shareholder Centre at:

> **challenger.com.au/shareholder**

Operating and financial review

1 About Challenger

Challenger Limited (Challenger, CGF, the Group or the Company) was founded in 1985 and is Australia's largest annuity provider[1] as well as one of its largest[2] active fund managers.

Challenger is listed on the Australian Securities Exchange (ASX) and has offices in Australia, London, Singapore and Tokyo. At 31 December 2021, Challenger employed 735 people on a full-time equivalent (FTE) basis.

Challenger is regulated by the Australian Prudential Regulation Authority (APRA), the Australian banking, superannuation and insurance regulator. Challenger's activities are also subject to supervision by other regulatory agencies both in Australia and the other offshore markets in which it operates.

Challenger's assets under management (AUM) were $114.9 billion, increasing by 19.6% for the period ended 31 December 2021 (31 December 2020: $96.1 billion).

Normalised net profit before tax (NPBT) for the period was $237.5 million, increasing by $41.3 million or 21.0% (31 December 2020: $196.2 million). This increase was driven by the 19.6% increase in Group AUM.

Normalised net profit after tax (NPAT) was $165.6 million, increasing by $28.8 million or 21.1% for the period (31 December 2020: $136.8 million).

Statutory net profit after tax was $282.0 million, which includes investment experience, being the valuation movements on assets and liabilities supporting the Life business, and increased by $59.2 million for the period (31 December 2020: $222.8 million).

Challenger's total equity as at 31 December 2021 was $4.1 billion (31 December 2020: $3.5 billion).

2 Operating segments and principal activities

Challenger's purpose is to provide customers with financial security for a better retirement. To fulfil this purpose, Challenger leverages capabilities across its three operating segments, Life, Funds Management and the recently acquired Bank. These core operating segments are supported by Group functions which are responsible for providing centralised regulatory, compliance, financial reporting, legal, tax, risk management and human resource services.

Life — The Life operating segment focuses on the retirement spending phase of superannuation, providing products that help customers convert retirement savings into safe and secure income in retirement. The Life segment includes Challenger Life Company Limited (CLC), an APRA-regulated life insurance company which is Australia's leading provider of annuities and guaranteed retirement income products.

As Australia's leading provider of annuities[1], Challenger Life is expected to benefit from the long-term growth in Australia's superannuation system and regulatory reforms designed to enhance the retirement phase.

The purpose of the superannuation system is to provide income in retirement to substitute or supplement the Government-funded age pension. With the transition from Government-funded age pensions to private pensions, retirees are seeking retirement income products that convert savings into regular and secure income, helping to provide financial security in retirement.

Challenger has been recognised as a retirement income product innovator and has won the Association of Financial Advisers 'Annuity Provider of the Year' for the last 13 years, and remains the dominant retirement income brand in Australia.

Challenger is also focused on building institutional partnerships with large superannuation funds. As their members transition to retirement, major superannuation funds are increasing their focus on providing more comprehensive retirement solutions to their members. As the retirement system develops, the profit-for-member sector provides a significant growth opportunity for Challenger.

Life has an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary), a leading provider of Australian dollar and US dollar annuities in Japan. MS Primary is part of MS&AD Insurance Group Holdings Inc. (the MS&AD Group).

The retirement incomes which Life pays are backed by a high-quality investment portfolio, predominantly invested in fixed income and commercial property investments. These long-term investments generate regular and predictable investment income which is used to fund retirement income paid to Life's customers.

Funds Management — The Funds Management operating segment focuses on building savings for retirement. As people work and save for retirement, the business supports them to build their wealth and savings by providing investment strategies that seek to deliver superior investment returns.

Funds Management is Australia's fastest growing[3] and third largest active fund manager[2] and is diversified globally with operations in the United Kingdom, Europe, Japan and more recently Singapore.The Funds Management operating segment comprises two business divisions: Fidante Partners and CIP Asset Management (CIPAM).

Fidante Partners generally holds minority equity interests in individually branded boutique investment management firms. Fidante Partners provides distribution, administration and business support services to the boutique investment managers and shares in the profits of these businesses through equity ownership.

Fidante Partners' business model has allowed it to attract and build successful active equity, active fixed income and alternative investment managers, which deliver strong investment performance.

CIPAM principally originates and manages fixed income and commercial real estate, along with providing investment solutions for leading global and Australian institutions, including CLC.

[1] Plan for Life – September 2021 – based on annuities under administration.
[2] Calculated from Rainmaker Roundup, September 2021 data.
[3] Based on Rainmaker Roundup, September 2021 and September 2016 - 5-year CAGR for active managers.

2 Operating segments and principal activities (continued)

Bank — The Bank operating segment provides the Group a highly strategic opportunity to significantly expand its secure retirement income offering, and access to Australia's term deposit market.

The Bank provides retail financial services and banking products to consumers in Australia, in the form of deposit and loan products. The Bank provides Challenger with access to a wide range of customers through multiple distribution channels, including direct and intermediated channels.

Principal activities — During the period Challenger acquired an Australian-based customer digital bank MyLifeMyFinance Limited (MLMF) and created a new business segment - Bank. There have been no other significant changes in the nature of the principal activities of the Group during the period.

3 Challenger's purpose and strategic priorities

Challenger's purpose is to provide customers with financial security for a better retirement.

Challenger also introduced explicit vision statements for each key stakeholder group: customers; shareholders; employees; and the community, to help clarify Challenger's objectives and long-term ambitions.

These vision statements will be achieved through the execution of four core strategic priorities.

- Broaden the ways customers can access products across multiple channels;
- Expand the range of products and services offered to support a better retirement;
- Leverage the combined capabilities of the Group; and
- Continue to strengthen the resilience and sustainability of Challenger.

4 Risk management

The management of risk is fundamental to Challenger's business and to building long-term shareholder value. The Board's Risk Appetite Statement outlines the level of risk that is acceptable and is combined with an effective risk management framework which monitors, mitigates and manages the risks to which Challenger is exposed.

The Board recognises the broad range of risks that Challenger faces as a participant in the financial services industry. These include:

- funding and liquidity risk;
- investment and pricing risk;
- counterparty risk;
- strategic, business and reputation risk;
- operational risk;
- climate change risk;
- conduct risk; and
- licence and regulatory risk.

An integral part of risk management for Challenger is the maintenance of a strong risk culture amongst its employees. Challenger's expectations of its employees are encapsulated in the 'Challenger I ACT' values of:

- Act with integrity;
- Aim high;
- Collaborate; and
- Think customer.

All employees are assessed against the Challenger I ACT values as part of the annual performance review process, and this outcome contributes to their overall performance rating and individual remuneration outcomes.

5 Challenger's 1H22 strategic progress

Progress over 1H22 has been measured against the execution of Challenger's four core strategic priorities.

1. Broaden customer access across multiple channels

Challenger is focused on broadening the ways customers can access products and solutions across multiple channels to help provide them with financial security for a better retirement.

1H22 progress:

Diversification strategy delivering record Life sales – up 44% to $4.9 billion

Challenger is building more resilient sales by diversifying across a range of retail and institutional products and clients.

In 1H22, Life achieved both record sales and record annuity sales, despite the disruption from the COVID-19 pandemic, which particularly impacted retail sales.

Record sales were primarily driven by strong growth in institutional sales, representing institutional term annuities and the Challenger Index Plus product.

Total institutional sales were $3.4 billion in 1H22 (up 91%) and represented 69% of total Life sales. Sales are benefiting from an expansion in the institutional product offering, including the introduction of institutional term annuities, and a growing institutional client base. With the low interest rate environment, Challenger's institutional clients are focused on diversifying their investments and maximising returns. Institutional term annuity sales were $1.0 billion in 1H22 and increased by 146% on 1H21.

Building institutional partnerships

Challenger is focused on providing institutional investors with targeted solutions that help address their strategic and fiduciary objectives. Challenger does this by offering innovative strategies catering to the needs of superannuation funds, insurance companies and multi-managers.

Challenger's offering provides institutional clients with access to Challenger Life's capabilities, including:

- investment and structuring skills;
- asset and liability management; and
- intellectual property and thought leadership, especially around retirement income.

Challenger Life's institutional business continues to grow strongly, with the number of clients increasing fourfold over the past five years.

The focus on more comprehensive solutions, including using guaranteed income products, by retail and profit-for-member superannuation funds represents a significant growth opportunity for Challenger.

Superannuation fund clients are increasing their focus on providing retirement income solutions for their members and are engaging with Challenger as they build more comprehensive retirement solutions for their members. The Retirement Income Covenant is also increasing superannuation funds' focus on providing their members with products that provide longevity risk protection.

Stable retail sales throughout COVID-19 pandemic

Since March 2020, the COVID-19 pandemic has impacted the ability of financial advisers to meet new clients, and their focus has been on servicing their existing client base, rather than on-boarding new clients. New clients on-boarded at the point of retirement represent an opportunity to recommend annuities, particularly lifetime and aged care focused annuities.

Retail annuity sales remained stable in 1H22 throughout the COVID-19 pandemic lockdowns.

Extending customer reach and entering Australia's term deposit market

The acquisition of MLMF in July 2021 is highly strategic and provides Challenger the opportunity to expand its secure retirement income offering, including entering Australia's term deposit market.

Adding an Authorised Deposit-Taking Institution (ADI) capability to sit alongside the Life and Funds Management businesses will broaden both Challenger's product and distribution reach and help fulfil Challenger's purpose to provide customers with financial security for a better retirement. Term deposits are Government guaranteed[1]. They are a familiar product among both retirees and those approaching retirement and form a significant portion of their wealth.

The acquisition also provides Challenger the opportunity to attract and engage with customers at an earlier age as they approach and enter the retirement phase, increasing Challenger's brand recognition in early age demographics. Initial sales of MLMF branded term deposits were $73 million, with 75% of term deposit sales to customers above 50 years of age.

International Funds Management expansion

Funds Management continues to see significant growth opportunities in Australia and recognises the significant opportunity to diversify globally. In recent years, Funds Management has expanded into Europe through its UK office and established a presence in Japan. More recently, Fidante Partners opened a Singapore office, which will provide a distribution hub and access to Asian investors.

Fidante Partners has also established Undertakings for Collective Investment in Transferable Securities (UCITS) funds to support its clients and provide access to its investment products. This includes an Ardea specific UCITS fund.

Fidante Partners offshore distribution efforts are succeeding, including winning a €1 billion (~A$1.5 billion) UK fixed income mandate, which was received in early January 2022.

In addition, the team won a significant mandate from a US-based investor, with Fidante Partners' product included in the clients multi-manager fund.

In Europe, the business also secured a new German client and commitments from a new Italian client to invest into Whitehelm Capital's Low Carbon Core Infrastructure Fund. This follows both wins in the Nordics and the strategic sale of Whitehelm Capital to PATRIZIA AG.

[1] Bank term deposits are guaranteed under the Financial Claims Scheme up to $250,000 per account-holder per authorised deposit-taking institution (ADI).

5 Challenger's 1H22 strategic progress (continued)

1. Broaden customer access across multiple channels (continued)

Resonance Asset Management, a UK-based boutique manager specialising in environmental assets including wind, water and waste treatment, closed further commitments into its second Wind Fund, taking total commitments to £150 million, and is close to fully deployed as at January 2022.

In 1H22, Ardea Investment Management (Ardea), a Fidante Partners fixed income manager with over $25 billion of funds under management, established a UK office. This represents the first Australian-based boutique to establish a business presence offshore. Ardea has now received Financial Conduct Authority authorisation and will commence managing money in 2H22.

2. Expand the range of financial products and services for a better retirement

Challenger is focused on expanding the range of products and services it provides customers to support a better retirement.

1H22 progress:

Innovative new retirement income solutions

In October 2021, Challenger introduced innovative market-linked payment options to its award-winning Liquid Lifetime annuity.

The market-linked lifetime annuity complements Challenger's existing lifetime annuity, providing customers with the ability to link future payments to changes in investment markets.

Customers can gain exposure to investment markets by choosing from five different indexation options: cash, conservative, conservative balanced, balanced, or growth. The indexation options are constructed from different combinations of investment market indices, including the AusBond Bank Bill; AusBond Government; MSCI World and S&P/ASX200 index returns.

Combining the benefit of a monthly income with exposure to investment markets, with the flexibility to review this annually, is a compelling option for clients and their advisers.

The market-linked lifetime annuity was introduced via a soft launch in October 2021. Initial focus has been on research agencies and seeking approval for the product to be included on Approved Product Lists to enable advisers to recommend the product to their clients. While some initial sales were made in 1H22, sales volumes are not expected until the product is on Approved Product Lists and supported by marketing activity, which will be undertaken during 2H22.

This product innovation is part of a broader strategy by Challenger to lead industry innovation, expand its range of innovative retirement income solutions, increase customer reach and provide retirees with better financial outcomes.

Ox Capital launched by Fidante Partners

In July 2021, Fidante Partners launched a new emerging market boutique, Ox Capital Asset Management (Ox Capital), under the leadership of Dr Joseph Lai, a renowned emerging markets investor.

Ox Capital will leverage the expertise of a five-strong team with a long and successful track record of investing across Asia and other emerging markets.

In September 2021, Ox Capital announced the launch of its flagship emerging market equity fund, the Ox Capital Dynamic Emerging Markets Fund. The fund will be a concentrated portfolio of companies in Asia ex-Japan and other emerging markets, diversified across countries, sectors and thematic exposures.

Alphinity launched Global Sustainable Equity Fund

In July 2021, Australian and global equities boutique fund manager, Alphinity Investment Management, launched a new Alphinity Global Sustainable Equity Fund which aims to invest in quality global companies that are supporting the transition to a more sustainable future and are also identified as undervalued and within an earnings upgrade cycle.

The new fund seeks to invest in a diversified portfolio of leading companies that offer attractive financial returns, have strong environmental, social and governance (ESG) practices, and are aligned with one or more of the 17 UN Sustainable Development Goals (SDGs). These SDGs cover key themes like equality, promoting healthier lives and wellbeing, building resilient infrastructure and combating climate change.

Whitehelm Capital sold to PATRIZIA

Whitehelm Capital (Whitehelm) was established in 2014 and is a global infrastructure boutique manager and investment adviser.

During 1H22, Challenger entered into an agreement to sell Fidante Partners' 30% equity interest in Whitehelm to a German-based global listed real estate manager, PATRIZIA, for €32 million (~A$50 million). The sale was completed on 1 February 2022.

Fidante Partners seeks to build longstanding relationships with boutique partners and benefit from their long-term growth. While not its strategy to sell interests in its boutique partners, the offer provided a unique and compelling opportunity for Challenger to deliver value for shareholders while ensuring clients benefit from a much broader and more diversified infrastructure investment offering.

CIPAM launched wholesale share class of Multi-Sector Private Lending Fund

Challenger is Australia's largest fixed income manager, with Fidante Partners managing $39 billion and CIP Asset Management (CIPAM) fixed income franchise managing over $16 billion across multiple strategies, comprising both public and private credit investments.

5 Challenger's 1H22 strategic progress (continued)

2. Expand the range of financial products and services for a better retirement (continued)

CIPAM launched a new share class of its successful CIPAM Multi-Sector Private Lending Fund, providing the opportunity for wholesale/sophisticated individual investors to access this unique offering. The fund is a multi-sector credit strategy investing in Australian and New Zealand private securitised, corporate and real estate lending.

The Fund aims to generate a consistent, high level of income by harvesting the illiquidity premium that exists in private lending markets. After first launching the fund in 2020, the wholesale share class was launched in June 2021. The fund is now over $350 million in size and has an impressive track record with a 1-year return of 6.75%.

3. Leverage the combined capabilities of the Group

Challenger is focused on leveraging the combined capabilities of the Group to help provide its customers with financial security for a better retirement.

1H22 progress:

Leverage Challenger Group to integrate MyLife MyFinance Bank

Following the acquisition of MyLifeMyFinance Limited (MLMF or the Bank) in late July 2021, integration of the Bank into Challenger is well underway and distribution partnerships are being formed to make Challenger's term deposits available via the retail broker channel.

To maximise the potential of the acquisition and streamline the integration process, Challenger has been leveraging capability right across the Group.

In 1H22, the Bank's employees relocated to Challenger's Melbourne office and its customer contact centre has been integrated into Challenger, with the Challenger customer service team now interacting directly with Bank customers. The Bank's general ledger has been migrated to Challenger's systems, enabling significant operational efficiencies for the broader finance function, and IT systems have also been migrated, including key websites and customer interfaces.

To support the Bank's ongoing growth, a treasury capability has been established, which leverages Challenger's established operations. Challenger is also investing in the Bank's lending activities, and expects to broaden its activities from residential lending to include SME and corporate lending. This will allow the Bank to access a wider range of assets, which will support its product offering.

Embed ESG across the business

The Challenger-wide ESG Steering Committee meets on a regular basis to support the business in managing sustainability risks and opportunities. Since inception, this committee has been integral in progressing important work, educating internal stakeholders and integrating ESG risks into Challenger's risk management framework.

In 1H22, to enhance governance across all sustainability issues and initiatives, the ESG Steering Committee started reporting to the Group Risk Committee quarterly, which also ensures appropriate oversight over key sustainability risks and opportunities. In addition, formalised reporting into the board for each Funds Management boutique partner was established. Challenger has enhanced ESG monitoring, which has been implemented across its investment teams and worked with Fidante Partners' first emerging markets boutique, Ox Capital, to develop an ESG integration process.

4. Strengthen resilience and sustainability of Challenger

Challenger is focused on strengthening the resilience and sustainability of Challenger to help provide its customers with financial security for a better retirement.

1H22 progress:

Market leading Life and Funds Management businesses and Bank capability

Challenger has three complementary businesses that help provide customers with financial security for a better retirement.

The Funds Management business helps customers build savings for retirement; the Bank helps customers save and transition to retirement; and the Life business helps customers convert their retirement savings to income in retirement.

Both the Life and Funds Management businesses hold market leading positions, with Life widely recognised as a market leader in Australian retirement incomes and the Funds Management business rated one of Australia's largest and fastest growing active fund managers[2]. The Bank will broaden Challenger's product and distribution reach by allowing it to offer term deposits to a wider cohort of customers as they approach and enter the retirement phase.

Challenger wins Longevity Cover Overall Excellence Award 2021

In November 2021, Challenger won the Plan For Life Overall Longevity Cover Excellence Award for 2021. The award recognises Australian Life companies and fund managers who design products to assist retirees in meeting the challenges of longevity.

Challenger also won the Client & Adviser Technical Support Award, for its in-depth, ongoing support for advisers, evidenced by the frequency of questions fielded from advisers, well attended adviser webinars, and highly informative and technical information material.

Fidante Partners wins Distributor of the Year and ranked number one for retail flows

Fidante Partners' distribution capability continues to be externally recognised and, for the second consecutive year, won Zenith Investment Partners (Zenith) Distributor of the Year.

Zenith recognises the quality of Fidante Partners' boutique managers and their ratings across the product suite, strong FUM flows, and the quality of its adviser support.

[2] Rainmarker Roundup, September 2021.

5 Challenger's 1H22 strategic progress (continued)

4. Strengthen resilience and sustainability of Challenger (continued)

Fidante Partners also ranked as the top Australian active manager for retail net flows in the last 12 months to September 2021, with the highest net flows among 114 active managers[3]. Fidante Partners ranked number one for domestic fixed income flows (out of 32 managers) and number one for equities (out of 64 active managers).

Challenger and Apollo explore expanded strategic relationship

Challenger and Apollo (NYSE:APO) have entered into a non-binding Memorandum of Understanding with the intention to establish a joint venture to build a leading non-bank lending business in Australia and New Zealand. Apollo and Athene acquired an 18% minority interest in Challenger over the course of 2021, and Challenger and Apollo have since been engaged in confidential discussions over a number of months to explore additional opportunities to work together.

The strategic dialogue is part of a broader focus on building upon and enhancing the parties' retirement services offering in Australia. The proposed initiative is strongly aligned to Challenger's strategy and focus on pursuing growth opportunities, as well as further diversifying its business and providing important origination capability to support the growth of both the Life and Bank businesses. For Apollo and Athene, leading global providers of both guaranteed and non-guaranteed yield solutions, the proposed initiative is designed to enhance their ability to offer retirement services in scale in the region.

Challenger's relationships in Australian lending markets and its operating platform, coupled with Apollo's extensive global credit investing capabilities and range of retirement services products, provides significant opportunities and potential value for both parties over the medium term.

Further detail will be provided in due course as negotiations progress.

Maintain market leading risk culture

Challenger has a strong risk culture, which was reflected in a risk culture score of 86% in the latest employee engagement score (conducted by Willis Towers Watson in April 2021). The score was four points above the Global High Performing Norm, and 10% higher than the Australian National Norm.

Challenger has continued to monitor its risk culture and undertakes a quarterly risk culture survey, with the latest survey completed in December 2021. Challenger also makes use of external reviews of Challenger's risk culture and monitors a range of metrics to determine how Challenger's risk culture compares to its target risk culture as articulated by the Board.

Overall, these results show a strong risk culture, a culture of discussing and addressing risk management issues, and clarity of what is expected of employees with respect to their risk objectives.

Second Modern Slavery statement

In December 2021, Challenger published its second modern slavery statement, which further strengthens the approach, and implemented actions to reduce the risk of modern slavery.

Supporting the community

Challenger has been recognised as one of the 30 best workplaces for giving back to the community in the country. The 2021 'Australia's Best workplaces to give back' recognised organisations empowering their employees to create social impact through donations, fundraising and volunteering.

In 2021, Challenger launched the Good2Give payroll giving platform, which now has approximately 10% of employees participating as at 31 December 2021, supporting over 60 charities.

In December 2021, Challenger also launched the Give a Jab for Christmas campaign, making a $5 donation (equivalent of two COVID-19 vaccines) for each vaccinated employee who took part in the initiative. These vaccines were donated to low income countries, reflecting Challenger's commitment to supporting those in need.

[3] Plan For Life Wholesale Trust Data, September 2021.

6 Market overview

Challenger's purpose is to provide customers with financial security for a better retirement. To fulfil this purpose, Challenger leverages capabilities across its Life, Funds Management and recently acquired Bank businesses.

Challenger's Life, Funds Management and Bank businesses are expected to benefit from the long-term growth in Australia's superannuation system and savings culture.

Australia's superannuation system commenced in 1992 and is the fifth largest pension system globally and one of the fastest growing, with assets increasing by 11% per annum over the past 20 years[1].

Critical features driving the growth of Australia's superannuation system include government-mandated and increasing contributions, tax incentives to encourage retirement savings and an efficient and competitive institutional model.

Australia's superannuation system is forecast to grow from over $3 trillion today[2] to almost $9 trillion[3] over the next 20 years.

Growth in the retirement phase of the system is supported by ageing demographics and the Government's focus on enhancing the retirement phase of superannuation.

Life

Life focuses on the retirement spending phase of superannuation, providing products that help customers convert retirement savings into safe and secure income in retirement.

As Australia's superannuation system grows, the retirement phase of superannuation is expected to increase significantly. The number of Australians over the age of 65, which is Life's target market, is expected to increase by 50% over the next 20 years[4]. Reflecting these demographic changes, and growth in the superannuation system, the annual transfer from the savings phase of superannuation to the retirement phase was estimated to be approximately $70 billion[5] in 2020.

The purpose of the superannuation system is to provide income in retirement to substitute or supplement the Government-funded age pension. With the transition from Government-funded age pensions to private pensions, retirees need retirement income products that convert savings into regular and secure income, helping to provide financial security in retirement.

The Australian Government is progressing a range of retirement income regulatory reforms designed to enhance the retirement phase and better align it with the overall objective of the superannuation system.

These reforms provide an opportunity to increase the proportion of savings invested in products that deliver stable, regular and reliable retirement income. Annuities currently represent only a small part of the retirement phase, with lifetime annuities representing less than 2% of the annual transfer to the retirement phase.

As Australia's leading provider of annuities[6], Challenger Life is expected to continue to benefit from the long-term growth in Australia's superannuation system and regulatory reforms designed to enhance the retirement phase.

Challenger has been recognised as a retirement income product innovator and has won the Association of Financial Advisers 'Annuity Provider of the Year' for the last 13 years and remains the dominant retirement income brand in Australia.

An important distribution channel for Life's products are third-party financial advisers. Life's products are included on all major advice hubs' Approved Product Lists (APLs) and are available on leading independent investment and administration platforms.

Challenger is also focused on building institutional partnerships with large superannuation funds. As their members transition to retirement, major superannuation funds are increasing their focus on providing more comprehensive retirement solutions to their members. As the retirement system develops, the profit-for-member sector provides a significant growth opportunity for Challenger.

In Japan, Life has an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary) to provide Australian dollar and US dollar annuities. MS Primary is a leading provider of annuity products in Japan and is part of MS&AD Insurance Group Holdings Inc. (MS&AD Group).

Under a reinsurance arrangement with MS Primary, which commenced in July 2019, MS Primary provides Challenger an annual amount of reinsurance, across both Australian and US dollar annuities, of at least ¥50 billion (equivalent to ~A$600 million[7]) per year[8]. This is subject to review in the event of a material adverse change for either MS Primary or Challenger Life.

At 30 June 2021, MS&AD held ~15% of Challenger Limited issued share capital and a representative from MS&AD and an Alternate Director have been appointed Non-Executive Directors of Challenger Limited.

The retirement incomes that Life pays are backed by a high-quality investment portfolio, predominantly invested in fixed income and commercial property investments. These long-term investments generate regular and predictable investment income which is used to fund retirement income paid to Life's customers.

[1] Willis Towers Watson Global Pension Study 2021.
[2] APRA), as at September 2021.
[3] Deloitte Dynamics of the Australian Superannuation System: The Next 20 Years to 2041.
[4] 2021 – 2041 comparison based on Australian Bureau of Statistics, Population Projections Series B, cat no. 3222.0.
[5] Based on Taxation Statistics 2018-19 from Australian Taxation Office.
[6] Plan for Life – September 2021 – based on annuities under administration.
[7] Based on the exchange rate as at 30 June 2021.
[8] Reinsurance across both Australian and US dollar annuities, of at least ¥50b per year for a minimum of five years, commencing 1 July 2019.

6 Market overview (continued)

Funds Management

Funds Management focuses on building savings for retirement. As people work and save for retirement, the business supports them to build their wealth and savings by providing investment strategies that seek to deliver superior investment returns.

Funds Management is one of Australia's fastest growing[9]and third largest active fund manager[10], and is diversifying globally with operations in the United Kingdom and Europe, Japan and more recently Singapore.

Growth in funds under management can be attributed to the strength of Challenger's retail and institutional distribution teams, a market-leading business model focused on alignment with clients and high-quality managers with strong long-term investment performance.

Funds Management is well positioned to benefit from ongoing growth in both Australia's superannuation system and global pension markets.

Funds Management comprises Fidante Partners and CIP Asset Management.

The Fidante Partners' business model involves taking minority equity interests in separately branded boutique funds management firms, with Challenger providing distribution, administration and business support, leaving investment managers to focus entirely on managing investment portfolios.

Fidante Partners' business model has allowed it to attract and build successful active equity, active fixed income and alternative investment managers, while maintaining strong investment performance. Over the last three years, long-term performance for Fidante Partners Australian boutiques remains strong with 97% of funds and mandates outperforming their respective benchmarks.

Fidante Partners is focused on broadening its product offering, which includes partnering with best-in-class managers, expanding the product offering of existing managers and accessing new distribution channels.

Funds Management has extensive client relationships, for example over 90% of Australia's top 50 superannuation funds are clients of Fidante Partners.

CIP Asset Management principally originates and manages fixed income and commercial real estate, along with providing investment solutions for leading global and Australian institutions, including Challenger Life. Challenger is committed to growing the business and building on CIP Asset Management's breadth of investment expertise.

Bank

Challenger is diversifying its product offering and extending its customer reach.

In December 2020, Challenger announced it had entered into an agreement to acquire MyLifeMyFinance Limited (MyLife MyFinance or the Bank), an Australian-based customer digital bank.

The acquisition received formal approval from the Treasurer of the Commonwealth of Australia, with the acquisition completing on 30 July 2021.

MyLife MyFinance is an Australian-based authorised deposit-taking institution (ADI) and digital bank, offering a range of simple savings and lending products. MyLife MyFinance has an ADI licence with an existing term deposit offering.

The Bank provides Challenger the opportunity to significantly expand its secure retirement income offering by entering Australia's term deposit market.

Adding an ADI capability to sit alongside the existing Life and Funds Management operations broadens Challenger's product and distribution reach and helps fulfil its purpose of providing customers with financial security for a better retirement.

The Bank provides Challenger the opportunity to attract and engage with customers at an earlier age, as they approach and enter the retirement phase, increasing Challenger's brand recognition in early age demographics.

Initially, Challenger will offer government guaranteed retail term deposits[11], which are familiar banking products and represent a significant portion of both retiree and pre-retiree wealth.

The Bank will provide Challenger with access to a wider range of customers through multiple distribution channels, including new intermediated channels, such as the broker term deposit market and retail aggregator websites, to help accelerate Challenger's direct to customer offering.

To ensure speed to market, term deposits have initially been marketed under the MyLife MyFinance brand, with the business to transition to the Challenger brand during 2H22.

[9] Based on Rainmaker Roundup, September 2021 and September 2016 - 5-year CAGR for active managers.
[10] Calculated from Rainmaker Roundup, September 2021 data.
[11] Bank term deposits are guaranteed under the Financial Claims Scheme up to $250,000 per account-holder per authorised deposit-taking institution (ADI).

6 Market overview (continued)

COVID-19 pandemic

The COVID-19 pandemic has presented significant challenges to global economies and investment markets.

Looking after the health of our people during this time has been a key business priority for Challenger, which transitioned almost all its employees to working from home arrangements from mid-March 2020 and again in July 2021.

Throughout 1H22, Challenger continued to support its employees with flexible work practices so they can continue to work from home or return back to the office for those employees that are double vaccinated. Challenger continues to fully comply with national and state public health orders.

Challenger has also been supporting its customers and business partners throughout the pandemic, including advisers, superannuation fund clients and commercial property tenants.

Investment market conditions have been significantly disrupted by the COVID-19 pandemic, initially resulting in a market sell-off and increased market volatility. Following the initial pandemic related market sell-off in March 2020, Life actively repositioned its investment portfolio to more defensive settings, which have been partially maintained.

Commencing in FY22, Challenger also extended its target capital ratios and intends to operate toward the top end of its range, which will provide increased flexibility in the face of future investment market volatility and reduce the risk of realising negative investment experience during significant market shocks.

Risks

The above outlook for the Life, Funds Management and recently acquired Bank businesses is subject to the following key business risks:

- investment market volatility;
- ongoing impact of COVID-19 pandemic on the global economy and the ability of individuals, businesses and governments to operate;
- general uncertainty around the global economy and its impact on markets in which Challenger operates and invests;
- regulatory and political changes impacting financial services markets participants;
- demand for and competition with Challenger products, including annuities, term deposits and managed funds; and
- operational risk.

7 Key performance indicators (KPIs)

7.1 Profitability and growth

KPIs for the period ended 31 December 2021 (with the period to 31 December 2020 being the prior comparative period (pcp), unless otherwise stated) are set out below.

	31 Dec 2021	31 Dec 2020	Change %
Profitability			
Statutory profit attributable to equity holders ($m)	282.0	222.8	26.6
Normalised NPBT ($m)	237.5	196.2	21.0
Normalised NPAT ($m)	165.6	136.8	21.1
Statutory EPS (cents)	41.8	33.2	25.9
Normalised EPS (cents)	24.5	20.4	20.1
Total dividend (cents)	11.5	9.5	21.1
Total dividend franking	100%	100%	—
Normalised cost: Income ratio	38.1%	39.0%	0.9
Statutory RoE after tax	14.3%	13.0%	1.3
Normalised RoE pre-tax	12.1%	11.5%	0.6
Normalised RoE after tax	8.4%	8.0%	0.4
Sales, Flows, AUM			
Total Life sales ($m)	4,943.1	3,437.5	43.8
Total Life net flows ($m)	1,446.0	708.7	large
Total Life net book growth (%)	8.4%	4.7%	3.7
Total FM net flows ($bn)	0.9	6.4	(85.9)
Total AUM ($bn)	114.9	96.1	19.6

Challenger's statutory profit attributable to equity holders for the period ended 31 December 2021 was 26.6% higher than the pcp. The increase was driven by higher pre-tax normalised earnings and positive net fair value changes on CLC's assets and liabilities.

Normalised NPAT increased by 21.1%, and normalised EPS increased by 20.1% compared to the pcp, reflecting higher Life cash operating earnings and Funds Management net fee income offset by higher expenses.

Investment experience profit after tax was $109.1 million compared to a $87.1 million profit in the pcp.

An interim dividend of 11.5 cents was announced, franked at 100% (31 December 2020: 9.5 cents, 100% franked), up 21.1% on pcp.

Challenger's normalised cost to income ratio of 38.1% is lower than the pcp (31 December 2020: 39.0%). Higher normalised cash operating earnings (NCOE) for Life was the main driver of the lower normalised cost to income ratio for the period. Operating costs were higher than the pcp due to additional costs associated with operating the Bank and increased costs to support business growth.

The normalised pre-tax return on equity (RoE) was 12.1% compared to 11.5% in the pcp and increased due to higher normalised NPBT partly offset by higher average capital levels, up 15% on pcp. The normalised pre-tax RoE outcome was in line with the group's pre-tax RoE target of 12.1% (RBA cash rate plus 12%). Normalised RoE after tax increased from 8.0% in the pcp to 8.4%, primarily reflecting higher normalised NPAT.

Statutory RoE after tax of 14.3% has increased compared to the pcp (31 December 2020: 13.0%) as a result of the higher statutory NPAT primarily resulting from higher Life cash operating earnings and the positive net fair value movements on CLC's assets and liabilities.

7.2 Capital management

Challenger holds capital to ensure that under a range of adverse scenarios it can continue to meet its regulatory requirements and contractual obligations to customers.

Challenger's Australian based companies are regulated by APRA and/or the Australian Securities and Investments Commission (ASIC). Challenger's Funds Management business also has operations in Singapore, Japan, the UK and Europe, which are subject to regulation in each jurisdiction. The relevant regulatory body in each jurisdiction requires a minimum level of regulatory capital to be held. The main minimum regulatory capital requirements for Challenger's regulated businesses are determined as follows:

- CLC: capital requirements are specified under APRA life insurance prudential capital standards; and
- MyLife MyFinance: capital requirements as specified under APRA ADI prudential standards.

Challenger's capital position is managed with the objective of maintaining the financial stability of the Group, CLC and the Bank while ensuring that shareholders earn an appropriate risk-adjusted return. Challenger reports a consolidated or level 3 equivalent capital position across the entire business. At 31 December 2021, the Challenger Group was holding $2.0 billion in excess regulatory capital, which equates to a Group Minimum Regulatory Requirement ratio (times) of 1.75 times. This ratio represents that Challenger is holding 75.0% more regulatory capital than required by its regulators.

7 Key performance indicators (KPIs) (continued)

7.2 Capital management (continued)

The following table highlights the key capital metrics for the Group.

Capital as at 31 December 2021	CLC $m	MLMF $m	Group[1] $m
Regulatory capital base			
Common Equity Tier 1 (CET1) regulatory capital	3,120.3	76.0	3,196.3
Additional Tier 1 capital	872.7	—	872.7
Total Tier 1 regulatory capital	**3,993.0**	**76.0**	**4,069.0**
Tier 2 capital[2]	402.4	0.5	402.9
Total capital base	**4,395.4**	**76.5**	**4,630.8**
Minimum Regulatory Requirement[3,4]	2,593.8	11.0	2,640.7
Excess over Minimum Regulatory Requirement	**1,801.6**	**65.5**	**1,990.1**
CET1 capital ratio (times)[5]	1.20	6.90	—
Tier 1 capital ratio (times)[6]	1.54	6.90	—
Minimum Regulatory Requirement ratio (times)[7]	1.69	6.95	1.75

[1] Includes CLC, MLMF, Funds Management, Corporate and other Life/Bank entities. Refer to Note 10 for detailed split.
[2] Refers to subordinated debt for CLC and general credit loss reserve for Bank.
[3] Minimum Regulatory Requirement is equivalent to PCA for CLC.
[4] Minimum Regulatory Requirement for MLMF represents total capital requirements of 8% (of risk weighted assets) plus the capital conservation buffer of 2.5% (of risk weighted assets), as stipulated under APS 110 Capital Adequacy.
[5] CET1 capital ratio is Common Equity Tier 1 regulatory capital divided by Minimum Regulatory Requirement.
[6] Tier 1 capital ratio is Total Tier 1 regulatory capital divided by Minimum Regulatory Requirement.
[7] Minimum Regulatory Requirement ratio is total capital base divided by Minimum Regulatory Requirement.

CLC regulatory capital

CLC holds capital in order to ensure that under a range of adverse scenarios it can continue to meet its regulatory requirements and obligations to its customers. CLC is regulated by APRA and is required to hold a minimum level of regulatory capital. CLC's regulatory capital base and PCA (or minimum regulatory requirement) have been calculated based on the prudential standards issued by APRA.

CLC maintains a target level of capital representing APRA's PCA plus a target surplus. The target surplus is a management guide to the level of excess capital that CLC seeks to hold over and above APRA's minimum requirements. CLC's target surplus is set to ensure that it provides a buffer against adverse market conditions and having regard to CLC's credit rating. CLC uses internal capital models to determine its target surplus, which are risk-based and are responsive to changes in CLC's asset allocation and market conditions.

CLC's internal capital models currently result in a target PCA ratio range of 1.3 to 1.7 times. This range can change over time and is dependent on numerous factors.

The PCA ratio at 31 December 2021 was 1.69 times (30 June 2021: 1.63 times), within the range of 1.3 to 1.7 times. The CET1 ratio was 1.20 times at 31 December 2021 up from 1.14 times at 30 June 2021.

Bank regulatory capital

The Bank is an ADI regulated by APRA under the authority of the ***Banking Act 1959***. The Bank's regulatory capital base and minimum regulatory capital requirement is specified under APRA's ADI prudential standards.

The Bank's regulatory capital base at 31 December 2021 was $76.5 million and predominantly represents CET1 regulatory capital. The CET1 regulatory capital base is similar to the Bank's 31 December 2021 net assets. The minimum regulatory capital requirement for the Bank relates to a total capital requirement of 8% of risk weighted assets, plus a capital conservation buffer of 2.5% as stipulated under Prudential Standard APS 110 ***Capital Adequacy*** (APS 110). The Bank's excess over the minimum regulatory capital requirement at 31 December 2021 was $65.5 million and the Bank capital ratios were as follows:

- Minimum regulatory requirement ratio 6.95 times;
- Common Equity Tier 1 (CET1) capital ratio 6.90 times; and
- Capital adequacy risk weighted asset ratio 72.9%.

Following its recent acquisition, the Bank is establishing its lending activities. Currently, a significant portion of the Bank's financing and lending assets are invested in cash and cash equivalents. Over time, assets will be redeployed to other forms of bank lending such as corporate, SME and commercial lending, which capture higher returns and are more capital intensive. As this occurs, it is expected the Bank's capital ratios will reduce.

Funds Management and Other

In addition to CLC's and MLMF's excess over minimum regulatory capital, Challenger maintains cash and tangible assets within legal entities outside CLC. These assets can be used to meet regulatory capital requirements. Challenger also has a corporate debt facility of $400.0 million in place, which provides additional financial flexibility. The facility was undrawn as at 31 December 2021.

Dividends and dividend reinvestment plan

Dividends	31 Dec 2021	31 Dec 2020	Change
Interim dividend (cents)	11.5	9.5	2.0
Interim dividend franking	100%	100%	—
Normalised dividend payout ratio	46.9%	46.6%	0.3

The Board targets a dividend payout ratio range of 45% to 50% of normalised earnings per share. The dividend payout ratio for the period ended 31 December 2021 was 46.9% (31 December 2020: 46.6%) and is within Challenger's targeted range.

The Company seeks to frank its dividends to the maximum extent possible and expects future dividends over the medium term to be also fully franked. However, the actual dividend payout ratio and franking will depend on prevailing market conditions and capital allocation priorities at the time.

The Company continued to operate its Dividend Reinvestment Plan (DRP) during the period. The participation rate for the 2021 final dividend was 19.0%, and 2,109,802 ordinary shares were issued to satisfy DRP requirements on 22 September 2021.

7 Key performance indicators (KPIs) (continued)

7.2 Capital management (continued)

Dividends and dividend reinvestment plan (continued)

The DRP will continue in operation for the 2022 interim dividend, and the Board has determined that new shares will be issued to fulfil DRP requirements in respect of the interim dividend. The new shares will not be issued at a discount to the prevailing Challenger share price.

7.3 Credit ratings

Challenger Limited and CLC are rated by Standard & Poor's (S&P). In December 2021, S&P reaffirmed both CLC and Challenger Limited's credit ratings.

Ratings were confirmed as:

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

MyLife MyFinance, Challenger's recently acquired bank is currently not rated by S&P. The Bank is very strongly capitalised and Challenger expects to scale and grow the business over time. Once the Bank achieves sufficient scale, Challenger will seek to have the Bank rated by S&P.

8 Normalised profit and investment experience

Normalised framework (Non-IFRS)

CLC and its consolidated entities are required by AASB 1038 ***Life Insurance Contracts*** to value all assets and liabilities at fair value where permitted by other accounting standards.

This gives rise to fluctuating valuation movements on assets and liabilities being recognised in the profit and loss in CLC and on consolidation in Challenger Limited. CLC is generally a long-term holder of assets, due to holding assets 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 CLC's medium to long-term expected returns together with new business strain[1] that results from writing new annuities. Investment experience also includes any impact from changes in economic and other actuarial assumptions.

A reconciliation between statutory revenue and the management view of revenue and net income is included in the financial report as part of Note 3 Segment information.

This note also includes a reconciliation of statutory NPAT and normalised NPAT (the management view of post-tax profit). The application of the normalised profit framework has been reviewed by Challenger's independent auditor to ensure that the reported results are consistently applied in accordance with the methodology described in Note 3 Segment information in the financial report.

Management analysis – normalised results

	31 Dec 2021 $m	31 Dec 2020 $m	Change $m	Change %
Net income[1]	386.5	325.3	61.2	18.8
Comprising:				
– Life normalised COE	287.4	244.0	43.4	17.8
– FM net income	98.2	81.3	16.9	20.8
– Bank net income[2]	0.9	—	0.9	—
Operating expenses[1]	(147.1)	(126.8)	(20.3)	(16.0)
Normalised EBIT	**239.4**	**198.5**	**40.9**	**20.6**
Comprising:				
– Life normalised EBIT	233.0	192.8	40.2	20.9
– FM normalised EBIT	45.1	35.3	9.8	27.8
– Bank normalised EBIT	(3.3)	—	(3.3)	—
– Corporate and other normalised EBIT	(35.4)	(29.6)	(5.8)	(19.6)
Interest and borrowing costs	(1.9)	(2.3)	0.4	17.4
Normalised NPBT	**237.5**	**196.2**	**41.3**	**21.0**
Tax on normalised profit	(71.9)	(59.4)	(12.5)	(21.0)
Normalised NPAT	**165.6**	**136.8**	**28.8**	**21.1**
Investment experience after tax	109.1	87.1	22.0	25.3
Significant items after tax	7.3	(1.1)	8.4	large
Statutory net profit after tax attributable to equity holders	**282.0**	**222.8**	**59.2**	**26.6**

[1] 'Net income' and 'Operating expenses' are internal classifications and are defined in Note 3 Segment information in the financial report. These differ from the statutory revenue and expenses classifications, as certain costs (including distribution expenses, property expenses, management fees, special purpose vehicle expenses and finance costs) are netted off against gross revenues. These classifications have been made in the Directors' report and in Note 3 Segment information to reflect how management measures business performance. While the allocation of amounts to the above items and investment experience differ to the statutory view, both approaches result in the same total net profit after tax attributable to equity holders.

[2] Represents net normalised income generated since the acquisition of MyLifeMyFinance Limited on 30 July 2021.

[1] New business strain is a non-cash accounting adjustment recognised when annuity rates on new business are higher than the risk-free rate used to fair value annuities. The new business strain unwinds over the life of the annuity contract.

8 Normalised profit and investment experience (continued)

Management analysis – normalised results (continued)

Life normalised cash operating earnings (COE) and earnings before interest and tax (EBIT) increased as a result of higher Life average investment assets with a relatively stable margin.

Life's average assets under management (AUM) increased by 17.4% as a result of the net book growth in annuities and external unit holders' liabilities accompanied by favourable valuation movements on Life's investment assets.

Funds Management net income increased (up $16.9 million) due to increased equity accounted profits and distribution fee revenue. Funds Management average FUM increased by 26.0% as a result of mark-to-market gains on investments and net inflows over the year.

Normalised NPBT includes net income of $0.9 million for the Bank which was acquired on 30 July 2021.

Operating expenses increased by $20.3 million (or 16.0%) for the period reflecting additional operating costs associated with operating the Bank, higher personnel costs, and higher costs to support business growth.

Challenger's full-time equivalent employee numbers increased by 26 (or 3.7%) to 735. The increase was driven primarily by the onboarding of existing MLMF employees as part of the acquisition.

The normalised effective tax rate was in line with pcp at 30.3%. The effective tax rate is similar to Australia's statutory tax rate of 30% and includes offshore earnings, which are generally taxed below 30%, and interest payments on the various Challenger Capital Notes, which are generally not tax deductible.

Significant items were $7.3 million (after tax) in the period and represent the gain on the sale of Accurium Pty Ltd partly offset by costs associated with the acquisition and integration of MyLifeMyFinance Limited.

Management analysis – investment experience

	31 Dec 2021 $m	31 Dec 2020 $m
Actual capital growth[1]		
– Cash and fixed income	(6.8)	212.4
– Equity and infrastructure	20.0	42.4
– Property (net of debt)	114.8	(9.7)
– Alternatives	2.3	0.2
Total actual capital growth	**130.3**	**245.3**
Normalised capital growth[2]		
– Cash and fixed income	(29.3)	(25.1)
– Equity and infrastructure	17.1	8.2
– Property (net of debt)	35.0	33.2
– Alternatives	—	—
Total normalised capital growth	**22.8**	**16.3**
Investment experience		
– Cash and fixed income	22.5	237.5
– Equity and infrastructure	2.9	34.2
– Property (net of debt)	79.8	(42.9)
– Alternatives	2.3	0.2
– Policyholder liability experience[3]	84.4	(108.4)
Asset and policy liability experience	191.9	120.6
New business strain[4]	(36.0)	3.9
Investment experience before tax	155.9	124.5
Tax expense	(46.8)	(37.4)
Investment experience after tax	**109.1**	**87.1**

[1] Actual capital growth represents net realised and unrealised capital gains or losses and includes the attribution of interest rate, inflation and foreign exchange derivatives that are used to hedge exposures.
[2] Normalised capital growth is determined by multiplying the normalised capital growth rate for each asset class by the average investment assets for the period. The normalised capital growth rates represent Challenger's expectations for each asset class over the investment cycle. The annual normalised growth rate is +4.0% for equity and infrastructure, +2.0% for property, 0.0% for alternatives, and -0.35% for cash and fixed income in order to allow for credit defaults. The rates have been set with reference to medium to long-term market growth rates and are reviewed to ensure consistency with prevailing market experience.
[3] Policy liability experience represents the impact of changes in macroeconomic variables, including bond yields and inflation factors, expense assumptions and other factors applied in the valuation of life contract liabilities.
[4] New business strain is a non-cash accounting adjustment recognised when annuity rates on new business are higher than the discount rate, being a risk-free rate plus an illiquidity premium used to fair value annuities. The new business strain unwinds over the annuity contract.

8 Normalised profit and investment experience (continued)

Management analysis – investment experience (continued)

Investment experience after tax relates to changes in the fair value of Life's assets and liabilities. Investment experience is a mechanism employed to remove the volatility arising from asset and liability valuation movements and new business strain from Life business earnings so as to more accurately reflect the underlying performance of the Life business.

Pre-tax investment experience for the period comprised an asset and policyholder liability experience gain of $191.9 million and a loss of $36.0 million from new business strain. These gains are largely unrealised and were primarily due to increased property valuations and gains on the fixed income portfolio.

9 Life segment results

Life normalised results	31 Dec 2021 $m	31 Dec 2020 $m	Change $m	Change %
Normalised COE	287.4	244.0	43.4	17.8
– Cash earnings	264.6	227.7	36.9	16.2
– Normalised capital growth	22.8	16.3	6.5	39.9
Operating expenses	(54.4)	(51.2)	(3.2)	(6.3)
Normalised EBIT	**233.0**	**192.8**	**40.2**	**20.9**

Life normalised EBIT increased by $40.2 million (up 20.9%) due to higher normalised COE (up $43.4 million or 17.8%), which was partially offset by operating expenses increasing $3.2 million (or 6.3%).

The higher normalised COE was attributable to an increase in Life's average investment assets, which increased by 17.3%.

Life generated a normalised RoE (pre-tax) of 13.1%, up by 0.6 percentage points from the pcp driven by higher normalised EBIT.

Total Life sales increased from the prior period (up 43.8%), with increased annuity sales (up 14.8%) and other Life sales (up 94.7%).

CLC participates in the Japanese foreign currency annuity market via a reinsurance agreement with MS Primary. The reinsurance agreement with MS Primary provides CLC with an annual amount of reinsurance across both Australian and US dollar annuities of at least ¥50.0 billion (approximately A$600.0 million based on the exchange rate at 31 December 2021)[1] each year for a minimum of five years commencing from 1 July 2019. MS Primary sales comprised 16.8% of Life's total annuity sales in the period.

Life sales	31 Dec 2021 $m	31 Dec 2020 $m	Change $m	Change %
Fixed-term annuities	2,295.5	1,844.4	451.1	24.5
Lifetime annuities	220.8	346.6	(125.8)	(36.3)
Total Life annuity sales	2,516.3	2,191.0	325.3	14.8
Other Life sales	2,426.8	1,246.5	1,180.3	94.7
Total Life sales	**4,943.1**	**3,437.5**	**1,505.6**	**43.8**
Annuity net flows	607.7	157.6	450.1	large
Other Life net flows	838.3	551.1	287.2	52.1

Annuity net flows (new annuity sales less capital repayments) increased to $607.7 million, driven by higher fixed-term annuity sales. Based on the opening Life annuity book for the 2022 financial year ($12.8 billion), annuity net book growth for the period was 4.4%, up from 1.3% in the pcp.

Other Life sales represents Challenger's Index Plus products and increased as a result of sales from both new and existing clients during the period. Other Life net flows for the period were $838.3 million, increasing by $287.2 million compared to the pcp.

Total Life net flows were $1,446.0 million, representing total Life net book growth of 8.4% (31 December 2020: $708.7 million or 4.7% book growth).

10 Funds Management segment results

FM normalised results	31 Dec 2021 $m	31 Dec 2020 $m	Change $m	Change %
Net income	98.2	81.3	16.9	20.8
Fidante Partners	65.5	49.7	15.8	31.8
CIPAM	32.7	31.6	1.1	3.5
Operating expenses	(53.1)	(46.0)	(7.1)	(15.4)
Normalised EBIT	**45.1**	**35.3**	**9.8**	**27.8**

Funds Management normalised EBIT increased by 27.8% for the period, with increased net income primarily from an increase in average FUM, which increased by 26.0% on pcp.

Fidante Partners' net income includes distribution fees, transaction fees, administration fees and a share in the equity accounted profits for the boutique investment managers in which it has an equity interest.

Fidante Partners' net income improved for the period primarily as a result of higher FUM income (up $17.3 million) partially offset by lower performance fees (down $2.2 million).

CIPAM's net income increased primarily due to higher net management fees (up $2.1 million) offset by lower transaction fees (down $1.0 million).

Funds Management's normalised RoE (pre-tax) for the period was 33.8%, up by 6.0 percentage points from the pcp.

[1] This is subject to review in the event of a material adverse change for either MS Primary or Challenger.

10 Funds Management segment results (continued)

FM FUM and flows	31 Dec 2021 $bn	31 Dec 2020 $bn	Change $bn	Change %
Total FUM	109.3	91.2	18.1	19.8
– Fidante Partners	88.5	71.8	16.7	23.3
– CIPAM	20.8	19.4	1.4	7.2
Net flows	0.9	6.4	(5.5)	(85.9)
– Fidante Partners	1.1	5.8	(4.7)	(81.0)
– CIPAM	(0.2)	0.6	(0.8)	(large)

Fidante Partners' FUM increased by $16.7 billion (or 23.3%) compared to the pcp. During the period, Fidante Partners' net inflows were $1.1 billion compared to net inflows of $5.8 billion in the pcp.

11 Bank segment results

Bank normalised results[1]	31 Dec 2021 $m	31 Dec 2020 $m	Change $m	Change %
Net income	0.9	—	0.9	n/a
Operating expenses	(4.2)	—	(4.2)	n/a
Normalised EBIT	**(3.3)**	**—**	**(3.3)**	**n/a**
Interest and borrowing costs	—	—	—	n/a
Normalised loss before tax	**(3.3)**	**—**	**(3.3)**	**n/a**

[1] Represents normalised result since the acquisition of MyLifeMyFinance Limited on 30 July 2021.

Bank's normalised EBIT was a loss of $3.3 million for the period and represents approximately five months of earnings since the acquisition completed on 30 July 2021.

Net interest income for the period was $0.9 million and represents interest earned on the Bank's lending and financing assets ($1.3 million), less interest costs associated with the Bank's deposit products ($0.4 million).

Bank expenses for the period were $4.2 million and predominantly relate to personnel expenses ($3.0 million).

12 Corporate and other segment results

Corporate and other normalised results	31 Dec 2021 $m	31 Dec 2020 $m	Change $m	Change %
Operating expenses	(35.4)	(29.6)	(5.8)	(19.6)
Normalised EBIT	**(35.4)**	**(29.6)**	**(5.8)**	**(19.6)**
Interest and borrowing costs	(1.9)	(2.3)	0.4	17.4
Normalised loss before tax	**(37.3)**	**(31.9)**	**(5.4)**	**(16.9)**

Normalised EBIT for the Corporate and other segment was down $5.8 million as a result of higher operating expenses driven primarily by higher personnel expenses. Personnel costs increased by $5.3 million on the prior period due to increased variable reward costs and reduced annual leave uptake as a result of the COVID-19 pandemic.

Other expenses and long-term incentive costs were broadly in line with the pcp.

The financial results also include borrowing costs associated with Group debt facilities.

13 Guidance for the 2022 financial year

Challenger's normalised net profit before tax guidance is a range of between $430 million and $480 million for the 2022 financial year. The mid-point of the guidance range ($455 million) represents Challenger's best estimate and would result in Challenger achieving its normalised RoE (pre-tax) target (refer below) and maintaining a stable Life COE margin of approximately 2.5%.Challenger is on track to achieve the guidance with 31 December 2021 normalised net profit before tax of $237.5 million, representing 52% of the mid-point of the guidance range.

Directors' report

The information appearing on pages 1 to 15 forms part of the Directors' report for the financial period ended 31 December 2021 and is to be read in conjunction with the following information.

1 Directors

The names and details of the Directors of the Company holding office during the six months to 31 December 2021 and as at the date of this report are listed below. Directors were in office for the entire period, unless otherwise stated.

Directors	
Peter Polson	Independent Chair
Nick Hamilton (appointed 1 January 2022)	Managing Director and Chief Executive Officer
Richard Howes (retired 1 January 2022)	Former Managing Director and Chief Executive Officer
John M Green	Independent Non-Executive Director
Steven Gregg	Independent Non-Executive Director
Masahiko Kobayashi[1]	Non-Independent Non-Executive Director
Heather Smith	Independent Non-Executive Director
JoAnne Stephenson	Independent Non-Executive Director
Duncan West	Independent Non-Executive Director
Melanie Willis	Independent Non-Executive Director

[1] Hiroyuki Iioka is an Alternate Director to Masahiko Kobayashi.

2 Significant events after the balance date

On 13 September 2021, Challenger announced that it had entered into an agreement to sell its 30% equity interest in Whitehelm Capital Pty Ltd to PATRIZIA AG for €32.0 million (A$51.1 million). The transaction settled on 1 February 2022 and Challenger's sale consideration was paid in full, in cash. The provisional results from the sale are set out below.

- The Group will record a $44.6 million pre-tax gain on sale of an associate in the Statement of comprehensive income for the period ended 30 June 2022. The gain will be reported as a significant item in Note 3 Segment information in the 30 June 2022 Annual Report.
- The Group will derecognise $6.5 million of investment in associates in the Statement of financial position.
- The Funds Management segment will derecognise $5.2 billion of funds under management.

At the date of this financial report, no other matter or circumstance has arisen that has, or may, significantly affect the Group's operations, the results of those operations or the Group's state of affairs in future financial years which has not already been reflected in this report.

3 Rounding

The amounts contained in this report and the financial report have been rounded to the nearest $100,000, unless otherwise stated, under the option available to the Group under Australian Securities and Investments Commission (ASIC) Corporations Instrument 2016/191.

4 Authorisation

Signed in accordance with a resolution of the Directors of Challenger Limited:

P Polson
Independent Chair
16 February 2022

N Hamilton
Managing Director and Chief Executive Officer
16 February 2022

5 Auditor's independence declaration

The Directors received the following declaration from the auditor of Challenger Limited:

Building a better working world

Ernst & Young
200 George Street
Sydney NSW 2000 Australia
GPO Box 2646 Sydney NSW 2001
Tel: +61 2 9248 5555
Fax: +61 2 9248 5959
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Auditor's independence declaration to the Directors of Challenger Limited

As lead auditor for the review of the half-year financial report of Challenger Limited for the half-year ended 31 December 2021, I declare to the best of my knowledge and belief, there have been:

a. no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review;
b. no contraventions of any applicable code of professional conduct in relation to the review; and
c. no non-audit services provided that contravene any applicable code of professional conduct in relation to the review.

This declaration is in respect of Challenger Limited and the entities it controlled during the financial period.

Ernst & Young

Graeme McKenzie
Partner
Sydney
16 February 2022

This interim financial report covers Challenger Limited (the Company) and its controlled entities (the Group or Challenger).

Statement of comprehensive income

For the six months ended 31 December	Note	2021 $m	2020 $m
Revenue	1	1,481.4	1,282.2
Expenses	2	(938.3)	(841.6)
Finance costs		(172.7)	(144.3)
Share of profits of associates		21.0	16.1
Profit before income tax		**391.4**	**312.4**
Income tax expense	4	(109.4)	(89.6)
Profit for the period after income tax		**282.0**	**222.8**
Other comprehensive income			
Items that may be reclassified to profit and loss, net of tax			
Translation of foreign entities		6.5	(41.9)
Hedge of net investment in foreign entities		(4.0)	39.6
Net gain/(loss) on cash flow hedges		0.1	(0.6)
Other comprehensive income for the period		2.6	(2.9)
Total comprehensive income for the period after tax		**284.6**	**219.9**
Earnings per share attributable to ordinary shareholders of Challenger Limited		**Cents**	**Cents**
Basic	14	41.8	33.2
Diluted	14	33.9	27.3

The Statement of comprehensive income should be read in conjunction with the accompanying notes.

Statement of financial position

As at	Note	31 Dec 2021 $m	30 Jun 2021 $m	31 Dec 2020 $m
Assets				
Cash and cash equivalents		913.9	989.4	773.9
Receivables		588.3	830.4	412.6
Derivative assets		620.3	738.3	1,042.4
Investment assets	5	22,356.9	22,174.7	21,094.9
Investment and development property - held for sale	6	388.0	396.0	6.7
Investment and development property	6	3,496.2	3,389.7	3,656.7
Loan assets	7	600.1	570.3	637.9
Finance leases		22.8	26.8	30.2
Property, plant and equipment		26.4	28.2	25.1
Investment in associates[1]		79.7	83.2	63.3
Other assets		58.1	63.1	61.4
Right-of-use lease assets		31.5	34.7	37.9
Deferred tax assets		2.2	4.0	3.8
Goodwill		599.0	579.9	579.9
Other intangible assets		8.4	9.2	17.6
Total assets of shareholders of Challenger Limited		**29,791.8**	**29,917.9**	**28,444.3**
Liabilities				
Payables		814.3	1,744.1	985.6
Current tax liability		46.0	48.1	10.9
Derivative liabilities		405.8	507.6	682.3
Deposits from customers	12	152.6	—	—
Interest bearing financial liabilities	11	5,670.7	6,323.5	7,314.7
External unit holders' liabilities		4,381.8	3,632.2	3,031.5
Provisions		39.3	35.7	31.8
Lease liabilities		66.3	70.3	72.4
Deferred tax liabilities		63.2	60.7	32.6
Life contract liabilities	8	14,092.5	13,669.9	12,769.7
Total liabilities of shareholders of Challenger Limited		**25,732.5**	**26,092.1**	**24,931.5**
Net assets of shareholders of Challenger Limited		**4,059.3**	**3,825.8**	**3,512.8**
Equity				
Contributed equity	10	2,451.8	2,425.5	2,422.6
Reserves		(55.0)	(50.9)	(55.5)
Retained earnings		1,662.5	1,451.2	1,145.7
Total equity of shareholders of Challenger Limited		**4,059.3**	**3,825.8**	**3,512.8**

[1] Investment in associates includes $6.5 million investment in Whitehelm Capital Pty Ltd which is classified as held for sale. Refer to Note 19 Subsequent events for further information.

The Statement of financial position should be read in conjunction with the accompanying notes.

Statement of changes in equity

		Attributable to shareholders of Challenger Limited						
For the period ended 31 December 2020	Note	Contributed equity $m	Share-based payment reserve $m	Cash flow hedge reserve $m	Foreign currency translation reserve $m	Adjusted controlling interest reserve $m	Retained earnings $m	Total shareholder equity $m
Balance at 1 July 2020		**2,377.6**	**(56.2)**	**0.1**	**(0.5)**	**5.7**	**922.9**	**3,249.6**
Profit for the period		—	—	—	—	—	222.8	222.8
Other comprehensive income for the period		—	—	(0.6)	(2.3)	—	—	(2.9)
Total comprehensive income for the period		**—**	**—**	**(0.6)**	**(2.3)**	**—**	**222.8**	**219.9**
Other equity movements								
Ordinary shares issued	10	34.8	—	—	—	—	—	34.8
Treasury shares purchased	10	—	—	—	—	—	—	—
Treasury shares vested	10	10.2	—	—	—	—	—	10.2
Settled forward purchases of Treasury shares	10	—	—	—	—	—	—	—
Share-based payment expense net of tax less releases		—	(1.7)	—	—	—	—	(1.7)
Dividends paid	13	—	—	—	—	—	—	—
Balance at 31 December 2020		**2,422.6**	**(57.9)**	**(0.5)**	**(2.8)**	**5.7**	**1,145.7**	**3,512.8**
For the period ended 31 December 2021								
Balance at 1 July 2021		**2,425.5**	**(52.8)**	**(0.4)**	**(3.4)**	**5.7**	**1,451.2**	**3,825.8**
Profit for the period		—	—	—	—	—	282.0	282.0
Other comprehensive income for the period		—	—	0.1	2.5	—	—	2.6
Total comprehensive income for the period		**—**	**—**	**0.1**	**2.5**	**—**	**282.0**	**284.6**
Other equity movements								
Ordinary shares issued	10	13.4	—	—	—	—	—	13.4
Treasury shares purchased	10	(7.9)	—	—	—	—	—	(7.9)
Treasury shares vested	10	12.9	—	—	—	—	—	12.9
Settled forward purchases of Treasury shares	10	7.9	—	—	—	—	—	7.9
Share-based payment expense net of tax less releases		—	(6.7)	—	—	—	—	(6.7)
Dividends paid	13	—	—	—	—	—	(70.7)	(70.7)
Balance at 31 December 2021		**2,451.8**	**(59.5)**	**(0.3)**	**(0.9)**	**5.7**	**1,662.5**	**4,059.3**

The Statement of changes in equity should be read in conjunction with the accompanying notes.

Statement of cash flows

For the period ended 31 December	Note	2021 $m	2020 $m
Operating activities			
Receipts from customers		330.0	308.7
Annuity and premium receipts	8	2,531.2	2,206.3
Annuity and claim payments	8	(2,044.0)	(2,192.3)
Bank deposit receipts		72.6	—
Bank deposit payments		(54.2)	—
Receipts from external unit holders		2,426.8	1,246.6
Payments to external unit holders		(1,821.9)	(744.5)
Payments to vendors and employees		(322.7)	(297.7)
Dividends received		39.7	33.6
Interest received		320.7	325.6
Interest paid		(24.8)	(26.8)
Income tax paid		(98.9)	(9.0)
Net cash inflows from operating activities	9	**1,354.5**	**850.5**
Investing activities			
Payments for net purchases of investments		(773.9)	(436.4)
Proceeds from sale of controlled entity, net of disposal costs and cash disposed	17	8.7	—
Payments for purchase of controlled entity, net of cash acquired[1]	17	(28.9)	—
Net loan repayments		84.5	52.2
Payments for purchases of property, plant and equipment		(1.8)	(3.5)
Net cash outflows from investing activities		**(711.4)**	**(387.7)**
Financing activities			
Proceeds from issue of ordinary shares		13.4	35.0
Costs associated with issue of ordinary shares		—	(0.2)
Net repayments of borrowings – interest bearing financial liabilities	11	(656.0)	(465.4)
Payments for lease liabilities		(3.7)	(3.4)
(Payments for)/proceeds from Treasury shares		(1.6)	2.4
Net dividends paid		(70.7)	—
Proceeds from the issue of Challenger Capital Notes 3		—	385.0
Costs associated with the issue of Challenger Capital Notes 3		—	(6.7)
Repayment of Challenger Capital Notes 1		—	(297.5)
Net cash outflows from financing activities		**(718.6)**	**(350.8)**
Net (decrease)/increase in cash and cash equivalents		**(75.5)**	**112.0**
Cash and cash equivalents at the beginning of the period		989.4	661.9
Cash and cash equivalents at the end of the period		**913.9**	**773.9**

[1] Payment excludes deposit of $1.8 and acquisition costs of $0.7 million paid during the year ended 30 June 2021.

The Statement of cash flows should be read in conjunction with the accompanying notes.

Basis of preparation and overarching significant accounting policies

Challenger Limited (the Company or the parent entity) is a company limited by shares, incorporated and domiciled in Australia. Challenger shares are publicly traded on the Australian Securities Exchange (ASX).

The interim financial report for Challenger Limited and its controlled entities (the Group or Challenger) for the six months ended 31 December 2021 was authorised for issue in accordance with a resolution of the Directors of the Company on 16 February 2022.

(i) Basis of preparation and statement of compliance

This is a general purpose interim financial report that has been prepared in accordance, and complies, with the requirements of the ***Corporations Act 2001*** and AASB 134 ***Interim Financial Reporting***. Challenger Limited is a for-profit entity for the purposes of preparing financial statements.

The Group has prepared the financial statements on the basis that it will continue to operate as a going concern. The Directors consider that there are no material uncertainties that may cast significant doubt over this assumption. They have formed a judgement that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future, and not less than 12 months from the end of the reporting period.

The interim financial report does not include all the notes normally included in an annual financial report. It is recommended that this interim financial report be read in conjunction with the financial report for the year ended 30 June 2021 and any public announcements made by the Group in accordance with the continuous disclosure obligations of the ASX Listing Rules.

Unless otherwise stated, amounts in this interim financial report are presented in Australian dollars and have been prepared on a historical cost basis. The assets and liabilities disclosed in the Statement of financial position are grouped by nature and listed in an order that reflects their relative liquidity.

(ii) Significant accounting judgements, estimates and assumptions

The carrying values of amounts recognised on the Statement of financial position are often based on estimates and assumptions of future events. The key estimates and assumptions that have a significant risk of causing a material adjustment to the recognised amounts within the next annual reporting period are disclosed individually within each of the relevant notes to the financial statements. The impact of COVID-19 has been considered in relation to the disclosures made in these financial statements.

Coronavirus (COVID-19) impact

Background

The COVID-19 pandemic and its effects on the capital markets and global economy continue to pose uncertainty for businesses worldwide. The impact of the pandemic and the related government measures is continuously evolving, which has resulted in the application of continued enhanced judgement in the areas in which significant judgement already occurs. Given the dynamic and unprecedented nature of COVID-19 and the limited certainty of the economic and financial impacts of such a pandemic, changes to the estimates and outcomes that have been applied in the measurement of the Group's assets and liabilities may arise in the future.

Processes applied

As a consequence of COVID-19 and in preparing these consolidated financial statements, management:

- assessed the carrying values of its assets and liabilities and determined any impact that may occur as a result of market inputs and variables impacted by COVID-19; and
- considered the impact of COVID-19 on the Group's financial statement disclosures.

(iii) New and revised accounting standards and policies

Except for the matters referred to below, the accounting policies and methods of computation are the same as those adopted in the annual report for the period ended 30 June 2021.

Changes to significant accounting policies and disclosures

Investment assets

Effective 1 July 2021, the Group amended Note 5 Financial assets at fair value through profit and loss to Note 5 Investment assets in order to encompass changes in the asset mix following the acquisition of MyLifeMyFinance Limited (MLMF) and the trading of precious metals commodities. The precious metals commodities strategy is outlined on page 24. The strategy results in an immaterial exposure to the underlying commodity price.

Historically, the Group categorised its financial assets as financial assets – fair value through profit and loss (being initially designated as such). Assets designated as fair value through profit and loss consist of fixed income, equity, infrastructure and property securities. They are carried at fair value with unrealised gains and losses being recognised through the Statement of comprehensive income.

The newly acquired MLMF has investment assets that are primarily term deposits with ADIs and fixed income securities. These assets are measured at amortised cost as they are held within a business model to solely collect contractual cashflows and the contractual terms of the assets give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI). Amortised cost is calculated by taking into account any discount or premium on the issue of the asset and costs that are an integral part of the effective interest rate. Gains and losses are recognised in the Statement of comprehensive income when the assets are derecognised or impaired.

Basis of preparation and overarching significant accounting policies (continued)

Changes to significant accounting policies and disclosures (continued)

Hedged commodities

In July 2021, the Group commenced trading precious metals futures. Precious metals are recognised in the Statement of financial position under the 'Investment assets' line item. Precious metals are disclosed in the 'Investment assets' note under 'Other assets' as 'Hedged commodities'. Assets are measured at fair value with changes recognised in the Statement of comprehensive income under 'Realised and unrealised gains/losses on hedged commodities'. Hedged commodities are treated as Level 1 investment assets under the fair value hierarchy on the basis that they are valued using active market prices. Commodities futures are recorded as 'Derivative financial instruments' and treated as Level 1 under the fair value hierarchy. The precious metals commodities strategy provides Challenger an opportunity to earn a spread between the price of physical commodities and the price of short futures contracts, resulting in an immaterial exposure to the underlying commodity price.

Loan assets

Loan assets are defined as loans that are not held for trading purposes and include the Group's lending activities to bank customers (mortgages, personal loans, and investment loans, as well as the existing CLC mortgages held within SPV trusts), which were previously disclosed in a separate 'Mortgage assets – SPV' note. Due to the decreasing materiality of SPV related balances, other SPV specific disclosures have been reduced. Loans are non-derivative financial loan assets with fixed or determinable payments that are not quoted in an active market. They are recognised net of any credit loss provision.

Deposits from customers

Deposits from customers include variable rate at-call deposits as well as fixed rate term deposits from retail and wholesale customers. All bank customer deposits are initially recognised at the fair value of the amount received adjusted for any transaction costs. Deposits from customers are derecognised when they are extinguished, discharged, cancelled or expired. After initial recognition, deposits are measured at amortised cost using the effective interest rate method. Interest is calculated on the daily balance. Interest expense is recognised in the Statement of comprehensive income on an accrual basis.

New accounting standards and amendments that are effective in the current financial period

There have been no new or revised accounting standards or interpretations that are effective from the period beginning on or after 1 July 2021 that materially impact the financial results. Where applicable, comparative figures have been updated to reflect any changes in the current period.

Accounting standards and interpretations issued but not yet effective

AASB 17 *Insurance Contracts*

AASB 17 ***Insurance Contracts*** replaces AASB 4 ***Insurance Contracts***, AASB 1038 ***Life Insurance Contracts*** and AASB 1023 ***General Insurance Contracts,*** and is effective for Challenger from 1 July 2023. The Group is not expected to early adopt the standard. AASB 17 ***Insurance Contracts*** establishes globally consistent principles for the recognition, measurement, presentation and disclosure of life insurance contracts issued. Life investment contracts are currently measured under the financial instruments standard and will continue to be recognised under this standard.

AASB 17 introduces changes to the profit emergence profiles of life insurance contracts but does not affect the underlying economics or cash flows of the contracts. The impact on income tax is unknown, pending a regulatory response from the Australian Taxation Office (ATO). On 13 December 2021, APRA released a number of draft prudential and reporting standards aimed at integrating AASB 17 into the insurance and capital reporting frameworks. For the capital framework, the majority of the existing requirements for the regulatory capital calculation for life insurers will be maintained. For the reporting framework, APRA has confirmed that insurers will be able to use the AASB 17 accounting policies and principles to report financial statement information to APRA. Additional data requirements are proposed to ensure that APRA continues to have appropriate data for capital assessments and profitability monitoring.

The main changes anticipated for the Group under AASB 17 are set out below.

- Insurance contract portfolios will be disaggregated to more granular levels and will be required to be evaluated by risk type, issue year and profitability.
- Although conceptually similar, the Contractual Service Margin (CSM) recognises profit on a different basis to the current Margin on Services (MoS) approach and therefore the profit signature is likely to change for portfolios with positive profit margins.
- A new risk adjustment for non-financial risk will be introduced which reflects the compensation that the Group requires for bearing the uncertainty in relation to the amount and timing of cash flows. The confidence level associated with the risk adjustment will need to be disclosed.
- Additional disclosures will be more extensive, requiring increased granularity and more analysis of movements.

The Group has conducted a business impact assessment and has identified the following focus areas.

- Measurement model – The Group will adopt the General Model approach, also referred to as the Building Block Approach (BBA). In principle, the General Model approach is similar to the current MoS methodology as prescribed under AASB 1038. The General Model approach is a more detailed methodology that will require enhanced data capture and storage for additional modelling and other processes.
- Contracts affected – The Group expects that all material groups of contracts classified as insurance contracts under AASB 1038 will meet the definition of insurance contracts under AASB 17.

Basis of preparation and overarching significant accounting policies (continued)

Accounting standards and interpretations issued but not yet effective (continued)

- Separating components – The Group has assessed the requirement to unbundle features and components under AASB 17 and expects that no change will be required given no contracts are currently unbundled under AASB 1038.
- Assumption review frequency – Under AASB 17, assumptions are to be reviewed on an annual basis at a minimum with some items requiring more frequent review.
- Level of aggregation – AASB 17 requires insurance contracts that are subject to similar risks and managed together, to be allocated to a portfolio. AASB 17 requires that each portfolio be divided into a minimum of:
  1. a group that is onerous (loss-making) at initial recognition;
  2. a group that at initial recognition has no significant possibility of becoming onerous subsequently; and
  3. a group of any remaining contracts in the portfolio.

  The Group has conducted a high-level review of historical data to ascertain the feasibility of meeting the level of aggregation required by AASB 17. In addition, the Group will be formalising a policy for defining portfolios and contract groups. Due to the nature of the insurance products that Challenger offers its customers, the Group expects that most of the portfolios will be designated as onerous. If a portfolio is designated as onerous, a CSM calculation will not be required, however, tracking of the loss component will be required under AASB 17.
- Risk adjustment – The Group expects the risk adjustment methodology to align with the cost of capital approach.
- Disclosure – AASB 17 introduces a new way of viewing life insurance revenue and expenses and accompanying financial disclosures. Under AASB 17, insurance contract revenue will be allocated to each period in proportion to the reduction in liability over the remaining coverage period. The Group has assessed the capability of the Group's general ledger system and confirms that no issues are anticipated for configuring the system to meet the new financial reporting and disclosure requirements under AASB 17.
- Insurance contracts will need to be restated at 1 July 2023 (being the date of initial application). The first full year financial statements presented under AASB 17 will be for the year ended 30 June 2024 with comparatives required for 30 June 2023. The first half year financial statements will be for the period ended 31 December 2023, with comparatives required for 31 December 2022. The Group notes that the full retrospective approach may be impracticable in some cases, especially for older cohorts where assumptions cannot be determined without hindsight.

While the standard is expected to impact the Group's comprehensive income, it is not yet practicable to determine the quantum.

Existing standards and interpretations not yet effective

Other amendments to existing standards or interpretations that are not yet effective are not expected to result in a material impact to the Group's financial statements.

Note 1 Revenue

	31 Dec 2021 $m	31 Dec 2020 $m
Investment revenue		
Fixed income securities and cash[1]	251.4	667.6
Investment property and property securities	236.1	123.1
Equity and infrastructure investments	33.2	54.6
Realised and unrealised gains/(losses) on hedges and foreign exchange translation	114.1	(77.6)
Fee revenue	140.3	111.7
Other revenue		
Life insurance contract premiums and related revenue[2]	697.6	402.8
Gain on disposal of subsidiary[3]	8.7	—
Total revenue	**1,481.4**	**1,282.2**

[1] This includes interest revenue earned for items measured at amortised cost using the effective interest method $12.2 million (31 December 2020: $15.3 million) and interest revenue earned for items measured at fair value through profit and loss $312.5 million (31 December 2020: $322.6 million).
[2] Changes in life insurance and investment contract liabilities arising from new business, annuity payments, discount rates, inflation rates and other assumptions are recognised as revenue, with other movements being included in Note 2 Expenses.
[3] Gain on the disposal of Accurium Pty Ltd. Refer to Note 17 for further detail.

Note 2 Expenses

	31 Dec 2021 $m	31 Dec 2020 $m
Life insurance contract claims and expenses[1]	633.0	577.3
Cost of deposits from customers	0.4	—
Investment property-related expenses[2]	37.9	39.2
Management and other fees	88.5	67.1
Distribution expenses	25.9	25.5
Employee benefits expenses	103.5	86.5
Other expenses[3]	49.1	46.0
Total expenses	**938.3**	**841.6**

[1] Cost of life insurance and life investment contract liabilities recognised as an expense consists of the interest expense on the liability and any loss on the initial recognition of new business less the release of liability in respect of expenses incurred in the current period. The interest expense on the liability represents the unwind of the discount on the opening liability over the period, whereas the impacts of changes in the discount rate applied for the current valuation are included in the change in life contract liabilities, which is part of life insurance contract premiums and related revenue as disclosed in Note 1 Revenue.
[2] Investment property-related expenses relate to rental income-generating investment properties.
[3] Includes amortisation of right-of-use lease assets $3.0 million (31 December 2020: $2.7 million).

Note 3 Segment information

The reporting segments[1] of the Group have been identified as follows.

For the six months ended 31 December 2021	Life $m	Funds Management $m	Bank $m	Total reporting segments $m	Corporate and other[2] $m	Total $m
Net income	287.4	98.2	0.9	386.5	—	386.5
Operating expenses	(54.4)	(53.1)	(4.2)	(111.7)	(35.4)	(147.1)
Normalised EBIT	**233.0**	**45.1**	**(3.3)**	**274.8**	**(35.4)**	**239.4**
Interest and borrowing costs	—	—	—	—	(1.9)	(1.9)
Normalised net profit/ (loss) before tax	**233.0**	**45.1**	**(3.3)**	**274.8**	**(37.3)**	**237.5**
Tax on normalised profit						(71.9)
Normalised net profit after tax						**165.6**
Investment experience after tax						109.1
Significant items after tax						7.3
Profit attributable to the shareholders of Challenger Ltd						**282.0**
Other statutory segment information						
Revenue from external customers[3]	1,021.3	135.4	—	1,156.7	—	1,156.7
Interest revenue	323.4	—	1.3	324.7	—	324.7
Interest expense	(152.2)	(1.3)	(0.4)	(153.9)	(18.8)	(172.7)
Intersegment revenue	(44.8)	44.8	—	—	—	—
Depreciation and amortisation	(3.3)	(3.1)	(0.1)	(6.5)	(0.9)	(7.4)
As at 31 December 2021						
Segment assets	23,633.0	297.6	254.4	24,185.0	5,606.8	29,791.8
Segment liabilities	(19,973.1)	(29.4)	(158.9)	(20,161.4)	(5,571.1)	(25,732.5)
Net assets attributable to shareholders	**3,659.9**	**268.2**	**95.5**	**4,023.6**	**35.7**	**4,059.3**

[1] Refer below for definitions of the terms used in the management view of segments.
[2] Corporate and other includes corporate companies and Group eliminations.
[3] Funds Management revenue from external customers is predominantly management fees.

Note 3 Segment information (continued)

For the six months ended 31 December 2020	Life $m	Funds Management $m	Total reporting segments $m	Corporate and other[2] $m	Total $m
Net income	244.0	81.3	325.3	—	325.3
Operating expenses	(51.2)	(46.0)	(97.2)	(29.6)	(126.8)
Normalised EBIT	**192.8**	**35.3**	**228.1**	**(29.6)**	**198.5**
Interest and borrowing costs	—	—	—	(2.3)	(2.3)
Normalised net profit/(loss) before tax	**192.8**	**35.3**	**228.1**	**(31.9)**	**196.2**
Tax on normalised profit					(59.4)
Normalised net profit after tax					**136.8**
Investment experience after tax					87.1
Significant items after tax					(1.1)
Profit attributable to the shareholders of Challenger Ltd					**222.8**
Other statutory segment information					
Revenue from external customers[3]	849.7	101.9	951.6	—	951.6
Interest revenue	337.9	—	337.9	—	337.9
Interest expense	(128.0)	(0.6)	(128.6)	(15.7)	(144.3)
Intersegment revenue	(22.3)	22.3	—	—	—
Depreciation and amortisation	(3.7)	(2.8)	(6.5)	(0.9)	(7.4)
As at 31 December 2020					
Segment assets	20,530.0	278.2	20,808.2	7,636.1	28,444.3
Segment liabilities	(17,365.2)	(24.0)	(17,389.2)	(7,542.3)	(24,931.5)
Net assets attributable to shareholders	**3,164.8**	**254.2**	**3,419.0**	**93.8**	**3,512.8**

Definitions

Operating segments

The following segments are identified and reported based on the Group's organisational and management structures, the nature of profit generated and services provided. The operating segments comprise component parts of the Group that are regularly reviewed by senior management in order to allocate resources and assess performance. During the period ending 31 December 2021, a new segment, 'Bank', was created following the acquisition of MyLife MyFinance Limited. The division is responsible for the provision of a range of banking products and services to customers in Australia.

Life

The Life segment principally includes the annuity and life insurance business carried out by CLC. CLC offers fixed rate and other retirement and superannuation products that are designed for Australian investors who are seeking a low-risk, fixed term or lifetime investment and reliable income. CLC also offers fixed term and lifetime investments to investors in Japan through its reinsurance arrangement with MS Primary. CLC invests in assets providing long-term income streams for customers.

Funds Management

Funds Management earns fees from its Fidante Partners and CIPAM operations, providing an end-to-end funds management business. Funds Management has equity investments in a number of the Fidante Partners boutique fund managers and, through the CIPAM business, offers a range of managed investments across fixed income and property.

Bank

The Bank provides retail financial services and banking products to consumers in Australia, in the form of deposit and loan products. The Bank provides Challenger with access to a wide range of customers through multiple distribution channels, including direct and intermediated channels.

Note 3 Segment information (continued)

Definitions (continued)

Corporate and other

The Corporate and other segment, which is not considered an operating segment of the Group, is used to reconcile the total segment results back to the consolidated results and consists of other income and costs that fall outside the day-to-day operations of the reportable segments. These include the costs of the Group CEO and CFO, shared services across the Group, long-term incentive costs, Directors' fees, corporate borrowings and associated borrowing costs, and shareholder registry services. To reconcile to Group results, the Corporate and other segment also includes eliminations and non-core activities of the Group.

Transactions between segments

All transactions and transfers between segments are determined on an arm's length basis and are included within the relevant categories of income and expense. These transactions eliminate on consolidation.

Normalised vs. statutory results

Net income and operating expenses differ from revenue and expenses as disclosed in the Statement of comprehensive income as certain direct costs (including distribution expenses, property expenses and management fees) included in expenses are netted off against revenues in deriving the management view of net income above. Net income consists of the following sub-categories of management views of revenue:

- normalised cash operating earnings (Life segment);
- net interest margin (Bank segment)
- net income (Funds Management segment); and
- other income (Corporate and other segment).

Revenue also includes investment gains and losses which are excluded from the management view as they form part of investment experience (refer below).

Normalised cash operating earnings

This is calculated as cash earnings plus normalised capital growth (refer below). Cash earnings represent the sum of investment yield (being the management view of revenue from investment assets, such as net rental income, dividends and interest), interest expense, distribution expenses and fees.

Normalised EBIT

Normalised earnings before interest and tax (EBIT) comprises net income less operating expenses, as defined above. It excludes investment experience, corporate interest and borrowing costs, tax and any significant items (refer below).

Tax on normalised profit

This represents the consolidated statutory tax expense or benefit for the period, less tax attributable to non-controlling interests, investment experience and significant items.

Investment experience after tax

The Group is required by accounting standards to value applicable assets and liabilities supporting the life insurance business at fair value. This can give rise to fluctuating valuation movements being recognised in the Statement of comprehensive income, particularly during periods of market volatility.

As the Group is generally a long-term holder of assets, due to assets being held to match the term of life contract liabilities, the Group takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term volatility. Investment experience is a mechanism employed to isolate the volatility arising from asset and liability valuation within the results so as to more accurately reflect the underlying performance of the Group.

Investment experience is calculated as the difference between the actual investment gains/losses (both realised and unrealised) and the normalised capital growth (refer below) plus life contract valuation changes and new business strain. Investment experience after tax is investment experience net of tax at the prevailing income tax rate.

Normalised capital growth

This is determined by multiplying the normalised capital growth rate for each asset class by the average investment assets for the period. The normalised growth rates represent the Group's medium to long-term capital growth expectations for each asset class over the investment cycle.

The annual normalised growth rates are +4.0% for equity and infrastructure, +2.0% for property, 0.0% for alternatives and -0.35% for cash and fixed income.

Life contract valuation experience

Life contract valuation experience represents the impact of changes in macroeconomic variables including bond yields and inflation factors, illiquidity premium, expense assumptions and other factors applied in the valuation of life contract liabilities. It also includes the attribution of the corresponding interest rate, foreign exchange and inflation derivatives used for hedging.

Note 3 Segment information (continued)

Definitions (continued)

New business strain

New business strain is a non-cash valuation adjustment recognised when annuity rates on new business are higher than the risk-free rate used to fair value life contracts. Maintenance expense allowances over the expected future term of the new business are also included in the life contract valuation. New business strain reported in the period represents the valuation loss on new sales generated in the current period net of the reversal of new business strain of prior period sales.

Significant items after tax

The Group presents additional non-IFRS financial information to the market to provide meaningful insights into the financial condition of the business. Due consideration has been given to ensure that disclosure of Challenger's normalised profit framework is explained, reconciled and calculated consistently period-on-period. Within this framework, Challenger defines significant items as non-recurring or abnormal income or expense items.

Major customers

No individual customer amounted to greater than 10% of the Group's segment as defined above.

Geographical areas

The Group operates predominantly in Australia, hence no geographical split is provided to the chief operating decision maker. Reinsurance of annuities issued by MS Primary accounted for $417.9 million of the Group's life insurance premium income in the period to 31 December 2021 out of total life insurance premium income of $638.7 million (31 December 2020: $542.1 million out of a total of $888.6 million) and comprised 16.1% of total policy liabilities outstanding as at 31 December 2021 (30 June 2021: 15.2%). While the underlying annuitant resides in Japan, the reinsurance service provided by CLC is considered to be Australian business and is therefore not recognised as a geographically separate segment.

	31 Dec 2021 $m	31 Dec 2020 $m
Reconciliation of management to statutory view of after-tax profit		
Operating segments normalised net profit before tax	274.8	228.1
Corporate and other normalised net loss before tax	(37.3)	(31.9)
Normalised net profit before tax (management view of pre-tax profit)	**237.5**	**196.2**
Tax on normalised profit	(71.9)	(59.4)
Normalised net profit after tax	**165.6**	**136.8**
Investment experience after tax	109.1	87.1
Significant items after tax	7.3	(1.1)
Statutory view of profit after tax	**282.0**	**222.8**
Reconciliation of management view of revenue to statutory revenue		
Operating segments	386.5	325.3
Net income (management view of revenue)	**386.5**	**325.3**
Expenses and finance costs offset against revenue		
SPV expenses and finance costs offset against SPV income	1.4	1.8
Bank expenses and finance costs offset against Bank income	0.3	—
Distribution expenses offset against related income	25.9	25.5
Change in life contract liabilities and reinsurance contracts recognised in expenses	633.0	577.3
Property related expenses offset against property income	37.9	39.2
Interest and loan amortisation costs	153.3	125.5
Management fee expenses	88.5	67.1
Adjustment for other items	(1.3)	(4.0)
Difference between management view of investment experience and statutory recognition		
Actual capital growth	130.3	245.3
Normalised capital growth	(22.7)	(16.3)
Life contract valuation experience	84.5	(108.4)
New business strain	(36.1)	3.9
Statutory revenue (refer Note 1 Revenue)	**1,481.5**	**1,282.2**

Note 4 Income tax

Reconciliation of income tax expense	31 Dec 2021 $m	31 Dec 2020 $m
Profit before income tax	391.4	312.4
Prima facie income tax based on the Australian company tax rate of 30%	(117.4)	(93.7)
Tax effect of amounts not assessable/deductible in calculating taxable income:		
– Challenger Capital Notes distributions	(4.1)	(3.8)
– non-assessable and non-deductible items	13.5	7.6
– other items	(1.4)	0.3
Income tax expense	**(109.4)**	**(89.6)**
Underlying effective tax rate	**28.0%**	**28.7%**

Analysis of income tax expense	31 Dec 2021 $m	31 Dec 2020 $m
Current income tax expense for the period	(106.0)	(19.6)
Current income tax benefit prior period adjustment	7.7	—
Deferred income tax expense	(1.9)	(70.1)
Deferred income tax (expense)/benefit prior period adjustment	(9.2)	0.1
Income tax expense	**(109.4)**	**(89.6)**
Income tax (expense)/benefit on translation of foreign entities	(0.7)	13.0
Income tax benefit/(expense) on hedge of net investment in foreign entities	1.7	(17.0)
Income tax benefit/(expense) from other comprehensive income	**1.0**	**(4.0)**

Recognised deferred tax balances	31 Dec 2021 $m	30 Jun 2021 $m
Tax consolidated group losses	9.0	0.8
Non-tax consolidated group losses	1.5	5.3
Deferred tax asset on losses	**10.5**	**6.1**

Unrecognised deferred tax balances	31 Dec 2021 $m	30 Jun 2021 $m
Non-tax consolidated group revenue losses – tax effected	9.6	7.6
Tax consolidated group capital losses – tax effected	56.4	56.4

Note 5 Investment assets

Held at fair value through profit and loss	31 Dec 2021 $m	30 Jun 2021 $m	31 Dec 2020 $m
Domestic sovereign bonds and semi-government bonds	5,172.1	6,054.8	8,178.3
Floating rate notes and corporate bonds	5,750.1	6,576.3	4,793.6
Residential mortgage and asset-backed securities	8,633.3	7,653.6	6,367.1
Non-SPV/ADI mortgage assets	106.2	112.2	121.1
Fixed income securities	**19,661.7**	**20,396.9**	**19,460.1**
Shares in listed and unlisted corporations	192.9	143.1	83.6
Unit trusts, managed funds and other	1,343.5	1,201.3	1,098.6
Equity securities	**1,536.4**	**1,344.4**	**1,182.2**
Units in listed and unlisted infrastructure trusts	54.6	48.8	51.3
Other infrastructure investments	275.4	296.6	315.8
Infrastructure investments	**330.0**	**345.4**	**367.1**
Indirect property investments in listed and unlisted trusts	93.3	88.0	85.5
Property securities	**93.3**	**88.0**	**85.5**
Hedged commodities[1]	658.6	—	—
Other investment assets	**658.6**	**—**	**—**
Total investment assets – fair value through profit and loss	**22,280.0**	**22,174.7**	**21,094.9**

[1] The precious metals commodities strategy provides Challenger an opportunity to earn a spread between the price of physical commodities and the price of short futures contracts, resulting in an immaterial exposure to the underlying commodities price.

Held at amortised cost	31 Dec 2021 $m	30 Jun 2021[1] $m
Floating rate notes	27.3	—
Negotiable certificates of deposits	31.0	—
Term deposits	11.5	—
Corporate and government bonds	6.0	—
Deposits with credit unions/ADIs	1.1	—
Fixed income securities	**76.9**	**—**
Total investment assets – amortised cost[2]	**76.9**	**—**

[1] No investment assets held at amortised cost prior to the acquisition of MyLife MyFinance on 30 July 2021.
[2] The fair values of assets held at amortised cost are materially in line with their amortised cost values due to the short duration of these investments. These assets would be classified as Level 2.

Note 6 Investment and development property

	31 Dec 2021 $m	30 Jun 2021 $m	31 Dec 2020 $m
Investment property held for sale[1]	388.0	388.0	—
Investment property in use	3,496.2	3,389.7	3,656.7
Development property held for sale[2,3]	—	8.0	6.7
Total investment and development property[4]	**3,884.2**	**3,785.7**	**3,663.4**

[1] Investment property held for sale: County Court (30 June 2021: County Court), expected settlement in May 2022.
[2] No development property held for sale (30 June 2021: Maitland).
[3] Development property held for sale is recognised at fair value.
[4] Investment and development property held for sale is considered current. All other investment property is considered non-current.

Note 7 Loan assets

Loan assets	31 Dec 2021 $m	30 Jun 2021 $m	31 Dec 2020 $m
Residential mortgages[1]	453.8	421.8	465.2
Investment loans[2]	152.4	160.3	184.7
Reverse mortgages[3]	4.2	—	—
Personal loans[4]	0.7	—	—
Less: provision for impairment	(11.0)	(11.8)	(12.0)
Balance at the end of the period	**600.1**	**570.3**	**637.9**

[1] Residential mortgages are held both by MLMF and CLC. The CLC book is held within Special Purpose Vehicle (SPV) trusts that hold residential mortgage-backed assets and issue securitised financial liabilities. The trusts are entities that fund pools of residential mortgage-backed securities (RMBS). All borrowings of these SPVs are limited in recourse to the assets of the SPV. MLMF mortgages are core investment assets that are funded by term deposits of the business and include owner occupied loans.
[2] Investment loans are loans to resident households for the purpose of housing, where the funds are used for a residential property that is not owner occupied.
[3] Reverse mortgages represent loans provided by MLMF to individuals to supplement income while in retirement and are secured over residential property.
[4] Personal loans represent secured and unsecured loans provided by MLMF to individuals for the financing of such items as the acquisition of a new vehicle, funding renovations or the consolidation of debt.

Accounting policy

Loans and advances are non-derivative financial loan assets with fixed or determinable payments that are not quoted in an active market. They are recognised net of any credit loss provision. These are held at amortised cost.

Key estimates and assumptions

The Group continues to primarily apply the historical provisioning methodology which is considered to be materially consistent with the provision estimated under the expected credit loss (ECL) impairment model. In estimating ECL for individual mortgage loans, the Group makes judgements and assumptions in relation to expected repayments, the realisable value of the secured property, the prospects of the customer, the value of any mortgage insurance and the likely cost and duration of a workout process.

Judgements and assumptions in respect of these matters have been updated to reflect the potential impact of COVID-19. The Group has also considered historical probabilities of default, the relative age of the mortgage loan portfolio and the loan to valuation ratios applicable to the mortgage loans, and has determined that the current provision estimated by the ECL impairment model is adequate and no further overlay for the impact of COVID-19 is required.

Analysis of loan assets impairment provision	31 Dec 2021 $m	30 Jun 2021 $m	31 Dec 2020 $m
Balance at the beginning of the period	11.8	11.5	11.5
Increase in provision	0.1	0.5	0.9
Utilisation of provision against incurred losses and adjustments to estimates	(0.9)	(0.2)	(0.4)
Balance at the end of the period[1]	**11.0**	**11.8**	**12.0**

[1] Impairment provision balance includes provision of $0.04 million related to the Bank loan assets.

Note 8 Life contract liabilities

Fair value of life contract liabilities	31 Dec 2021 $m	30 Jun 2021 $m	31 Dec 2020 $m
Life investment contract liabilities – at fair value	6,565.7	6,230.4	5,520.5
Life insurance contract liabilities – at margin on services value	7,527.4	7,440.5	7,250.0
Outwards reinsurance contract liabilities – at margin on services value	(0.6)	(1.0)	(0.8)
Total life contract liabilities	**14,092.5**	**13,669.9**	**12,769.7**

	Life investment contract liabilities		Life insurance contract liabilities		Outwards reinsurance contract liabilities		Total life contract liabilities	
Movement in life contract liabilities	31 Dec 2021 $m	31 Dec 2020 $m	31 Dec 2021 $m	31 Dec 2020 $m	31 Dec 2021 $m	31 Dec 2020 $m	31 Dec 2021 $m	31 Dec 2020 $m
Balance at the beginning of the period	6,230.4	5,867.8	7,440.5	6,714.4	(1.0)	(1.0)	13,669.9	12,581.2
Deposits and premium receipts	1,877.6	1,302.3	653.6	904.0	—	—	2,531.2	2,206.3
Payments and withdrawals	(1,535.9)	(1,730.7)	(508.1)	(461.6)	—	—	(2,044.0)	(2,192.3)
Revenue per Note 1	(76.4)	23.8	(621.6)	(426.8)	0.4	0.2	(697.6)	(402.8)
Expense per Note 2	70.0	57.3	563.0	520.0	—	—	633.0	577.3
Balance at the end of the period	**6,565.7**	**5,520.5**	**7,527.4**	**7,250.0**	**(0.6)**	**(0.8)**	**14,092.5**	**12,769.7**

Accounting policy

The operations of the Group include the selling and administration of life contracts through Challenger Life Company Limited (CLC). These contracts are governed under the ***Life Insurance Act 1995*** (the Life Act) and are classified as either life insurance contracts or life investment contracts. Life insurance and life investment contract liabilities are collectively referred to as life contract liabilities or policy liabilities.

Life investment contract liabilities

Life investment contracts are contracts regulated under the Life Act but which do not meet the definition of life insurance contracts under AASB 1038 ***Life Insurance Contracts,*** and similar contracts issued by entities operating outside of Australia.

For fixed term policies, the liability is based on the fair value of the income payments and associated expenses, being the net present value of the payments and expenses using an appropriate discount rate curve as determined by the Appointed Actuary.

For cash business, the liability is determined using an accumulation approach.

Life insurance contract liabilities

Life insurance contracts are contracts regulated under the Life Act that involve the acceptance of significant insurance risk. Insurance risk is defined as significant if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (i.e. have no discernible effect on the economics of the transaction).

The financial reporting methodology used to determine the value of life insurance contract liabilities is referred to as margin on services (MoS). Under MoS, the excess of premiums received over payments to customers and expenses (the margin) is recognised over the life of the contract in a manner that reflects the pattern of risk accepted from the policyholder (the service) unless future margins are negative, in which case the future losses are recognised in the Statement of comprehensive income immediately. The planned release of this margin is recognised in the Statement of comprehensive income as part of the movement in life insurance contract liabilities.

Life insurance contract liabilities are usually determined using a projection method, whereby estimates of policy cash flows (premiums, payments and expenses) are projected into the future. The liability is calculated as the net present value of these projected cash flows using a risk-free discount rate curve.

The key areas of judgement in the determination of the liabilities are actuarial assumptions for mortality, surrenders, acquisition and maintenance expenses, and economic assumptions for discount and inflation rates.

Life insurance premium revenue

Life insurance premiums are recognised as revenue when risk is transferred to the Group.

Life insurance claims expense

Life insurance claims expense is recognised in expenses when the liability to the policyholder under the contract has been established.

Note 8 Life contract liabilities (continued)

Inwards reinsurance

The Group has maintained inwards reinsurance arrangements during the period that meet the definition of a life insurance contract. The MoS methodology requires the present value of future cash flows arising from reinsurance contracts to be included in the calculation of life insurance contract liabilities.

Valuation

The MoS valuation, calculated in accordance with APRA Prudential Standards and AASB 1038 ***Life Insurance Contracts*** results in the systematic release of planned margins over the life of the policy via a 'profit carrier'. The Group maintains life insurance contracts, including individual lifetime annuities, wholesale mortality, wholesale morbidity, longevity reinsurance and wholesale lifetime annuities. Annuity payments are used as the profit carrier for lifetime annuities and premium receipts or best estimate claim payments, are used as the profit carrier for wholesale mortality, wholesale morbidity and longevity reinsurance.

Key assumptions applied in the valuation of life contract liabilities

Tax rates

The bases of taxation (including deductibility of expenses) are assumed to continue in accordance with legislation current at the reporting date.

Discount rates

Under APRA Prudential Standards and AASB 1038 ***Life Insurance Contract***s, life insurance contract liabilities are calculated by discounting expected future cash flows at a risk-free rate, set at the Commonwealth Government Bond curve plus an illiquidity premium where applicable, or for foreign-denominated liabilities, a curve derived from the yields of highly liquid AAA-rated sovereign risk securities in the currency of the policy liabilities plus an illiquidity premium where applicable. The illiquidity premium is determined by reference to observable market rates including Australian sovereign debt, corporate, securitised and collateralised debt publicly placed in the domestic market, and market swap rates.

Life investment contract liabilities are calculated under the fair value through profit and loss provisions of AASB 9 ***Financial Instruments***. The discount rates are determined based on the current observable, objective rates that relate to the nature, structure and term of the future liability cash flows.

For both insurance and investment contracts the approach is the same as adopted at June 2021. Discount rates applied for Australian liabilities were between 0.6% - 2.9% per annum (30 June 2021: 0.3% - 2.8%).

Expenses

Forecasted expenses for the next year are allocated between acquisition, maintenance and investment based on the nature of the expense. Forecasted maintenance expenses then are converted to a per-contract unit cost or percentage of account balance, depending on the nature of the expense.

Inflation

Inflation estimates are based on long-term expectations and reviewed at least annually for changes in the market environment based on a comparison of real and nominal yields of instruments of equivalent term and credit risk. The current assumption for Australia is 2.4% per annum for short-term inflation and 2.4% per annum for long-term inflation (30 June 2021: 2.0% short-term, 2.3% long-term).

Surrenders

For life investment contracts, no surrenders or voluntary discontinuances are assumed. For Australian life insurance contracts where a surrender value is payable on withdrawal, a rate of surrenders is assumed in line with Challenger's own experience on these products, currently between 0.0% - 2.1% per annum (30 June 2021: 0.0% - 2.1%). For inwards reinsurance of Japanese business a rate of surrenders is assumed in line with local experience in relation to similar contracts, currently 3.5% per annum (30 June 2021: 3.5%).

Where policyholders have the option to commute a life insurance contract, the value of this option is included within the life contract liabilities. We also assume surrender rates based on past experience for this business which vary by product types and duration in-force for the contract.

Mortality

Base mortality rates for individual lifetime annuities are determined as a multiple of annuitant experience based on LML08 and LFL08 tables, adjusted for Challenger's own recent experience. LML08 and LFL08 are mortality tables developed by the Continuous Mortality Investigation (CMI) based on United Kingdom annuitant lives experience from 2007–2010. The tables refer to male and female lives respectively. Rates are adjusted for expected future mortality improvements based on observed and expected improvements. For the age ranges and cash flow projection periods that contribute the majority of CLC's exposure, rates of future mortality improvement applied are between 0.3% - 2.4% per annum (30 June 2021: 0.3% - 2.5%).

Base mortality rates for wholesale mortality and longevity reinsurance are determined as a multiple of pensioner mortality rates (based on the self-administered pension schemes or SAPS3 tables mortality investigation developed by the Institute and Faculty of Actuaries (UK) using United Kingdom data collected between 2009–2016). Rates are adjusted for expected future mortality improvements based on observed and expected improvements. For the age ranges and cash flow projection periods that contribute the majority of CLC's exposure, rates of future mortality improvement applied are between 0.2% - 2.3% per annum (30 June 2021: 0.2% - 2.3%).

Base mortality rates for the inwards reinsurance of Japanese business are determined as a multiple of Japanese population mortality rates.

Mortality assumptions have been reviewed but not adjusted in light of the COVID-19 pandemic.

Note 8 Life contract liabilities (continued)

Valuation (continued)

Impact of changes in assumptions on life insurance contracts

Under MoS, changes in actuarial assumptions are recognised by adjusting the value of future profit margins in life insurance contract liabilities. Changes in future profit margins are released over future periods unless that product group is in an expected net loss position (loss recognition), in which case changes in assumptions are recognised in the Statement of comprehensive income in the period in which they occur. The valuation impact of changes to discount rate assumptions as a result of market and economic conditions, such as changes in benchmark market yields, are recognised in the Statement of comprehensive income in the period in which the changes occur.

Restrictions on assets

Investment assets held in the Group can only be used within the restrictions imposed under the Life Insurance Act 1995 (the Life Act). The main restrictions are that the assets in a statutory fund can only be used to meet the liabilities and expenses of that statutory fund, to acquire investments to further the business of the statutory fund or as distributions when capital adequacy requirements are met.

Statutory fund information

The life contract operations of CLC are conducted within four separate statutory funds. Both the shareholders' and policyholders' interests in these statutory funds are reported in aggregate in the financial report of the Group. Fund 1 is a non-investment-linked fund and Fund 3 is investment-linked. Both of these are closed to new business. Funds 2 and 4 are the principal operating funds of the Group. Fund 2 contains non-investment-linked contracts, including the Group's term annuity business, lifetime annuity policies and the related outwards reinsurance, plus the wholesale mortality, wholesale morbidity and longevity inwards reinsurance. Fund 4 contains inwards reinsurance of annuity business written in Japan.

Life contract liabilities for Statutory Funds 1, 2, 3 and 4 are set out below.

Life contract liabilities	31 Dec 2021 $m	30 Jun 2021 $m
Statutory Fund 1	1.5	1.5
Statutory Fund 2	11,824.8	11,582.4
Statutory Fund 3	2.9	3.0
Statutory Fund 4	2,263.3	2,083.0
Total life contract liabilities	**14,092.5**	**13,669.9**

Current/non-current split for total life contracts

There is a fixed settlement date for the majority of life contract liabilities. Approximately $3,940.0 million on a discounted basis (30 June 2021: $3,099.3 million) of life contract liabilities have a contractual maturity within 12 months of the reporting date. Based on assumptions applied for the 31 December 2021 valuation of life contract liabilities, $4,490.1 million of principal payments on fixed term and lifetime business are expected in the year to 31 December 2022 (expected in the year to 30 June 2022 $3,685.7 million).

Life insurance risk

The Group is exposed to longevity risk on its individual lifetime annuities (both direct and reinsured) and wholesale longevity reinsurance. Longevity risk is the risk that policyholders may live longer than expectations. The Group is exposed to mortality risk on the wholesale mortality reinsurance and reinsurance of fixed term business written in Japan. This is the risk that death rates in the reference portfolios exceed expectations. The Group is also exposed to morbidity risk on the wholesale morbidity reinsurance. That is the risk that morbidity rates in the reference portfolios exceed expectations.

The Group manages the longevity risk by regular reviews of the portfolio to confirm continued survivorship of policyholders receiving income plus regular review of longevity experience to ensure that longevity assumptions remain appropriate.

In addition, the Group maintains a reinsurance arrangement to manage longevity risk in respect of part of the closed book of individual lifetime annuities.

The Group manages the mortality and morbidity risk by regular reviews of the portfolio to ensure that mortality and morbidity assumptions remain appropriate. The Company's insurance risk policy is approved by the Board and sets out the relevant risk limits for insurance exposures, to ensure the insurance risk portfolio is appropriately diversified and contains no significant concentrations of insurance risk.

Actuarial information

Mr A Kapel FIAA, as the Appointed Actuary of CLC, is satisfied as to the accuracy of the data used in the valuations of life contract liabilities in the financial report and the tables in this note.

The life contract liabilities have been determined at the reporting date in accordance with the Life Act, APRA Prudential Standards, AASB 1038 ***Life Insurance Contracts***, and AASB 9 ***Financial Instruments***.

Note 9 Notes to Statement of cash flows

Reconciliation of profit to operating cash flow	31 Dec 2021 $m	31 Dec 2020 $m
Profit for the period	**282.0**	**222.8**
Adjusted for		
Net realised and unrealised losses/(gains) on investment assets	(160.2)	(278.8)
Share of associates' net profit	(21.0)	(16.1)
Change in life contract liabilities[1]	(64.6)	174.5
Depreciation and amortisation expense	7.4	7.4
Impairment of associate	0.1	—
Share-based payments	7.4	7.7
Dividends from associates	26.0	16.1
Change in operating assets and liabilities		
Decrease in receivables	42.4	35.5
Decrease/(increase) in other assets	3.5	(1.5)
Decrease in payables	(11.1)	(25.9)
Increase/(decrease) in provisions	3.6	(3.7)
Increase in life contract liabilities	487.2	14.0
Increase in external unit holders' liabilities	749.6	615.7
Increase in net tax liabilities	2.2	82.8
Net cash flows from operating activities	**1,354.5**	**850.5**

[1] Changes relate to movements through the Statement of comprehensive income.

Note 10 Contributed equity

	31 December 2021		30 June 2021		31 December 2020	
	No. of shares m	Value of shares $m	No. of shares m	Value of shares $m	No. of shares m	Value of shares $m
Analysis of contributed equity						
Ordinary shares issued and fully paid	678.1	2,475.8	676.0	2,462.4	675.6	2,459.5
CPP Trust shares treated as Treasury shares[1]	(0.9)	(9.6)	(1.4)	(14.6)	(1.4)	(14.6)
CPP deferred share purchases treated as Treasury shares	(1.2)	(14.4)	(2.0)	(22.3)	(2.0)	(22.3)
Total contributed equity	**676.0**	**2,451.8**	**672.6**	**2,425.5**	**672.2**	**2,422.6**
Movements in contributed equity						
Ordinary shares						
Balance at the end of the period	676.0	2,462.4	667.5	2,424.7	667.5	2,424.7
Equity placement	—	—	8.1	34.8	8.1	34.8
Issued under dividend reinvestment plan	2.1	13.4	0.4	2.9	—	—
Balance at the end of the period	**678.1**	**2,475.8**	**676.0**	**2,462.4**	**675.6**	**2,459.5**
CPP Trust						
Balance at the end of the period	1.4	14.6	2.4	24.8	2.4	24.8
Shares purchased (including settled forwards)	0.8	7.9	—	—	—	—
Vested shares released to employees	(1.3)	(12.9)	(1.0)	(10.2)	(1.0)	(10.2)
Balance at the end of the period	**0.9**	**9.6**	**1.4**	**14.6**	**1.4**	**14.6**
CPP share purchases						
Balance at the end of the period	2.0	22.3	2.0	22.3	2.0	22.3
Settled forward purchases	(0.8)	(7.9)	—	—	—	—
Balance at the end of the period	**1.2**	**14.4**	**2.0**	**22.3**	**2.0**	**22.3**

[1] Includes 0.8 million shares to which the CPP Trust has legal rights but not beneficial ownership.

Capital management

A company is generally limited in the risk-taking activities that it can engage in by the amount of capital it holds, with capital acting as a buffer against risk, ensuring that there are sufficient resources to enable the company to continue normal business in the event of an unexpected loss.

The prudentially-regulated Challenger Life Company Limited (CLC) manages capital via an Internal Capital Adequacy Assessment Process (ICAAP). Under the prudential standards, a life company must have in place an ICAAP, documented in an ICAAP Summary Statement. CLC complied with these requirements at all times during the period.

The objective of the ICAAP is to ensure that CLC maintains adequate capital in respect of the risks to which it is exposed so that it can fulfil its obligations to policy owners (in particular, the duty to give priority to the interests of owners and prospective owners of policies referable to a fund). The ICAAP also enables CLC to invest both strategically and tactically in opportunities that deliver a return on equity above the cost of capital for shareholders.

During the period, management enhanced the presentation of minimum capital requirements and capital base to encompass the addition of the new operating segment – Bank. For completeness, Funds Management and Corporate was also included, which has resulted in a Group-wide view of the capital position as detailed on the following page.

Other than the change above, there were no material changes to the Group's capital management process during the period.

All of the Group's regulated entities have at all times during the current and prior financial period complied with the externally imposed capital requirements to which they are subject.

Prescribed capital amount (PCA)

PCA refers specifically to CLC's regulatory capital requirements.

CLC holds capital in order to ensure that under a range of adverse scenarios it can continue to meet its obligations to its customers. CLC is regulated by APRA and is required to hold a minimum level of regulatory capital. CLC's regulatory capital base and PCA have been calculated based on the prudential standards issued by APRA.

CLC's target surplus

CLC maintains a target level of capital representing APRA's PCA plus a target surplus. The target surplus is a management guide to the level of excess capital that CLC seeks to hold over and above APRA's minimum requirements. CLC's target surplus is set to ensure that it provides a buffer against adverse market conditions and having regard to CLC's credit rating. CLC uses internal capital models to determine its target surplus, which are risk-based and are responsive to changes in CLC's asset allocation and market conditions.

Note 10 Contributed equity (continued)

Capital management (continued)

CLC's target surplus (continued)

CLC's internal capital models currently result in a target PCA ratio range of 1.3 to 1.7 times. This range can change over time and is dependent on numerous factors.

The PCA ratio at 31 December 2021 was 1.69 times (30 June 2021: 1.63 times), within the range of 1.3 to 1.7 times. The CET1 ratio was 1.20 times at 31 December 2021 up from 1.14 times at 30 June 2021.

Bank regulatory capital

The Bank is an authorised deposit-taking institution regulated by APRA under the authority of the ***Banking Act 1959***. APRA sets minimum regulatory capital requirements for banks based on the Basel Committee on Banking Supervision guidelines.

For the purposes of meeting capital adequacy as prescribed by APRA, certain items such as intangibles and deferred tax assets do not qualify as capital and are excluded from the calculation.

Regulatory capital is divided into Common Equity Tier 1 (CET1), Additional Tier 1 Capital and Tier 2 Capital. The Bank's regulatory capital base at 31 December 2021 was $76.5 million and predominantly represents CET1 regulatory capital and an immaterial amount of Tier 2 regulatory capital, and is in compliance with APRA minimum capital adequacy requirements. The capital adequacy ratio of 72.9% reflects this capital as a percentage of total risk weighted assets.

To manage its capital, management reviews its adequacy continuously and reports its capital position to the Executive Leadership Team and Asset and Liability Committee on a monthly basis.

Funds Management and Other capital

In addition to CLC's and MLMF's excess regulatory capital, Challenger maintains cash and tangible assets within the Funds Management and Corporate legal entities. These assets can be used to meet regulatory capital requirements. Challenger also has a Corporate debt facility of $400.0 million in place, which provides additional financial flexibility. The facility was undrawn as at 31 December 2021.

Capital as at 31 December 2021	CLC[1] $m	MLMF[2] $m	Other (including Funds Management)[3] $m	Group $m
Regulatory capital base				
Shareholder equity	3,419.4	76.5	563.4	4,059.3
Goodwill and other intangibles	(75.6)	—	(531.8)	(607.4)
Other adjustments[4]	(223.6)	(0.5)	127.3	(96.8)
Eligible regulatory debt	1,275.2	0.5	—	1,275.7
Total capital base	**4,395.4**	**76.5**	**158.9**	**4,630.8**
Minimum Regulatory Requirement[1,2]	2,593.8	11.0	35.9	2,640.7
Excess over Minimum Regulatory Requirement	**1,801.6**	**65.5**	**123.0**	**1,990.1**
Common Equity Tier 1 (CET1) regulatory capital	3,120.3	76.0	—	3,196.3
Additional Tier 1 capital	872.7	—	—	872.7
Total Tier 1 regulatory capital	**3,993.0**	**76.0**	**—**	**4,069.0**
Tier 2 capital[5]	402.4	0.5	—	402.9
Total capital base	**4,395.4**	**76.5**	**158.9**	**4,630.8**
CET1 capital ratio (times)[6]	1.20	6.90	—	—
Tier 1 capital ratio (times)[7]	1.54	6.90	—	—
Minimum Regulatory Requirement ratio (times)[8]	1.69	6.95	4.43	1.75

[1] Minimum Regulatory Requirement is equivalent to PCA for CLC.
[2] Minimum Regulatory Requirement for MLMF represents total capital requirements of 8% (of risk weighted assets) plus the capital conservation buffer of 2.5% (of risk weighted assets), as stipulated under APS 110 Capital Adequacy.
[3] Includes Funds Management, Corporate and other Life/Bank entities. Funds Management Minimum Regulatory Requirement (MRR) for capital based on requirements set by ASIC and regulators in other foreign jurisdictions. Challenger Retirement and Investment Services Limited MRR based on APRA and ASIC requirements.
[4] Other adjustments predominantly related to intercompany items.
[5] Refers to subordinated debt for CLC and general credit loss reserve for Bank.
[6] CET1 capital ratio is Common Equity Tier 1 regulatory capital divided by Minimum Regulatory Requirement.
[7] Tier 1 capital ratio is Total Tier 1 regulatory capital divided by Minimum Regulatory Requirement.
[8] Minimum Regulatory Requirement ratio is total capital base divided by Minimum Regulatory Requirement.

Note 10 Contributed equity (continued)

Dividend Reinvestment Plan (DRP)

The Company resumed the DRP for the 2021 final dividend, and on 22 September 2021 issued 2,109,802 ordinary shares to satisfy the plan.

The DRP issue price per share for the 2021 final dividend was $6.4010 and represented the volume weighted average share price over the 10 trading days from 2 September 2021 to 15 September 2021.

The final DRP participation rate was 19.0% of all issued shares, resulting in proceeds of $13.5 million.

Note 11 Interest bearing financial liabilities

	30 June 2021			Non-cash movements			31 December 2021	
	Facility $m	Opening balance $m	Cash flow repayments $m	Foreign exchange $m	Fair value changes $m	Other $m	Closing balance $m	Facility $m
Bank loans								
Corporate[1]	400.0	—	—	—	—	—	—	400.0
Controlled property trusts[2,3]	394.9	392.3	(8.8)	(2.0)	0.4	0.7	382.6	382.6
Controlled infrastructure trusts[3]	179.3	179.3	(3.6)	—	—	—	175.7	175.7
Term funding[4]	—	—	—	—	—	5.4	5.4	5.4
Repurchase agreements	4,111.1	4,111.1	(568.6)	—	—	—	3,542.5	3,542.5
Total bank loans	**5,085.3**	**4,682.7**	**(581.0)**	**(2.0)**	**0.4**	**6.1**	**4,106.2**	**4,506.2**
Non-bank loans								
Subordinated debt	400.0	404.5	—	—	(2.9)	—	401.6	400.0
Challenger Capital Notes 1[3]	27.7	27.7	—	—	—	—	27.7	27.7
Challenger Capital Notes 2[3]	460.0	456.3	—	—	—	1.0	457.3	460.0
Challenger Capital Notes 3[3]	385.0	379.0	—	—	—	0.6	379.6	385.0
Loan notes – SPV	373.3	373.3	(75.0)	—	—	—	298.3	298.3
Total non-bank loans	**1,646.0**	**1,640.8**	**(75.0)**	**—**	**(2.9)**	**1.6**	**1,564.5**	**1,571.0**
Total interest bearing financial liabilities	**6,731.3**	**6,323.5**	**(656.0)**	**(2.0)**	**(2.5)**	**7.7**	**5,670.7**	**6,077.2**
Current		4,310.0					3,738.4	
Non-current		2,013.5					1,932.3	
		6,323.5					**5,670.7**	

[1] No amounts were drawn from the facility in the period.
[2] Total facility limit consists of non-redraw loan facilities limits totalling $382.6 million (30 June 2021: $394.9 million).
[3] Held at amortised cost except for the controlled property trust loan in respect of County Court. The fair value of these are: Challenger Capital Notes 1 $28.0 million (30 June 2021: $27.8 million), Challenger Capital Notes 2 $476.1 million (30 June 2021: $480.8 million), and Challenger Capital Notes 3 $408.7 million (30 June 2021: $407.9 million); controlled property trusts $386.0 million (30 June 2021: $396.3 million); controlled infrastructure trusts $179.3 million (30 June 2021: $182.3 million).
[4] Reserve Bank of Australia (RBA) Term Funding Facility made available to ADIs. Balance taken on as part of MLMF's acquisition. MLMF accessed its allowance to the facility in two tranches: in September 2020 with a repurchase date in September 2023 and in June 2021 with repurchase date in June 2024.

Repurchase agreements

CLC has entered into repurchase agreements with certain counterparties whereby fixed income securities are sold for cash, while simultaneously agreeing to repurchase the fixed income security at a fixed price and fixed date in the future. These agreements finance bonds held for hedging purposes and are interest bearing, with interest factored into the price at which the bonds are repurchased and paid on repurchase. All agreements as at 31 December 2021 are current and all mature by March 2022. They will continue to be rolled into new agreements in the future.

CLC uses Australian Government and Semi-Government Bonds 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.

Note 12 Deposits from customers

Deposits from customers	31 Dec 2021 $m	30 Jun 2021 $m
At call	68.8	—
Term deposits	83.8	—
Total deposits from customers	**152.6**	**—**

Maturity analysis	31 Dec 2021 $m	30 Jun 2021 $m
At call	68.8	—
Up to 3 months (excluding at call)	24.2	—
From 3 to 6 months	16.0	—
From 6 to 12 months	38.2	—
From 1 to 3 years	5.4	—
Total deposits from customers	**152.6**	**—**

Accounting policy

All deposits from customers are initially recognised at the fair value of the amount received, adjusted for any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest rate method.

Financial liabilities are classified and measured at amortised cost unless they are held for trading or designated by the entity as being at fair value through profit and loss (FVTPL).

Deposits from customers are held at amortised cost as they are not held for trading nor designated as being at FVTPL.

Interest expense incurred is recognised in the Statement of comprehensive income on an accrual basis.

Note 13 Dividends paid and proposed

	31 Dec 2021 $m	31 Dec 2020 $m
Dividends declared and paid during the year		
Final 30 June 2021 100% franked dividend: 10.5 cents (30 June 2020: nil)	70.7	—
Dividend proposed (not recognised as a liability at 31 December 2021)		
2022 interim 100% franked dividend: 11.5 cents (2021 interim: 9.5 cents)	78.0	64.0

A DRP will be in operation for the 2022 interim dividend.

Dividend franking credits

Franking credits available to shareholders are $172.8 million (30 June 2021: $118.8 million), based on a tax rate of 30%. The amount is calculated from the balance of the franking account as at the end of the reporting period, adjusted for franking credits that will arise after the end of the reporting period from the settlement of current liabilities for income tax and franking debits in respect of interest on Challenger Capital Notes 1, 2 and 3. The impact of the proposed dividend will be to reduce the balance of the franking account by $33.3 million. All dividends are franked at a tax rate of 30%.

Note 14 Earnings per share

	31 Dec 2021 cents	31 Dec 2020 cents
Basic earnings per share	41.8	33.2
Diluted earnings per share	33.9	27.3
	$m	**$m**
Profit attributable to ordinary shareholders	282.0	222.8
Add back interest expense on Challenger Capital Notes 1, 2 and 3	13.8	12.6
Add back interest expense net of tax on CLC Subordinated Notes	3.0	3.1
Total earnings used in the calculation of diluted earnings per share	**298.8**	**238.5**
Number of shares	**Number**	**Number**
Weighted average of ordinary shares issued	677,214,590	674,558,206
Weighted average of Treasury shares	(2,565,984)	(3,710,222)
Weighted average ordinary shares for basic earnings per share	**674,648,606**	**670,847,984**
Adjusted for potential ordinary shares:		
Weighted average effect of Challenger Performance Plan	13,337,571	5,870,879
Weighted average effect of Challenger Capital Notes 1, 2 and 3	133,366,647	136,328,771
Weighted average effect of CLC Subordinated Notes	59,070,235	59,070,235
Weighted average ordinary shares for diluted earnings per share	**880,423,059**	**872,117,869**

Accounting policy

Basic earnings per share is calculated by dividing the total profit for the period attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the financial period. The number of ordinary shares outstanding is net of Treasury shares held by the Challenger Performance Plan (CPP) Trust or under CPP deferred share purchase agreements in respect of equity incentive plan awards to employees.

The weighted average number of Treasury shares for the period was 2,565,984 (31 December 2020: 3,710,222).

Note 14 Earnings per share (continued)

Accounting policy (continued)

Accounting treatment of Capital Notes and subordinated debt

Challenger Capital Notes 1, 2 and 3 and subordinated debt are an effective source of funding for Challenger.

Each of the Capital Notes 1, 2, 3 and subordinated debt have convertibility features that would result in these instruments converting to ordinary shares under certain circumstances, including APRA determining CLC to be non-viable.

With the exception of Challenger Notes 1, it is Challenger's current intention to refinance each of these instruments at their respective call dates, or prior to the Mandatory Conversion Date, and therefore conversion to ordinary shares is unlikely. The remaining Capital Notes 1 will mandatorily convert to ordinary Challenger shares on May 2022. In the interim, they will continue to receive quarterly distribution payments up until their conversion.

Under AASB 133 ***Earnings per Share***, convertible debt is considered dilutive whenever the interest per potential ordinary share for each of these instruments is less than Challenger's basic EPS for the period. As such, a test is required at each reporting period to determine if they are included in the dilutive share count.

Diluted earnings per share is calculated by dividing the total adjusted profit attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the period adjusted for the effects of dilutive shares that may be converted under the terms of Challenger Capital Notes 1, 2 and 3 (Notes), CLC Subordinated Notes and shares granted under the Challenger Performance Plan (CPP).

The dilutive share count for Challenger's convertible debt (Challenger Capital Notes 1, 2 and 3 and subordinated debt) is based on the following formula:

$$\frac{\text{Face value of debt}}{\text{Conversion factor x Challenger's 20-day VWAP}^{1}\text{ share price}}$$

The conversion factor on all Challenger's convertible debt is 99% of the weighted average Challenger share price over the last 20 days of trading (subject to a minimum VWAP floor) in each reporting period.

An assessment of the dilutive impact of convertible securities is usually done by reference to the determination as to whether the interest received would be more or less than the earnings per share and whether it would be rational for a holder to receive coupon from the convertible security or dividends from holding the shares.

The profit attributable to ordinary shareholders is adjusted by $16.8 million interest on the Notes and CLC Subordinated Notes (31 December 2020: $15.7 million adjustment) for the diluted calculation when the Notes and CLC Subordinated Notes are considered dilutive.

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of authorisation of these financial statements.

[1] Volume-weighted average share price

Note 15 Fair values of investment assets and liabilities

Fair value determination and classification

Fair value reflects the price that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The majority of the Group's financial instruments are held in the life insurance statutory funds of CLC and, as a result, are required by AASB 1038 ***Life Insurance Contracts*** to be designated at fair value through profit and loss where this is permitted under AASB 9 ***Financial Instruments.***

Financial instruments measured at fair value are categorised under a three level hierarchy, reflecting the availability of observable market inputs when estimating the fair value. If different levels of inputs are used to measure a financial instrument's fair value, the classification within the hierarchy is based on the lowest level that is significant to the fair value measurement. The three levels are set out below.

Level 1 Unadjusted quoted prices in active markets are the valuation inputs for identical assets or liabilities (i.e. listed securities).

Level 2 Valuation inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) are used.

Level 3 There are valuation inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The unobservable inputs into the valuation of the Group's Level 3 assets and liabilities are determined based on the best information available, including the Group's own assessment of the assumptions that market participants would use in pricing the asset or liability. Examples of unobservable inputs are estimates about the timing and amount of cash flows, discount rates, earnings multiples and internal credit ratings.

Valuation techniques

The majority of the Group's listed and unlisted fixed income securities, over-the-counter derivative financial instruments and interest bearing liabilities including the subordinated debt issuance are classified as Level 2. This recognises the availability of a quoted price but not from an active market as defined by the accounting standard.

Fixed income securities where market observable inputs are not available are classified as Level 3. The Group's derivative financial instruments are traded over-the-counter so, while they are not exchange traded, there is a market observable price. Most of the fixed income securities and all of the government/semi-government securities have market observable prices.

Externally rated unlisted fixed income securities are valued by applying market observable credit spreads on similar assets with an equivalent credit rating and are classified as Level 2. Internally-rated fixed income securities are classified as Level 3 as the determination of an equivalent credit rating is a significant non-observable input.

Equity, infrastructure and property securities that are exchange traded are generally classified as Level 1. Where quoted prices are available, but are not from an active market, they are classified as Level 2. If market observable inputs are not available, they are classified as Level 3. Valuations can make use of cash flow forecasts discounted using the applicable yield curve, earnings-multiple valuations or, for managed funds, the net assets of the trust per the most recent financial report.

External unit holders' liabilities are valued at the face value of the amounts payable, being an approximation of fair value, and classified as Level 2. The portion of life investment contract liabilities classified as Level 2 represents products or product options for which the liability is determined based on an account balance, rather than a discounted cash flow as applied to the rest of the portfolio.

Cash and cash equivalents are carried at amortised cost. To determine a fair value where the asset is liquid or maturing within three months, the fair value is approximate to the carrying amounts. This assumption is applied to liquid assets and the short-term elements of all other investment assets and liabilities.

The mortgage SPVs have total equity attributable to residual income unitholders (RIU) at amortised cost of $0.3 million (30 June 2021: $0.4 million). The fair value of this RIU holders' asset is $25.2 million (30 June 2021: $31.3 million) and would be classified as Level 3 in the fair value hierarchy.

The loan assets attributable to the Bank are carried at amortised cost. The carrying amount of those assets less ECL is considered a reasonable approximation of their fair value.

Challenger Capital Notes 1, 2 and 3 have carrying values (inclusive of unamortised issue costs) of $27.7 million, $457.3 million and $379.6 million respectively. The fair value of these notes is $28.0 million, $476.1 million and $408.7 million respectively and they are classified as Level 1 in the fair value hierarchy.

Valuation process

For financial instruments and investment properties categorised within Level 3 of the fair value hierarchy, the valuation process applied in valuing such instruments is governed by the CLC Practice Note on Investment Asset and Financial Liability Valuation. The Practice Note outlines the Valuation Committee's responsibilities in the governance of the valuation of investment assets and financial liabilities for the purposes of financial reporting. All significant Level 3 financial instruments are referred to the Valuation Committee which generally meets monthly, or more frequently if required.

The table on the following page summarises the financial instruments and investment properties measured at fair value at each level of the fair value hierarchy as at the Statement of financial position date.

Note 15 Fair values of investment assets and liabilities (continued)

Valuation process (continued)

	Level 1 $m	Level 2 $m	Level 3 $m	Total $m
31 Dec 2021				
Derivative assets	—	620.3	—	620.3
Fixed income securities[1]	—	17,874.2	1,787.5	19,661.7
Equity and other alternatives	1.3	1,383.5	151.6	1,536.4
Infrastructure investments[1]	—	0.1	329.9	330.0
Hedged commodities	658.6	—	—	658.6
Property securities	—	—	93.3	93.3
Investment and development property[2]	—	388.0	3,496.2	3,884.2
Total assets	**659.9**	**20,266.1**	**5,858.5**	**26,784.5**
Derivative liabilities	1.6	404.2	—	405.8
Interest bearing financial liabilities	912.8	408.5	—	1,321.3
External unit holders' liabilities	—	4,381.8	—	4,381.8
Life investment contract liabilities	—	43.0	6,522.7	6,565.7
Total liabilities	**914.4**	**5,237.5**	**6,522.7**	**12,674.6**
30 Jun 2021				
Derivative assets	—	738.3	—	738.3
Fixed income securities	—	18,522.1	1,874.8	20,396.9
Equity and other alternatives	1.2	1,188.2	155.0	1,344.4
Infrastructure investments[1]	—	—	345.4	345.4
Property securities	—	—	88.0	88.0
Investment and development property[2]	—	396.0	3,389.7	3,785.7
Total assets	**1.2**	**20,844.6**	**5,852.9**	**26,698.7**
Derivative liabilities	0.8	506.8	—	507.6
Interest bearing financial liabilities	916.5	418.2	—	1,334.7
External unit holders' liabilities	—	3,632.2	—	3,632.2
Life investment contract liabilities	—	47.2	6,183.2	6,230.4
Total liabilities	**917.3**	**4,604.4**	**6,183.2**	**11,704.9**
31 Dec 2020				
Derivative assets	—	1,042.4	—	1,042.4
Fixed income securities	—	17,681.1	1,779.0	19,460.1
Equity and other alternatives	1.8	930.4	250.0	1,182.2
Infrastructure investments[1]	—	—	367.1	367.1
Property securities	—	—	85.5	85.5
Investment and development property[2]	—	—	3,663.4	3,663.4
Total assets	**1.8**	**19,653.9**	**6,145.0**	**25,800.7**
Derivative liabilities	—	682.3	—	682.3
Interest bearing financial liabilities	919.4	422.1	—	1,341.5
External unit holders' liabilities	—	3,031.5	—	3,031.5
Life investment contract liabilities	—	47.8	5,472.7	5,520.5
Total liabilities	**919.4**	**4,183.7**	**5,472.7**	**10,575.8**

[1] The Group has exposures to structured entities (entities designed so that voting or similar rights are not the dominant factor in determining who controls the entity, for example when any voting rights relate purely to administrative tasks) via investments in asset-backed finance vehicles (where it may act as a lender or purchaser of notes and/or residual income units) and securitisations (such as mortgages, finance leases and other types of collateralised vehicles). The Company assesses, at inception and at each reporting date, whether a structured entity should be consolidated based on the accounting policy. The maximum exposure to loss is limited to the reported fair value of the underlying securities plus any guaranteed undrawn commitments to the counterparties. At 31 December 2021, the carrying value of asset-backed financing assets was $54.5 million (30 June 2021: $76.7 million) with $58.1 million undrawn commitments (30 June 2021: $56.4 million) and securitisations was $5,114.4 million (30 June 2021: $4,517.9 million) plus $56.4 million undrawn commitments (30 June 2021: $20.4 million).

[2] Refer to Note 6 Investment and development property for valuation techniques and key unobservable inputs.

Note 15 Fair values of investment assets and liabilities (continued)

Level 3 sensitivities

The following table shows the sensitivity of Level 3 financial instruments to a reasonably possible change in alternative assumptions in respect of the non-observable inputs into the fair value calculation.

	Level 3 value[1] $m	Positive impact $m	Negative impact $m	Valuation technique	Reasonably possible change in non-observable input[2,3]
31 Dec 2021					
Fixed income securities	1,787.5	12.3	(33.0)	Discounted cash flow	Primarily credit spreads
Equity and other alternatives	151.6	11.5	(12.5)	Discounted cash flow, external financial report	Mortality rate, 5% change in valuation
Infrastructure investments	329.9	4.3	(4.2)	Discounted cash flow, external financial report	Primarily discount rate on cash flow models
Property securities[4]	93.3	4.7	(4.7)	External financial report	5% change in valuation
Investment contract liabilities	(6,522.7)	2.2	(2.2)	Discounted cash flow	Primarily expense assumptions
Investment and development property	3,496.2	170.5	(125.7)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Total Level 3	**(664.2)**	**205.5**	**(182.3)**		
30 Jun 2021					
Fixed income securities	1,874.8	13.5	(54.0)	Discounted cash flow	Primarily credit spreads
Equities and other alternatives	155.0	12.0	(13.0)	Discounted cash flow, external financial report	Mortality rate, 5% change in valuation
Infrastructure investments	345.4	4.3	(4.2)	Discounted cash flow, external financial report	Primarily discount rate on cash flow models
Property securities	88.0	4.4	(4.4)	External financial report	5% change in valuation
Life investment contract liabilities	(6,183.2)	2.4	(2.4)	Discounted cash flow	Primarily expense assumptions
Investment and development property	3,389.7	152.3	(124.9)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Total Level 3	**(330.3)**	**188.9**	**(202.9)**		
31 Dec 2020					
Fixed income securities	1,779.0	11.7	(51.4)	Discounted cash flow	Primarily credit spreads
Equity and other alternatives	250.0	16.6	(17.8)	Discounted cash flow, external financial report	Mortality rate, 5% change in valuation
Infrastructure investments	367.1	2.7	(2.7)	Discounted cash flow, external financial report	Primarily discount rate on cash flow models
Property securities[4]	85.5	4.3	(4.3)	External financial report	5% change in valuation
Investment contract liabilities	(5,472.7)	2.3	(2.3)	Discounted cash flow	Primarily expense assumptions
Investment and development property	3,663.4	166.5	(116.8)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Total Level 3	**672.3**	**204.1**	**(195.3)**		

[1] The fair value of the asset or liability would increase/decrease if the credit spread or discount rate decreases/increases or if expense assumptions and the other inputs increase/decrease.
[2] Specific asset valuations will vary from asset to asset as each individual industry profile will determine appropriate valuation inputs to be utilised.
[3] The effect of a change to reflect a reasonably possible alternative assumption was calculated by moving the credit band by one tier, adjusting the discount rates by between 50bps and 100bps, adjusting property capitalisation rates by 25bps (Australia) or 10bps (Japan), adjusting credit spreads by 50bps, changing the valuation of the unlisted schemes by 5% and adjusting the expense assumption allocation splits by 10%.
[4] The effect of a change to reflect a reasonably possible alternative assumption was calculated by moving the capitalisation rate by 25bps (Australia) or 10bps (Japan).

Note 15 Fair values of investment assets and liabilities (continued)

Level 3 sensitivities (continued)

Level 3 reconciliation

The following table shows a reconciliation of the movement in the fair value of financial instruments categorised within Level 3 of the fair value hierarchy during the period.

	31 Dec 2021		30 Jun 2021		31 Dec 2020	
	Assets $m	Liabilities $m	Assets $m	Liabilities $m	Assets $m	Liabilities $m
Balance at the beginning of the period	5,852.9	6,183.2	6,315.9	5,817.9	6,315.9	5,817.9
Fair value gains/(losses)	67.5	(6.5)	(54.7)	95.2	(80.2)	80.8
Acquisitions	1,326.3	1,869.7	1,688.0	3,208.7	634.6	1,305.8
Maturities and disposals	(1,347.0)	(1,523.7)	(1,688.5)	(2,938.6)	(725.3)	(1,731.8)
Transfers to other categories[1,2]	(47.4)	—	(407.8)	—	—	—
Balance at the end of the period	**5,852.3**	**6,522.7**	**5,852.9**	**6,183.2**	**6,145.0**	**5,472.7**
Unrealised gains/(losses) included in the Statement of comprehensive income for assets and liabilities held at the Statement of financial position date	67.5	6.5	(54.7)	(95.2)	(84.6)	137.6

[1] The Group transfers between levels of the fair value hierarchy when there is a change in the observability of the pricing inputs or a change to valuation methodology and are deemed to have occurred at the end of the reporting period.

[2] Transfers to/from other categories are due to changes in the market observability of inputs used in the valuation of financial instruments. There were no transfers between Level 1 and Level 2 during the reporting period. There were no transfers into Level 3 (30 June 2021: nil) and there were $47.4 million (30 June 2021: $407.8 million) of transfers out of Level 3 and into Level 2 during the reporting period.

Note 16 Collateral arrangements

Accounting policy

CLC receives collateral, where it is considered necessary, when entering into certain financial arrangements. The amount of collateral required is subject to management's credit evaluation of the counterparty which is performed on a case-by-case basis. As at 31 December 2021, $204.3 million (30 June 2021: $264.5 million) of cash received from third parties as collateral is recorded in payables and $56.6 million (30 June 2021: $74.6 million) of collateral assets received from counterparties was repledged by the Company to third parties.

Except in the event of default, collateral received can be called back by the counterparty in accordance with the financial arrangement. CLC is required to pledge collateral, as part of the standard terms of transactions, when entering into certain financial arrangements. Cash paid to third parties as collateral is recorded in receivables. Other investment assets transferred as collateral are not derecognised from the Statement of financial position as the risks and rewards of ownership remain with CLC. As at the reporting date, the fair value of cash and investment assets pledged are as follows.

Collateral pledged as security	31 Dec 2021 $m	30 Jun 2021 $m
Cash	177.5	269.9
Other investment assets[1]	6,499.1	6,675.5
Total collateral pledged	**6,676.6**	**6,945.4**

[1] Includes assets sold under repurchase agreements. Refer to Note 11 Interest bearing financial liabilities for more information.

Note 17 Acquisitions and disposals of subsidiaries

Acquisition of MyLife MyFinance

On 23 December 2020, Challenger Limited entered into an agreement to acquire 100% of the equity of MyLifeMyFinance Limited (MyLife MyFinance), a small ADI providing a suite of savings and lending products. The acquisition received formal approval from the Treasurer of the Commonwealth of Australia on 29 July 2021, with the transaction completing on 30 July 2021.

The acquisition of MyLife MyFinance provides the Group a highly strategic opportunity to significantly expand its secure retirement income offering, and access to Australia's term deposit market.

From the date of acquisition, MyLife MyFinance contributed $1.3 million of revenue and a normalised loss of $3.3 million before tax. Acquisition related transaction costs of $0.7 million have been incurred and recorded in other expenses in the Statement of comprehensive income in the prior year. Details of the fair values of the assets and liabilities acquired and goodwill on acquisition are as follows, and may be adjusted during the measurement period (up to one year) should information be obtained which results in adjustments to identifiable assets acquired or liabilities assumed.

	31 Dec 2021 $m
Total purchase price consideration	37.0
Less: fair value of net identifiable assets acquired	(17.9)
Goodwill on acquisition	**19.1**

Note 17 Acquisitions and disposals of subsidiaries (continued)

Acquisition of MyLife MyFinance (continued)

	Acquiree's carrying amount $m	Fair value $m
Assets		
Cash and cash equivalents	6.4	6.4
Investment assets – amortised cost	37.4	37.4
Loan assets	106.7	106.7
Receivables	0.2	0.2
Deferred tax asset	—	7.7
Other assets	0.3	0.3
Property, plant and equipment	0.1	0.1
Total assets	**151.1**	**158.8**
Liabilities		
Payables	0.7	0.7
Provisions	0.6	0.6
Deposits from customers	134.2	134.2
Interest bearing liabilities	5.4	5.4
Total liabilities	**140.9**	**140.9**
Net assets	**10.2**	**17.9**

Disposal of Accurium

On 1 November 2021, Challenger sold 100% of its equity in Accurium Pty Ltd and its parent entity Accurium Holdings Pty Ltd to CountPlus Limited for total purchase consideration of $9.1 million.

At the time of sale, the combined tangible net assets of Accurium totalled $0.2 million.

The Group recognised $8.7 million profit before tax from the sale. The profit on the sale is calculated as proceeds less tangible net assets less the relative value of goodwill associated with the operation being disposed of, and less disposal costs incurred. The relative goodwill amount was assessed as immaterial.

	31 Dec 2021 $m
Cash consideration	9.1
Less: carrying value of net assets of Accurium	(0.2)
Less: disposal costs	(0.2)
Total gain on disposal	**8.7**

Other than the acquisition of MyLife MyFinance and the disposal of Accurium, there were no other significant acquisitions or disposals of controlled operating entities during the period.

Note 18 Contingent liabilities, contingent assets and credit commitments

Warranties

Over the course of its corporate activity the Group has given, as a seller of companies and as a vendor of assets, including real estate properties, warranties to purchasers on several agreements that are still outstanding as at 31 December 2021. Other than noted below, at the date of this report, no material claims against these warranties have been received by the Group.

Parent entity guarantees and undertakings

The Company has extended the following guarantees and undertakings to entities that form part of the Group:

1. a guarantee supporting the corporate banking facility and certain other financial commitments, such as hedging arrangements;
2. letters of support in respect of certain subsidiaries in the normal course of business. The letters recognise the Company's intention to provide support to those subsidiaries so that they can continue to meet their obligations;
3. Australian Financial Services Licence deeds of undertaking as an eligible provider; and
4. guarantees to support contractual commitments on warranties to certain third parties.

Third party guarantees

Bank guarantees have been issued by third party financial institutions on behalf of the Group and its subsidiaries for items in the normal course of business, such as rental contracts. The amounts involved are not considered to be material to the Group.

Contingent future commitments

CLC has made capital commitments to external counterparties for future investment opportunities such as development or investment purchases. As at 31 December 2021, there are potential future commitments totalling $456.5 million (30 June 2021: $867.9 million) in relation to these opportunities.

The Group has made capital commitments to associates to subscribe for up to $10.1 million (30 June 2021: $11.8 million) of non-redeemable preference shares to enable them to meet their working capital requirements. Contractual obligations for future property repairs and maintenance are in place but cannot be quantified until required.

Subsidiary guarantees

CLC has provided a guarantee to a third party regarding the performance of its subsidiary in respect of certain reinsurance arrangements.

Contingent tax assets and liabilities

From time to time the Group has interactions and matters under review, audit or dispute with the Australian Taxation Office in relation to the taxation treatments of various matters including reportable tax positions.

Any potential tax liability resulting from these interactions is only provided for when it is probable that an outflow will occur and a reliable estimate of the amount can be made. No specific contingent liability amounts have been disclosed in relation to these matters as it is considered that it would be prejudicial to their conduct and outcome.

Other information

In the normal course of business, the Group enters into various contracts that could give rise to contingent liabilities in relation to performance obligations under those contracts. At the date of this report, the possibility of any outflow in settlement is remote.

Note 19 Subsequent events

On 13 September 2021, Challenger announced that it had entered into an agreement to sell its 30% equity interest in Whitehelm Capital Pty Ltd to PATRIZIA AG for €32.0 million (A$51.1 million). The transaction settled on 1 February 2022 and Challenger's sale consideration was paid in full, in cash. The provisional results from the sale are set out below.

- The Group will record a $44.6 million pre-tax gain on sale of an associate in the Statement of comprehensive income for the period ended 30 June 2022.The gain will be reported as a significant item in Note 3 Segment information in the 30 June 2022 Annual Report.
- The Group will derecognise $6.5 million of investment in associates in the Statement of financial position.
- The Funds Management segment will derecognise $5.2 billion of funds under management.

At the date of this financial report, no other matter or circumstance has arisen that has, or may, significantly affect the Group's operations, the results of those operations or the Group's state of affairs in future financial years which has not already been reflected in this report.

Directors' declaration

In accordance with a resolution of the Directors of Challenger Limited, we declare that, in the opinion of the Directors:

a) the financial statements and notes of Challenger Limited and its controlled entities (the Group) are in accordance with the ***Corporations Act 2001*** (Cth), including:
   (i) giving a true and fair view of the Group's financial position as at 31 December 2021 and of its performance for the period ended on that date; and
   (ii) complying with Australian Accounting Standards and the ***Corporations Regulations 2001*** (Cth);

b) the financial statements and notes of the Group also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board, which is disclosed in Section 1(i) Basis of preparation and statement of compliance;

c) there are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable; and

d) this declaration has been made after receiving the declarations required to be made to the Directors from the Chief Executive Officer and Chief Financial Officer in accordance with section 295A of the ***Corporations Act 2001*** (Cth) for the financial period ended 31 December 2021.

On behalf of the Board

P Polson
Independent Chair

16 February 2022

N Hamilton
Managing Director and Chief Executive Officer

16 February 2022

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Independent auditor's review report to the Members of Challenger Limited

Conclusion

We have reviewed the accompanying half-year financial report of Challenger Limited (the Company) and its subsidiaries (collectively the Group), which comprises the statement of financial position as at 31 December 2021, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the half-year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration. Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of the Group does not comply with the ***Corporations Act 2001***, including:

a) giving a true and fair view of the consolidated financial position of the Group as at 31 December 2021 and of its consolidated financial performance for the half-year ended on that date; and
b) complying with Australian Accounting Standar***d*** AASB 134 ***Interim Financial Reporting*** and the ***Corporations Regulations 2001***.

Basis for Conclusion

We conducted our review in accordance with ASRE 2410 ***Review of a Financial Report Performed by the Independent Auditor of the Entity*** (ASRE 2410). Our responsibilities are further described in the ***Auditor's responsibilities for the review of the half-year financial report*** section of our report. We are independent of the Group in accordance with the auditor independence requirements of the ***Corporations Act 2001*** and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 ***Code of Ethics for Professional Accountants (including Independence Standards)*** (the Code) that are relevant to our audit of the annual financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

Directors' Responsibility for the Half-Year Financial Report

The directors of the Company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards and the ***Corporations Act 2001*** and for such internal control as the directors determine is necessary to enable the preparation of the half-year financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Review of the Half-year Financial Report

Our responsibility is to express a conclusion on the half-year financial report based on our review. ASRE 2410 requires us to conclude whether we have become aware of any matter that makes us believe that the half-year financial report is not in accordance with the ***Corporations Act 2001*** including giving a true and fair view of the Group's financial position as at 31 December 2021 and its performance for the half-year ended on that date and complying with Accounting Standard AASB 134 ***Interim Financial Reporting*** and the ***Corporations Regulations 2001***.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Ernst & Young

Ernst & Young

Graeme McKenzie
Partner
Sydney
16 February 2022

Additional information

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Nick Hamilton (Managing Director and Chief Executive Officer)
John M Green
Steven Gregg
Masahiko Kobayashi
Heather Smith
JoAnne Stephenson
Duncan West
Melanie Willis

Company secretary

Linda Matthews

Website

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Go electronic

Challenger can deliver all of your shareholder communications electronically, by updating your details via Computershare Investor Services.

Online digital version of this report

The 2022 Interim Report is available at:

> **challenger.com.au/interimreport2022**

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