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Some years are better than others

Company/ASX Code	Challenger Limited/CGF
AGM date	26 October 2018
Time and location	9.30am, Wesley Centre, 220 Pitt Street, Sydney
Registry	Computershare
Webcast	No
Poll or show of hands	Poll on all items
Monitor	Elizabeth Fish assisted by Joyce Yong
Pre-AGM Meeting?	Yes, with Chair Peter Polson

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

Summary of ASA Position

Challenger has had a disappointing year. The share price fell by $1.51, statutory net profit after tax (NPAT) by 18%, while normalised NPAT increased by 5.5%. The difference is significant and one-off items valued at $7.6m and investment experience after tax valued at $76.6m. The investment experience adjustment (IEA) serves to isolate the volatility arising from asset and liability valuation volatility. (There are more details on IEA in note 3 of the AR 18). The life business increased assets under management by 15%, with life sales increasing by 12% and total funds under management by 17%. The "one-off items" consisted of: $7m relating to writing off capitalised software and redundancy costs incurred in relation to a number of discontinued projects and operational functions in 2018. $6.4m relates to the write back of deferred consideration in respect of the acquisition of Dexion Capital in 2015 (now called Fidante Partners Europe). The acquisition price was subject to business performance, which has been lower than expected, resulting in a recovery of part of the acquisition price.

Subsequent to the pre-AGM meeting, we noted in the short-term incentive (STI) performance snapshot some criteria regarding the platform partnership with AMP and asked if the Board had any concern regarding the continuing partnership with AMP. In response we were told that there is no formal partnership with AMP and the annuity relationship referred to pertains to making Challenger's annuities available via AMP's superannuation and investment platforms, making it simpler and easier for AMP advisers to include annuities in their clients' portfolios.

Three new non-executive directors (NEDs) were appointed to the Board during the year and two resigned. The resignation of Mr Grunzwey came as a surprise to the ASA. From discussions we had with the Chair when Mr Grunzwey stood for re-election two years ago it seemed that he provided important feedback to Magellan on the state of the US market. When asked about the resignation, the Chair said that due to the relationship with Colony being dissolved no board seat was required. He expressed disappointment that Mr Grunzwey thought he would be too busy to remain on the Challenger Board but believed Challenger would look to the two new US boutique partnerships, Garelick Capital Partners in Boston and Latigo Partners in New York, to provide information on the US market. Ms Shannan's retirement in September 2017, was covered in the report on the 2017 AGM.

In August 2017, Challenger issued 38.3 million new ordinary shares at $12.97 per share to MS&AD Insurance Group Holdings. At June 2018 MS&AD's holdings have increased to 57.3m shares; 9.38% of the issued capital through on market purchase. At the pre-AGM meeting the Chair admitted some disappointment with sales in Japan. He thought there may have been some impact from rising interest rates in the US.

At the pre-AGM meeting we commented that interest income in 2018 financial year (FY18) was 38% of investment revenue and asked the Chair as if he thought rising interest rates in the US and Europe would affect Challenger. His response was that as Challenger held both loans and investments in these areas any such rises would not have a significant effect.

We asked about any concerns with the ASX's proposed move to blockchain technology, in particular if he thought it might have a detrimental effect on Challenger and if Challenger is ready. Mr Polson said he thought the two-day settlement system, along with instantaneous change in ownership, should not create any issues for Challenger and on the whole he thought it would be a far more secure system.

The ASA commented on the drop in the share price and asked the Chair for some insight on this. He said there were a number of contributing factors including; the issuing of shares to MS&AD, that MS&AD had been in the market for additional shares, disappointing Japanese sales, the political environment, the question of what will happen as a result of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. In fact, he said "there was a wall of worry and uncertainty out there".

He went on to confirm that Challenger has not been called to the Royal Commission.

(As at FYE)	**2018**	**2017**	**2016**	**2015**
NPAT ($m)	322.5	397.6	327.7	299.0
UPAT ($m)	406.1	384.9	361.7	334.0
Share price ($)	11.83	13.34	8.63	6.72
Dividend (cents)	35.5	34.5	32.5	30.0
TSR (%)	-8%	58.57%	37.64%	-.56%
EPS (cents)	54.0	70.7	58.5	54.8
CEO total remuneration, actual ($m)[1]	11.6	7.2	9.3	8.9

[1] As calculated by ASA using current market values of securities on vesting during the year (relating to grants 2013-2016)

For 2018, the CEO's total actual remuneration was **139 times** the Australian Full time Adult Average Weekly Total Earnings (based on May 2018 data from the Australian Bureau of Statistics).

Item 2 (a)	**Re-election of Mr Stephen Greg as a Director**
ASA Vote	**For**

Summary of ASA Position

Mr Greg was first appointed in October 2012. He holds Bachelor of Commerce degree. He has been a member of the Board of Tabcorp Holdings since July 2012 and was appointed Chair of Caltex Australia Ltd in August 2017. In addition, he is a member of Challenger's Risk, Audit, Remuneration and Nominations committees.

His recent work experience includes a partnership and senior executive roles with McKinsey and Co and ABN AMRO.

Mr Greg presently holds 14,000 Challenger shares, meeting ASA's expectation for skin in the game. ASA will support Mr Greg's re-election and hope he will speak at the meeting.

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

Summary of ASA Position

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 sits on the Board of Asaleo Care Ltd, Japara Healthcare Ltd and Myer Holdings Ltd. In addition, she chairs Challenger's Group Risk and Group Audit committees. Ms Stephenson holds 15,000 Challenger shares, equivalent to a year's board fees. ASA will support Ms Stephenson's re-election and we hope she will speak at the meeting.

Item 2 (c)	**Election of Mr John M Green as a Director**
ASA Vote	**For**

Summary of ASA Position

Mr Green joined the Board in December 2017. He holds Bachelor of Laws and Bachelor of Jurisprudence degrees, is a Fellow of the Australian Institute of Company Directors, and Senior Fellow of FINSIA. He is Deputy Chair of QBE Insurance Group Ltd and director of the Cyber Security Cooperative Research Centre. Mr Green was previously partner at two law firms. He was an executive director at Macquarie Group and NED at Worley Parsons until October 2016. In addition, he is a member of Challenger's Group Risk, Audit and Nominations committees. Mr Green does not hold any Challenger shares. While Mr Green does not appear to have "skin in the game" but we appreciate he has only recently joined the board. ASA will support Mr Green's election and hope he will speak at the meeting.

Item 2 (d)	Election of Mr Duncan West as a Director
ASA Vote	**For**

Summary of ASA Position

Mr West joined the Board in September 2018. Mr West holds a Bachelor of Science in Economics degree. He is a fellow of the Chartered Insurance Institute, and a member of the Australian Institute of Company Directors. He has held senior positions at CGU Insurance, Vero Insurance in addition to being EGM of insurance at MLC. Additional NED directorships are with Glenworth Mortgage Insurance Australia Ltd, appointed in 2018. ASA will support Mr West's election and hope he will speak at the meeting.

Item 2 (e)	Election of Ms Melanie Willis as a Director
ASA Vote	**Undecided**

Summary of ASA Position

Ms Willis joined the Challenger Board in December 2017. Ms Willis holds a Bachelor of Economics and Bachelor of Law, Tax and is a Fellow of the Australian Institute of Company Directors. Ms Wills has held senior executive roles at NRMA investments, Deutsche Bank and Bankers Trust. Past non-executive directorships include Ardent Leisure Ltd, Ardent Leisure Management Ltd, Mantra Group Ltd and Pepper Group Ltd. Mantra Group and Pepper Group have both delisted due to takeovers. Presently Ms Wills is NED and Chair of the Audit and Risk committees of Southern Cross Media Ltd. Ms Willis holds 149,892 Challenger. ASA would like to support her election and hope she will speak at the meeting and in particular regarding the lessons and skills learned from Dreamworld accident that are applicable to the Challenger board.

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

Summary of ASA Position

The remuneration report is clear and easy to understand. There are some changes to the methodology of previous years.

None of the tables shown in 2018 annual report (AR) directly reflect actual take home pay as advocated by the ASA. Following is a table showing actual remuneration which includes equity awards that vested in FY18 and distribution of dividends on unvested shares. Each vesting Deferred Performance Share Rights (DPSRS) and Hurdled Performance Share Rights (HPSRS) is valued at the VWAP in the five days prior to the grant at 17 September of $12.26.

KMP Take Home pay in 2018[1]	Fixed	Cash STI	DPSRS	HPSRS	Dist from CPP Trust	Total
B Benari	1,340,151	887,500	2,259,863	6,901,384	201,692	11,590,590
R Howes	751,802	712,500	1,830,285	3,986,405	118,750	7,399,741
I Saines	864,069	450,000	365,522	1,588,619	82,473	3,350,683
A Tobin	699,253	462,500	1,094,396	2,432,040	77,890	4,766,079
C Plater	693,123	612,500	1,129,594	1,765,579	78,709	4,279,505
	4,348,398	3,125,000	6,679,660	16,674,026	559,514	31,386,598

[1] As calculated by ASA using current market values of securities on vesting during the year (relating to grants 2013-2016)

To establish the quantum of STI awarded, the Board uses a balanced scorecard, with specific objectives for each key management personnel (KMP) (page 31 AR). There are some changes to the scorecard used in earlier years. In FY18 there are 10 measures of specific objectives. Of these only one is based on verifiable financial performance metrics. Two others are based on growth targets specific to the industry such as distribution and mix but these targets have been combined with a non-verifiable criteria such as “support superannuation reform through ongoing engagement and advocacy”. Other targets relate to achieving “leading industry benchmarking results around customer and partner service and support” and “maintaining brand strength and monitoring through appropriate use of marketing, thought leadership, media and industry awards”, most of which are relevant to the business but not necessarily verifiable. Outcome in all categories is measured in terms of below or above. We are not told what the target is, neither is it possible to establish how much each of the measures contribute to the final outcome for each KMP. However, we note that the verifiable measure achieved its target. Given that STI incentives are not granted until September following the June year end, are partially paid in cash and the equity portion (DPSRs) vest 50% each on the first and second anniversary of the grant it is not possible to establish the quantum of outcome achieved in FY18. ASA is concerned with this lack of disclosure given this matter was highlighted in the 2017 voting intentions. The number of DPSRs granted is determined by the 5-day VWAP of Challenger shares prior to the September grant date.

For the long-term equity-based incentive plan, (HPSRS) fair value (Monte Carlo methodology) is used to calculate the number of performance rights allocated. Long-term incentive (LTI) has only one hurdle; absolute total shareholder return (TSR) compounded annually, set at target of 10% p.a. over 4 years (from 2017 onwards). Previous 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 4.5 of the remuneration report that TSR outcomes for grants made in 2012, 13 and 14 were 33%, 39% and 24% respectively, so all HSPRS vested at September 2017 and in the previous year. KMP do not appear to be particularly challenged by their target. Two thirds of HPSRs awarded are eligible to commence vesting on the third anniversary of the grant with the remaining third on the fourth anniversary.

We note that KMP wages overall have increased by 25% over FY17. The CEO’s total take home pay has increased by 62% over 2017. His fixed pay increased 6.7% and other KMP had similar increases. NED board fees have remained the same as in FY17 but some subcommittee member fees have increased by $2,250.

ASA does not support the use of fair value to calculate the number of performance rights issued, and consider that there should be at least two hurdles for an LTI scheme. ASA considers that dividends should not accrue or be paid on unvested shares. Also the disclosure on the STI scheme is poor. KMPs take home pay is well in excess of the company's peers. Therefore, we will vote against the remuneration report.

The individual involved in the preparation of this voting intention has a shareholding in this company.