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

The new Bank makes a loss!

Company/ASX Code	**Challenger (CGF)**
AGM date	**27 October 2022**
Time and location	9.30am AEDT The Wesley Theatre, Wesley Conference Centre, 220 Pitt Street, Sydney NSW 2000
Registry	Computershare
Type of meeting	Hybrid
Poll or show of hands	Poll on all items
Monitor	Elizabeth Fish assisted by Nick Bury
Pre AGM Meeting?	Yes with Chairman Duncan West, Joanne Stephenson (Chair of the Remuneration Committee) and Mark Chen (G.M. Investor Relations)

Monitor Shareholding: The individual(s) involved in the preparation of this voting intention have a shareholding in this company.

Summary of issues for meeting

The greatest concern is the loss making bank purchased in FY21 for $35m and the impairment of $19.1m in respect of goodwill relating to that acquisition.

Proposed Voting Summary

No.	Resolution description	
2a	Re-election of Mr Masahiko Kobayashi as a Director	For
2b	Re-election of Ms JoAnne Stephenson as a Director	For
3	Adoption of Remuneration Report	For
4	Approval of the grant of long-term hurdled Performance Share Rights to the CEO Mr Nick Hamilton	For

Summary of ASA Position

Consideration of accounts and reports - No vote required

<u>Governance and culture</u>

Challenger's 2022 Corporate Governance Report and Sustainability Report are available online at CGF.com.au/corporategovernance2022 and CGF.com.au/sustainabilityreport2022. At the pre-AGM meeting, ASA asked about the Directors skills matrix shown on page 27 of the Annual Report (AR). We asked what process was used to complete this matrix and how frequently it was reviewed. We were told that the matrix was reviewed annually, directors were assessed each year and that the skills were mostly identified by the individual.

Financial performance

CGF had another slow year, reporting a Statutory NPAT of $254.3m to June 2022. However, there was an increase in the share price from $5.41 to $6.64 and an increase in dividends paid for a one-year simple total shareholder return (TSR) of over 30%. Funds under management have decreased by $12.4b or 11% over the previous year. Net outflows in FY22 were $8.5b and this included $5.2b de-recognition following the sale of Whitehelm. In addition, a percentage of outflows was occasioned by the exit of one large investor, who may resume as a CGF investor at a future time.

Life annuity sales increased by 12% to $5,122.7m over the previous year. There were some changes to property valuations as a result of exchange rate movements. We understand from the pre-AGM meeting that CGF missed its Return on Equity target of the RBA cash rate + 12% by just 30bps.

ASA notes from the Management Analysis of Normalised Results, a table that removes unrealised losses and gains from statutory profit, (page 22 of the AR) that in this year the Investment Experience is negative $81.2m. Aggregate losses from the investment experience for the last seven years remains at $720.6m an increase of $81.2m over FY21. This latest loss experienced as a consequence of lower and domestic and international equity markets (MSCI down 19% in 2H22) offset by some property revaluations in addition to valuation losses driven by significant widening of credit spreads across the fixed income portfolio in 2H22. Previously CGF needed to divest some assets very cheaply to meet its redemption and capital adequacy ratio requirements, which had markedly impacted on its then share price, but is now seemingly cashed up to ride out any prospective forthcoming recession.

Key events

On note 27 in the Fy22 AR the Group has recognised an impairment of $19.1m in respect of goodwill relating to acquisition of Mylifemyfinance Bank acquired in December 2020 for $35m. At the time of purchase the company released a statement saying “The acquisition is highly strategic and provides CGF the opportunity to significantly expand its secure retirement income offering.” One-off transaction and integration costs of $8m were incurred in FY21 in relation to this acquisition. In FY22 the bank incurred a loss of $11m before interest and tax, not including the impairment expense. At the pre-AGM meeting we asked Mr Hamilton, how CGF would recover the losses the bank was making including the goodwill impairment. His response was that the Bank was acquired to provide access to term deposits for CGF customers, but then market conditions changed and CGF was certainly not getting the expected benefits. Presently the company is undertaking a strategic review which will look at all the options he said.

There were no capital raisings or buy backs in FY22. On 13 September 2021, CGF announced the sales of its 30% equity interest in Whitehelm Capital to Patrizia AG for $50m. The sale was completed in February 2022 and the consideration paid in cash.

In February 2022, CGF and Apollo entered into a joint venture to build a lending platform in Australia and New Zealand that will provide structured and asset-backed lending solutions, such as accounts receivable finance, invoice and trade finance, equipment finance, auto finance, agricultural funding and other bespoke credit solutions. Post the pre-AGM meeting the monitor tried unsuccessfully to find out who potential customers might be.

Key Board or senior management changes

Peter Polson will be standing down as Chairman after 19 years on the Board at the conclusion of the FY22 AGM. The new Chair will be Duncan West. Duncan West has served on the CGF Board as an Independent Non-Executive Director since 2018. His qualifications and experience are shown on p 53 of the AR.

The CEO Mr Howes announced his resignation in August 2021, although he agreed to complete a handover period to end in March 2022. His replacement Mr Nicholas Hamilton was announced in December 2021. Mr Hamilton joined CGF in 2015 and his most recent position was as Chief Executive Funds Management and Business. ASA, noting that Mr Howes had only held the position since January 2019, asked Mr Hamilton why there was such a rapid turnover in CEO's? His response was that Mr Howes was retiring. He had been with CGF for some years and he did not think the turnover particularly rapid.

Summary

(As at FYE)	**2022**	**2021**	**2020**	**2019**	**2018**
NPAT ($m)	254.3	592.3	(421.1)	310.7	322.5
UPAT ($m)	321.5	278.5	343.7	396.1	406.1
Share price ($)	6.84	5.41	4.41	6.64	11.83
Dividend (cents)	23.0	20.0	17.5	35.5	35.5
Simple TSR (%)	30.7%	27%	(8%)	(41%)	(8%)
EPS (cents)	37.5	88.2	(68.4)	50.9	54.0
CEO total remuneration, actual ($m)	1.8	2.2	2.5	5.4	11.6

The CEO's total remuneration for FY22. includes the period prior to his appointment in December 2021 when his position was Chief Executive, Funds Management. No LTI awards vested in FY22.

Re-election of Mr Masahiko Kobayashi as a Director

Mr Kobayashi was first appointed to the Board in August 2019. He holds an executive position with MS Primary, a subsidiary of MS&AD, as Director and Senior Executive Officer (Enterprise Risk Management and Investment Risk and Operations Management). He has held several executive positions for Japanese companies in Singapore and the United Kingdom. He holds a Bachelor of Law from Kyoto University and an MBA from the Questrom School of Business, Boston University. Mr Kobayashi joined the board in March 2019 as a result of MS&AD increasing its CGF shareholding to > 15% of issued capital. He sits on the nominations sub-committee but is not considered to be an independent director and does not accept a director's fee from CGF. This means there are now two non-independent directors on this board. ASA will vote open proxies in favour of Mr Kobayashi's re-election and we hope he will speak to the meeting.

Re-election of Ms JoAnne Stephenson as a Director

First elected in October 2012, Ms Stephenson holds Bachelor of Commerce and Bachelor of Laws degrees. She is a member of the Australian Institute of Chartered Accountants and the Australian Institute of Company Directors. She was previously a partner with KPMG. Ms Stephenson also chairs the Board of Myer Holdings Limited and CGF's Remuneration Committee and is a member of the Group Risk, Group Audit and Nomination committees. Ms Stephenson holds 26,629 CGF shares, equivalent to a year's board fees. ASA notes that Ms Stephenson has already served 9 years on the Board and that after 12 years, ASA will no longer consider her to be independent due to the length of time served. The Board however has 6 non-executive directors, 4 of whom joined the Board after 2016. ASA will vote open proxies in favour of Ms Stephenson's re-election and we hope she will speak to the meeting.

Adoption of Remuneration Report

The short-term incentive (STI) structure is still based on a balanced scorecard outcomes. The CEO's scorecard and outcomes are shown on page 59 of the AR. We note that 40% of the measures are financial, 10% strategic, 30% relate to people, culture and 20 relate to customer satisfaction. We find that two of the financial measures are based on normalised targets, and consider that the capital position, another financial measure comes about due to decisions of the Board rather than Executives and is not an effective measure. Further the final 50% of measures do not offer quantifiable performance metrics to support the award decisions. There is no information on how the other 4 key management personnel (KMPs) are assessed, apart from seeing the % of target and of maximum (stretch) achieved.

In FY21, CGF introduced a calculation termed an STI modifier. The modifier reduces the awarded % of target by whichever % the Board considers is appropriate. For example, if a KMP achieves 80% of target they would receive 56% due to the modification process. No modifier was applied in FY22. 50% of awarded STI is paid as cash with the remaining 50% paid as equity with 30% vesting in at the end of years 1 and 2, and 20% vesting at the end of years 3 and 4, subject to continuous service.

There were no fixed remuneration increases for KMPs in FY22 apart from an increase to Mr Hamilton on his appointment as CEO in January 2022. The Rem. report notes his total target remuneration is 16% less than his predecessors' as the Board continues to rebase executive remuneration.

From 2019, the long-term equity based incentive plan, (hurdled performance rights or HPSR) uses 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. HPSRs granted after 2019 will not vest until the 4th anniversary of the grant and will be subject to retesting on the 5th anniversary, although with a higher hurdle is applied in year five. No HSPRs vested to KMP at September 2021 or at September 2022 due to poor TSR performance with the share price in 2022 barely ahead of the 2019 share price. ASA notes that CGF's Remuneration Committee is aware of shareholders concern regarding the single LTI hurdle and is committed to undertaking a comprehensive review and consultation with shareholders now that APRA's new standard is released (CRS 511). ASA considers the committee should attend to providing more quantifiable STI performance metrics for KMPs, especially when we see that a KMP has exceeded their target and there is no indication as to how this occurred or what the stretch target was.

Although ASA has the impression that the STI's are designed to avoid scrutiny, the remuneration as a whole and in particular for the CEO is not excessive. We note that no long term entitlements have vested in the last three years and are also aware of the remuneration committee's commitment to rebase executive remuneration as positions become vacant. We will vote open proxies in favour of the remuneration vote.

Approval of Equity Grant of Long-Term Hurdled Performance Share Rights to the CEO Mr Nick Hamilton

Mr Hamilton is eligible for a long-term incentive each year. Currently this award is set at 225% of TFR, that is $2,418,750 and is awarded in the form of a single HPSR tranche. The Board proposes to grant 386,381 HPSRs to Mr Hamilton. The number of HPSRs is calculated by dividing 225% of TFR by the 5-day volume weighted average price (VWAP) of CGF shares over the five trading days from Friday 2 September 2022 to Thursday 8 September 2022 (being $6.26). Details of the Performance Hurdles are covered in the Remuneration Report. Mr Hamilton's remuneration framework is shown in appendix 1. ASA will vote open proxies in favour of this resolution.

Appendix 1
Remuneration framework detail

CEO rem. Framework for FY22	Target* $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	1.075	22%	1.075	19%
STI - Cash	0.715	14.5%	1.075	19%
STI - Equity	0.715	14.5%	1.075	19%
LTI	2.418	49%	2.418	43%
Total	4.923	100%	5.643	100%

The amounts in the table above are the amounts that are envisaged in the design of the remuneration plan. *Target remuneration is sometimes called budgeted remuneration and is what the company expects to award the CEO in an ordinary year, with deferred amounts subject to hurdles in subsequent years before vesting. The CEO Mr Hamilton commenced in January 2022.