Australian Shareholders' Association

Australian Shareholders' Association Limited
ABN 40 000 625 669
Suite 11, Level 22
227 Elizabeth Street, Sydney NSW 2000
PO Box A398, Sydney South NSW 1235
t (02) 9252 4244 | f (02) 9071 9877
e share@asa.asn.au

Code	**Challenger Limited (CGF)**
AGM date	**29 October 2020**
Time and location	9.30am (Sydney time). Virtual
Registry	Computershare
Webcast	Yes
Poll or show of hands	Poll
Monitor	Elizabeth Fish, Nick Bury
Pre AGM Meeting?	Yes, virtual meeting with Chair Peter Polson, Joanne Stephenson, Stuart Kingham.

Please note any potential conflict as follows: The individuals involved in the preparation of this voting intention have a shareholding in this company.

Item 1	**Consideration of accounts and reports**
ASA Vote	No vote required

Summary of ASA Position

Governance and culture

Challenger's 2020 Corporate Governance Report and Sustainability Report are available online at challenger.com.au/corporategovernance2020 and Challenger.com.au/sustainabilityreport2020.

Financial performance

It was an extraordinarily disappointing year for shareholders, a statutory loss of $416m, the share price down to $4.41 and no final dividend.

The FY20 Investment Experience contributed $750.3m to this loss, for the last 5 years $958.0m.

When the ASA monitors commented on the significant losses the Chair's response was that we did not understand the company's business.

When asked as to whether CGF bought risk on its book to buy yield, and as to whether its derivatives trading was utilised to ameliorate risk and currency risk, given its Japanese activities segment, CGF said 'no' on both counts, and advised that its risk appetite is not to take interest rate, FX or inflation risk. They do hedge those impacts through the use of derivatives and hedges, so as to remove the P&L impacts from those risks. Japanese investors who buy CGF's annuity products in Australian dollars bear their own currency risk.

Over the past 5 years, according to its annual reports, CGF appeared to have realised aggregate profits of $629.6m on investing in fixed income securities, $296.8m on property and property securities, $29.9m on equity investments, $99.6m on infrastructure investments and $80.6m on FX translation and hedges.

It seems the greatest haemorrhaging in aggregate during the past 5 years was when trading interest rate derivatives, equity swap derivatives and credit default swap derivatives, where respective aggregate losses over the past five years have been $369.2m, $179.7m and $194.8m. This sum total of $743.7m was a big hit for shareholders to take.

CGF explained the company's position in fact to be as follows:

The company is required to mark all assets and liabilities to market prices on their applicable reporting date, a substantive portion of the apparent $743m loss was unrealised at reporting time, and since that time prices have moved in CGF's favour to date, so reducing this stated loss by several hundred million dollars at the time of writing. CGF also expects further gains to be realised in this regard going forward, as the prices of some of their instruments purchased will be resumed at 100 cents in the dollar at maturity date going forward, as compared to the much lower current redeemable prices that would be realised were CGF to have to sell these assets now.

The company has in fact been severely affected by the COVID pandemic. More than $1.5bn has come out of fund management operations due to superannuation funds withdrawing funds as customers switched and made early drawdowns. Rental relief and the impact on the valuation of commercial properties available for rent is also significant (see note 6 of the FY20 AR). The market related sell-off as a result of the coronavirus pandemic incurred significant investment losses close to $1,070m pre-tax. Approximately half of these losses are unrealised. COVID-19 has also limited employee recruitment in the second half of FY20, this impacted to a degree Challenger’s target to have 40% of management roles held by women.

Capital Raising

Challenger Capital notes 2 a hybrid debt instrument dated September 2014, came due for redemption or replacement in May 2020. The CGF board noting the significantly disrupted investment market conditions and volatility at the time caused by the coronavirus pandemic decided not to redeem or replace the notes. The terms of the Capital Notes 2 remain the same.

CGF intends to launch Challenger Capital Notes 3 soon, the proceeds will be used to repay Challenger Capital Notes 1, which is due to mature shortly. See item 6 in the Notice of Meeting.

In May 2020, Challenger carried out a selective institutional placement of $270m, with 55.2 million ordinary shares issued at $4.89 per share, raising net of costs $264.1m. In July the Company conducted a share Purchase Plan (SPP) for retail shareholders raising $35m, issuing 8.1m shares at $4.32 per share.

Directors

In December 2019 Mr Hiroyuki Lioka was appointed a non executive director (NED) an alternate for Mr Masahiko Kobayashi an executive of MS&AD Insurance Group Holdings (MS&AD). At the pre AGM meeting we asked why MS&AD would require an additional member on the CGF Board and were told that while Mr Masahiko Kobayashi is a committed board member there may be times when he is unable to attend board meetings held at short notice. In such instances Mr Hiroyuki Lioka will attend in his place. Neither of the MS&AD employees receive fees from CGF. MS&AD Insurance Group Holdings acquired additional CGF shares on market by during the year taking their holding to 14.95% of issued capital. MS&AD did not participate in the share purchase plan announced on 22 July 2020.

During FY20 CGF has acquired the remaining 66.7% of Assetsecure Pty Ltd, an asset held by the Challenger Life Company. Consideration was $30.8m with $8.2m being identified as fair value of the assets acquired, $22.6m being charged to goodwill. (note 26 re acquisitions)

Summary at FYE)	**2020**	**2019**	**2018**	**2017**	**2016**
NPAT ($m)	(416)	307.8	322.5	397.6	327.7
UPAT ($m)	343.7	396.1	406.1	384.9	361.7
Share price ($)	4.41	6.64	11.83	13.34	8.63
Dividend (cents)	17.5	35.5	35.5	34.5	32.5
TSR (%)	-28%	-41%	-8%	58.6%	37.6%
EPS (cents)	(68.4)	50.9	54	70.7	58.5
CEO total remuneration, actual ($m)	2.5	5.4	11.6	7.2	9.3

For 2020 the CEO's total actual remuneration was 28 times the Australian Full time Adult Average Weekly Total Earnings (based on May 2020 data from the Australian Bureau of Statistics).

Item 2a	**Re-election of Mr Stephen Gregg as a Director**
ASA Vote	**For**

Summary of ASA Position

Mr Gregg was first appointed to the Challenger Limited Board in October 2012. He holds a Bachelor of Commerce Degree from the University of NSW. Mr Gregg has extensive experience in management consulting and investment banking. He has worked in both the U.S.A. and the U.K. Recent senior executive roles include Partner and Senior Advisor at McKinsey and Company, and Global Head of Investment Banking at ABN AMBRO. Current non-executive directorships are at Tabcorp Holdings Limited and Ampol Limited. He was appointed Chair of Ampol in August 2017. Mr Gregg is Chair of Challenger's Group Audit Committee and is a member of the Group Risk, Remuneration and Nomination Committees.

As Mr Gregg has already served 8 years this may be his final term as the ASA will not classify a director as independent after 12 service. In regard to independence of board members the ASA notes that the Chair, Peter Polson, has been on the Board since 2004, and the CEO joined the Board in January 2019 as an Executive Director. Of the eight NEDs only two are female, 25%. Challenger has a gender diversity target of 40% but seems not to have applied this target to the Board. From past conversations the ASA monitors have had with the Chair we understood the board was going through a refreshment process. We hope Mr Gregg will speak to the meeting in regard to his contribution to the Board.

Item 2b	Re-election of Ms JoAnne Stephenson as a Director
ASA Vote	**For**

Ms Stephenson was first appointed to the Challenger Board in October 2012. She holds a Bachelor of Commerce and Bachelor of Laws (honours}, from The University of Queensland.
Ms Stephenson is a member of Chartered Accountants Australia and New Zealand and the Australian Institute of Company Directors. Previous executive experience includes a partnership with KPMG as well as internal auditing, risk management and consulting. Current non-executive directorships are with Asaleo Care Limited, Japara Healthcare and Myer Holdings Limited. In addition, Ms Stephenson sits on the Group Audit, Group Risk and Nominations Committees.
As with Mr Gregg, the ASA notes that Ms Stephenson has already served 8 years on the Challenger Board and this may be her last term due to independence issues. As the Directors skills matrix shown page 25 of the AR does not show how well each NED fulfils the requisite skills, the ASA hopes that Ms Stephenson will address the meeting, detailing the skills she brings to the board

Item 3	Adoption of Remuneration Report
ASA Vote	**Against**

Summary of ASA Position

The remuneration report is clear and easy to understand. We note there is greater clarity in reporting the % of STI awarded to KMP. There have been no changes to the methodology used in Fy19. For all KMP the STI award is set at 200% of fixed salary and maximum LTI at 225%

To establish the quantum of short term incentive (STI) awarded, the Board uses a balanced scorecard, with specific objectives for each KMP (page 31 AR). However,r as the published scorecard combines the criteria, the specific objectives and outcomes, the result for each KMP is unclear. In the published scorecards, there are three groups of measures; 50% are verifiable financial performance metrics, 20% are based on surveys of risk culture and employee engagement, 15% are Customer related measures with the remaining 15% based on strategic distribution initiatives. Four of the nine financial performance metrics are measured against normalised rather that statutory measures, which is disappointing as over the last five years normalised profit is inflated by $958m due to the “investment experience”.

The FY20 outcome in each group is measured in terms of full or partial achievement. The financials based on core measures, only partially achieved the target. People and customer measures and the strategic targets were only partially met. Table 4.4 in the Remuneration Report indicates that the CEO was awarded 20% of his STI maximum, other KMPs were awarded between 34% and 40% of their maximum.

STI incentives are granted in September following the June year end, in FY20 STIs were paid in equity (DPSRs) only. The equity awarded is deferred as 30% for years 1 & 2 and then 20% for years 3 & 4. The number of DPSRs granted is determined by the 5 day VWAP of Challenger shares prior to the September grant date.

The long term equity based incentive plan, (HPSRS) use a 5 day VWAP methodology to calculate the number of performance rights allocated. LTI has only one hurdle; absolute TSR compounded annually, set at target of 10% p.a. over 4 years. Prior to 2017 this target was 12% p.a. From 2017 onwards 50% of HPSR awards vest at 7%, then on a straight line until 10% is reached. ASA notes from table 4.8 of the Remuneration Report that TSR outcomes for grants made in 2015, and 16 were 100%, 95% respectively. Two thirds of HPSRs awarded are eligible to commence vesting on the third anniversary of the grant the remaining third on the fourth anniversary. HPSRS granted after 2019 will not vest until the 4th anniversary of the grant, and will be subject to retesting on the 5th anniversary. No HSPRS will vest to KMP at September 2020 and neither did any in Sept 2019 due to deterioration of TSR performance.

CEO rem. framework	Target* $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	1.275	19%	1.275	19%
STI - Cash	0	0	0	0
STI - Equity	2.559	38%	2.559	38%
LTI	2.868	43%	2.868	43%
Total	6.693	100.0%	6.693	100%

While there were no increases to KMP salaries and NED fees in FY20, when compared to the GIG Remuneration Guide, the average remuneration for NED's and Chairman of listed ASX 200 companies in the financial sector, with market cap of 2-5bn is $173,000 and $293,000 respectively. Challenger's board remuneration at $233,000 and $517,000 is well in excess of that benchmark. We asked about this matter at the pre AGM meeting and the Chair was quite dismissive. We do note however that in response to the impact of COVID-19 the Board has determined to reduce its base fees by 20% for an initial period of six months, commencing 1 June 2020. It will review the position after six months.

The ASA is unable to vote in favour of this resolution given the significant losses suffered by shareholders.

Item 4	**Approval of LTI grant to Mr Howes**
ASA Vote	**For**

Summary of ASA Position

The Board proposes to grant 714,579 HPSRs (long term share rights) to Mr Howes in respect of the year ending 30 June 2020. The number of HPSRs is calculated by dividing 225% of TFR (being $2,868,750) by the face value determined as the 5-day volume weighted average price (VWAP) of Challenger shares over the five trading days from 31 August 2020 to 4 September 2020 (being $4.01). The long term share rights plan has only one hurdle, absolute TSR compounded annually, set at target of 10% per annum over 4 years. 50% of HPSRS vest when a threshold performance of 7% is reached, then progress to fully vest when 100% of target is reached. No HPSRs vested to Mr Howes in FY20 as the minimum absolute TSR was not reached.

Item 5	**Ratification of the issue of institutional placement shares**
ASA Vote	**For**

Summary of ASA Position

That the issue of ordinary shares under the $270 institutional placement announced on the 22 June 2020, be approved by shareholders. As ASX rule 7 restricts the number of shares an ASX listed company can issue in a twelve month period, the purpose of item five is to refresh Challengers placement capacity so that the capacity would be the same as if the issue of shares under the placement had been approved by shareholders at the time the placement occurred. A favourable vote will allow Challenger flexibility in managing its future capital position. The ASA will support item 5.

Item 6	**Approval of the Issue of Challenger Capital Notes 3**
ASA Vote	**For**

Summary of ASA Position

The issue of $375 million Capital Notes. Challenger Capital Notes 3 are a hybrid debt instrument that Challenger intends to launch in the next few weeks. The proceeds will be used to repay Challenger Capital Notes 1, which is due to mature shortly. Challenger Capital Notes 1 will be replaced by Challenger Capital Notes 3 and this will have no impact on the overall level of borrowings. The ASA will support this item.

Item 7	**Adoption of new constitution**
ASA Vote	**For**

Summary of ASA Position

At the pre AGM meeting we asked why item 7 was necessary and the response was as follows “Challenger’s constitution has not been updated since the company was formed and listed in 2003. Since then there have been significant changes to corporate governance principles and business practices. For example, the name of the company has changed but had not been reflected in the constitution, and the constitution did not allow for electronic communications or AGMs to be held on line. There should not be anything contentious in the new constitution”. We also sought confirmation from the ASA’s policy spokesperson, and will support this item.

Item 8	**Renewal of proportional takeover provisions**
ASA Vote	**For**

Summary of ASA Position

A proportional takeover bid occurs when a bidder offers to acquire only a portion of a shareholder's shares, leaving the shareholder with a possibly un-marketable shareholding.

Proportional takeover provisions are contained in the text of Challenger's existing Constitution however they had not been approved by shareholders within the last three years and are therefore deemed by the Corporations Act to have been omitted from the Constitution. Item 8 allows Challenger to refresh the provision. The ASA will support this renewal proposal.