

Challenger Limited

Annual Report 2013

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Challenger Limited is an ASX-listed investment management company established in 1985

Our vision and strategy

Challenger's vision is to provide Australians with financial security in retirement. Our teams are committed to achieving this goal, and their efforts are being invested in the following strategies to achieve our long-term vision.

Challenger's vision

Provide Australians with financial security in retirement

Challenger's strategies

- Increase the Australian retirement savings pool allocation to secure and lifetime income products
- Be recognised as the leader in retirement income solutions in Australia
- Be an active investment manager providing superior returns through aligned platforms
- Deliver quality brands, products, service and platforms demonstrating value for money
- Drive a culture where our people are highly engaged with a strong risk and compliance focus

Life

Leading provider of annuities and guaranteed retirement incomes in Australia

The Life business is regulated by the Australian Prudential Regulation Authority (APRA) and provides products aimed at investors seeking the security and certainty of guaranteed cash flows with protection against market, inflation and longevity risks.

Annuity premiums, along with shareholder capital, are invested in a diversified and high quality portfolio of assets to deliver predictable, long-term cash flows to meet commitments to our customers.

Funds Management

Australia's seventh largest and fastest growing investment manager

Challenger's Funds Management business comprises Fidante Partners and Aligned Investments, and is Australia's seventh¹ largest investment manager.

Fidante Partners comprises co-owned, separately branded, active fixed income and equity investment managers. Fidante Partners provides administration, distribution and partnership support to the investment managers and shares in the profits of the investment managers through its equity ownership.

Aligned Investments originates and manages assets on behalf of the Life business and third-party investors. Aligned Investments invests in fixed income, asset backed securities, property and infrastructure assets.

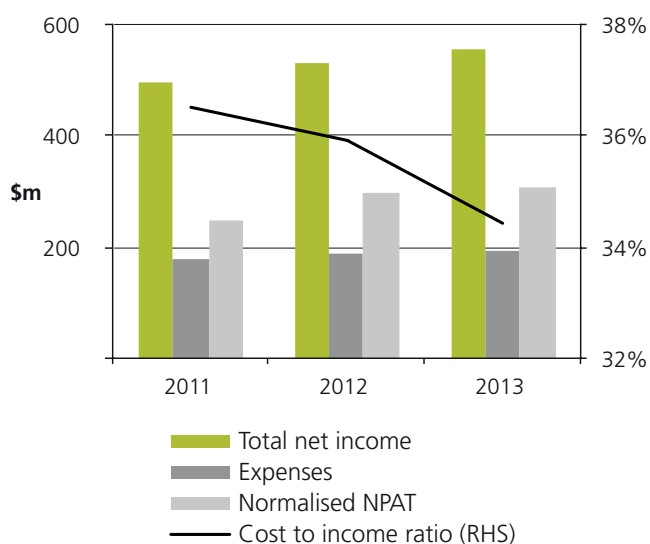
¹ Rainmaker Roundup – June 2013.

Results at a glance

Strong operating metrics delivered, with all key financial targets met or exceeded

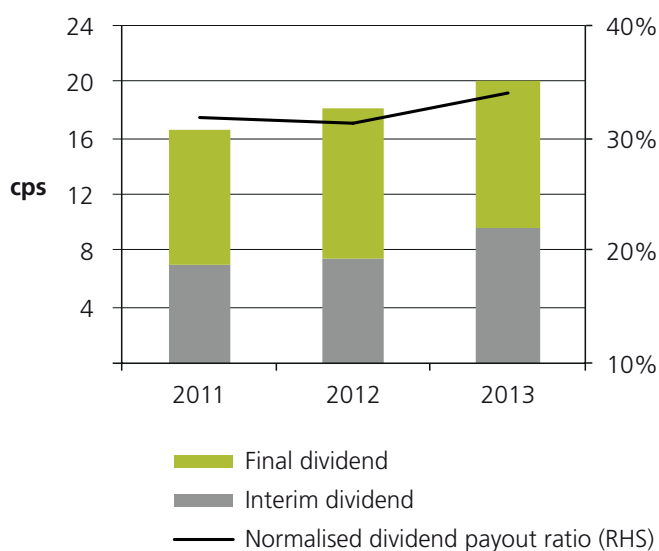
Financial performance

- 2013 normalised net profit after tax¹ (NPAT) increased by 4% to \$309 million
- Net income increased by 5% to \$557 million. Expenses increased by 2% in 2013, and cost to income ratio fell by 1.5 percentage points to 34.4%
- Statutory NPAT¹ increased strongly to \$417 million, up from \$149 million, due to higher normalised NPAT and positive investment experience



Dividend and payout ratio

- 2013 dividends up 11% to 20.0 cents per share (unfranked) and payout ratio of 34%
- 14 million shares bought back in 2013
- 2014 dividend payout ratio increasing to range of 35% to 40%
- Partial franking (40% to 50%) expected to recommence for final 2014 dividend



¹ Challenger's normalised profit framework and reconciliation to statutory profit is disclosed in the Directors' Report on pages 31 to 33.

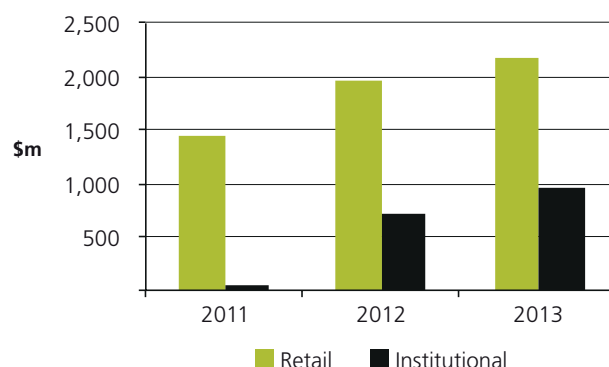
Assets Under Management (AUM) growing strongly

- Total AUM up 34% from \$33.4 billion to \$44.8 billion at 30 June 2013
- Life's AUM increased by 10% in 2013, driven by sales and positive market impacts
- Funds Management FUM increased by 33% in 2013 as a result of strong Fidante Partners net flows and positive market impacts



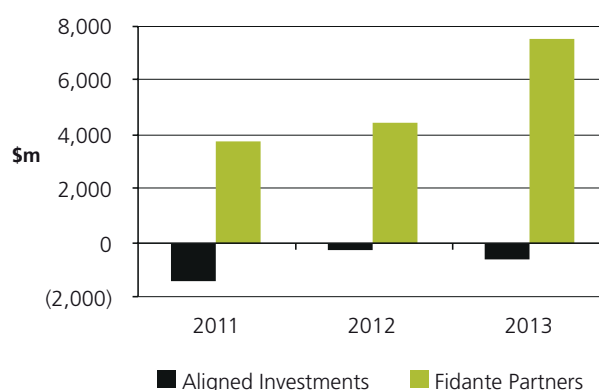
Life annuity sales driven by changes in demographics and retiree risk preferences

- Total annuity sales increased by 18% to \$3.1 billion in 2013
- Record retail annuity sales of \$2.2 billion in 2013, up 12%
- Institutional sales up 35% in 2013 to \$1.0 billion, mainly representing reinvestment of maturities



Funds Management net flows driven by distribution footprint and strong investment performance

- Funds Management net flows up 65% in 2013 to \$7.0 billion
- Flows driven by strong investment performance by Fidante Partners
- Aligned Investments net outflows of \$0.6 billion in 2013, representing new institutional mandates offset by legacy product outflows



Results at a glance

Key performance measures

	30 June 2013 \$m	30 June 2012 \$m	30 June 2011 \$m
Normalised profit after tax	308.5	296.8	248.0
Statutory profit after tax	416.8	148.5	261.4
Normalised cost to income ratio (%)	34.4%	35.9%	36.5%
Earnings per share			
Basic – normalised profit (cps)	58.6	57.5	51.7
Basic – statutory profit (cps)	79.2	28.8	54.5
Return on equity			
Normalised return on equity (RoE) – post-tax (%)	16.8%	18.8%	17.7%
Statutory return on equity (RoE) – post-tax (%)	22.7%	9.4%	18.7%
Dividends			
Dividend – Interim unfranked (cps)	9.5	7.5	7.0
Dividend – Final unfranked (cps)	10.5	10.5	9.5
Dividend – Total unfranked (cps)	20.0	18.0	16.5
Dividend payout ratio – normalised profit (%)	34.1%	31.3%	31.9%
Life sales			
Retail Life sales	2,179.2	1,954.3	1,903.4
Institutional Life sales	951.8	703.5	59.3
Total Life sales	3,131.0	2,657.8	1,962.7
Funds Management net flows			
Fidante Partners	7,554.7	4,458.0	3,749.0
Aligned Investments	(566.1)	(232.0)	(1,352.0)
Total Funds Management net flows	6,978.6	4,226.0	2,397.0
Total Assets Under Management	44,770	33,429	27,909
Share price at 30 June (\$)	4.01	3.25	4.89
Market capitalisation at 30 June	2,128.9	1,770.3	2,428.8

Chairman's report



Peter Polson
Chairman

In business, as in life, persistence pays, and resolve is ultimately rewarded. For this reason, 2013 was a pivotal year for your Company. Not because Challenger broke new ground, but because we have remained true to the differentiated strategies we set for each business some years ago. As a consequence, we have experienced record inflows.

Over the year, total assets under management rose 34% to \$44.8 billion, with Funds Management's market-leading net flows of \$7 billion being particularly noteworthy. With tight cost control maintained across the Company, these net flows translated to growth in earnings and normalised net profit after tax to \$309 million.

As a result, the Board was pleased to declare a final dividend of 10.5 cents per share, bringing the full-year distribution to 20.0 cents, an increase of 11%. In addition, we utilised some surplus capital to buy back 14 million shares. These decisions resulted in us achieving our target of returning 50% of the normalised profit to shareholders by either dividends or buying back shares.

We expect the Company's strong cash and capital generation to continue into 2014, and have announced our intention to increase the expected dividend payout ratio to a range of 35% to 40%, and to recommence partial franking of the final dividend during the year.

Whilst I will leave the details driving Challenger's record results to our Chief Executive Officer Brian Benari, I will make some high-level observations of the Company's performance this year.

Our boutique funds management business, Fidante Partners, continues to grow substantially faster than its competitors. The model aligns the interests of investors, boutique investment managers and Fidante Partners. The success of this model and the strong investment performance track record resulted in leading inflows. At the same time, under its new leadership structure, our Aligned Investments division consolidated and grew its mandate relationships with domestic and offshore superannuation and sovereign wealth funds.

Neither of these businesses can be described as having a conventional approach to traditional funds management, which perhaps explains why they have appealed to investors seeking more

contemporary models whereby risk and reward are shared among investing teams, financial sponsors and third-party investors.

While some institutional and other professional investors may have switched to a 'risk-on' strategy, many Australian retirees understand that investing in retirement requires a balanced approach. We ascribe the record annuity sales result for the year to several factors: principally our ageing population's desire for secure stable longer-term income streams, product innovation, focused and superior adviser and customer service and support, and growing brand and product category awareness.

As your Company has grown, so too has the level and diversity of financial services expertise seated around the Board table. In October 2012, we were fortunate to welcome two new, independent Non-Executive Directors to the Challenger Limited Board. Ms JoAnne Stephenson and Mr Steven Gregg were both re-appointed by shareholders at our subsequent Annual General Meeting in November 2012. JoAnne was a partner with KPMG with significant experience in internal audit, risk management and consulting. Steven was a Partner and Senior Adviser at McKinsey & Company and Global Head of Investment Banking at ABN AMRO. I look forward to their ongoing contribution to the governance and strategic direction of Challenger.

By the time you receive this report, we will already be well into the 2014 fiscal year, with all the opportunities and challenges that it holds. We are confident we can continue to grow our Funds Management business, and that the 'grey wave' of Baby Boomer retirees will increase their demand for investments which deliver stable, secure incomes in retirement.

In many ways, Challenger has long been a differentiated business in the Australian financial services sector. We hope that this coming year continues to see this point of difference deliver strong returns to you, our shareholders. I look forward to seeing you at our Annual General Meeting on 26 November 2013.



Brian Benari
Chief Executive Officer

There is a saying that we overestimate what we can achieve in one year, but underestimate what we can achieve in 10.

Less than five years ago, Challenger was a diversified financial services company operating businesses in traditional funds management, fixed term annuities and mortgage origination. As these markets changed, we made the difficult decision to narrow our focus to two businesses: a leaner funds management model centred around smaller individual brands, and guaranteed retirement income products, in relation to which there was a low level of market understanding and acceptance for a variety of reasons.

While obstacles lay ahead for Challenger, as they did for all industry participants, we worked diligently to reposition the Company to benefit from the enormous long-term structural growth in wealth management. As a nimble company, we were able to quickly adapt to changing conditions, and embraced challenging the status quo. We devised and pitched to the market a more supportive and aligned boutique fund model to free up investment professionals to do what they do best. We implemented a plan to provoke deeper industry, adviser and consumer thinking about retirement income generation, and how it differs from wealth accumulation during working years.

While it's too early to predict where we might be in another five years, I am pleased to say that at the half-way mark, our progress is reassuring.

After several years of establishing our Fidante Partners boutique proposition in the marketplace, building out our portfolio of boutiques and establishing investment track records, we were rewarded in 2013 with leading net flows. A 65% increase in net flows to \$7.0 billion boosted total funds under management by 33% to \$41.1 billion, delivering earnings growth of 62% to \$34 million for Funds Management. Our fledgling Aligned Investments division, in which we 'club' the capabilities of Challenger Life's business with those of third-party super funds, sovereign funds and other institutions searching for high relative value investments in fixed income, property and infrastructure, also performed strongly and benefited from new mandates and relationships.

Over in Challenger's Life or annuities business, we persisted with our ongoing campaign to highlight to retirees the virtues of guaranteed, long-term income in retirement. While Challenger has sold annuities for several decades, over the last few years we have been working to change the composition of the book from shorter, fixed term product to longer-term and lifetime annuities. Notably, we are doing most of the heavy lifting in what is ostensibly a 'new' product category for Australia. While partial annuitisation of retirement savings and annuity product innovation is supported by the likes of the Institute of Actuaries, Deloitte, Mercer, Towers Watson, the Financial Services Council and the Australian Superannuation Funds Association, Challenger is the main industry participant committed to innovating, marketing and selling annuities in this country.

So far, our messages appear to be resonating with retirees and their advisers. This year, we had record total annuity sales of \$3.1 billion, notable given the resurgent share market and relatively low interest rates, and supporting our contention that annuity sales will be driven primarily by long-term demographic tailwinds and retirees' risk aversion. Certainly, the demand for any fixed income investment will respond appropriately to market falls and ongoing volatility, but we remain firmly of the view that the trend to longer-term and lifetime annuities is sustainable.

While the need to manage the risk of outliving your savings may not dominate retiree investment decision-making, the unexpected need to care for parents aged in their late 80s and 90s has not gone unnoticed by today's 65 year olds. The idea of guaranteed income for the rest of your life, immune from market falls and indexed for inflation, seems to hold significant appeal, and propelled lifetime annuities sales to a record \$257 million, up from \$46 million the preceding year, and more than the entire industry has sold in any year since 2004. While not a huge amount in the overall scheme of investment flows, this figure is significant because it has been achieved by an independent manufacturer selling a product that isn't well-understood, to a marketplace that has been traditionally unreceptive to long-term fixed rate investing.

Thanks to our innovative lifetime products, and an increase in longer-term product sales, the average tenor of new annuities sold by Challenger rose from 5.4 to 6.2 years, with the retail annuity book growing by 9% in 2013. Challenger Life's \$10.8 billion under management represents a 10% increase over last year, with a 4.5% margin delivering Life cash operating earnings of \$452 million, an increase of 4%.

The value of a lifetime annuity is only as good as the regulatory framework and issuer that sits behind the promise of long-term certain income. While annuities were already a prudentially regulated, very safe investment, this year saw the introduction of the Australian Prudential Regulation Authority's (APRA's) new regulatory capital regime. These new rules are considered more onerous than those in North America and Europe, and are aimed at ensuring every issuer's ability to withstand 1:200 year adverse market events; far worse than the global financial crisis.

I am pleased to report that, before the new regime has been fully introduced, Challenger's capital position is compliant and has never been stronger. Challenger Life held \$897 million of surplus capital above APRA's regulatory requirements. In addition, the Group held \$177 million of cash.

As for the Distribution, Product and Marketing (DPM) function of the Company, innovation continues to be the focal point of new product development, distribution and sales strategies and tools, thought leadership and marketing. This year, the award-winning Challenger Care Annuity was formally launched to a very receptive aged-care advisory marketplace, which had been getting by on hybrid and partial solutions to very complex client needs. Further additions to the Care range are scheduled for 2014, along with Deferred Lifetime Annuities, legislation permitting.

In 2012, we announced the establishment of Challenger's Retirement Income Research division under the ex-Chair of the Federal Government's Super System Review, Jeremy Cooper. In 2013, DPM initiated a complementary strategy, expanding its Technical Services offering into a more comprehensive Advice Services unit, with a mandate to more cohesively communicate our approach to retirement income generation by means of masterclasses, professional development days and academic partnerships with universities.

I am confident that we can continue to grow our business. The very predictable Life business is targeted to produce cash operating earnings of between \$465 million and \$475 million in 2014, while the Funds Management business is off to a strong start in terms of opening funds under management and manager performance.

Critical to achieving our goals will be the engagement of our people. Challenger again surveyed its employees in 2013 to gain an insight into our people's experiences working at Challenger and our engagement score was five percentage points above the financial services benchmark. This was a very pleasing outcome. Aon Hewitt's research shows that companies with higher employee engagement scores consistently deliver better business outcomes.

Among my direct reports and the Executive Management Team there is a shared understanding and great enthusiasm for our vision. We are committed to this vision and believe we have the right people and strategies in place to achieve it.

We are well positioned to continue to grow and increase shareholder value.





Richard Howes
Chief Executive, Life

Richard Howes

Chief Executive, Life

Challenger Life Company Limited (CLC) is the leading provider of annuities and guaranteed retirement income solutions in Australia. Products appeal to investors seeking the security and certainty of guaranteed cash flows with protection against market, inflation and longevity risks.

Products are distributed via financial advisers, both independent and part of major dealer groups. Being an independent provider, CLC has representation on all major hubs.

CLC has won the Association of Financial Advisers/ Plan for Life annuity provider of the year for the past five years and has won the income stream innovation award for the past three years. The Care Annuity, which was launched in July 2012, also won Canstar's 2012 innovation excellence award.

CLC is an APRA regulated entity and its financial strength is rated by Standard & Poor's. In May 2013, CLC's 'A' credit rating with a stable outlook was reaffirmed by Standard & Poor's under its new global insurance criteria.

Changes in demographics and consumer risk preferences are leading to an increase in demand for Life's products. The increase in demand is being amplified by:

- Challenger's strong retirement income brand recognition;
- leading product innovation and development;
- thought leadership in retirement income research; and
- a highly regarded distribution team.

These favourable market dynamics and a range of business initiatives have resulted in ongoing strong organic sales growth. In 2013, annuity sales increased by 18% to \$3.1 billion and Life investment assets increased by 10% to \$10.8 billion.

The mix of annuity sales is continuing to evolve, with retirees' demand for longer dated and lifetime products increasing. As a result, the average tenor for new business sales in 2013 was 6.2 years, up from 5.4 years in 2012.

In order to ensure we meet our promises to our customers, we match future annuity cash flow obligations with high quality assets generating dependable cash flows. Fixed income investments account for 76% of Life's investment assets and a high quality property portfolio represents a further 16% of total investment assets.

The fixed income portfolio is diversified across sectors, geographies and rating bands with over 1,000 different securities held. The quality of the fixed income portfolio remains high, with 84% of the portfolio investment grade. Fixed income investments include domestic and offshore corporate credit, asset backed securities and cash equivalent investments.

Life's property portfolio is invested in a broad range of high quality properties. Property is an attractive asset class as contracted rental receipts, which are typically indexed to inflation, are a good match for long-term annuity payments. As we originate longer dated annuity business we will acquire longer dated assets, including property.

The Australian retirement income market is expected to grow strongly over the next 20 years as Australia's baby boomers (born 1943–1960) move from retirement savings to retirement spending. Baby boomers control approximately two thirds of Australia's \$1.6 trillion¹ of superannuation assets.

Life is also well positioned to benefit from changes in consumer risk preferences. Many retirees are risk averse and are focused on longevity risk and the need for regular and dependable income in retirement. Annuities address these concerns, and as a result we are experiencing increased demand for Life's products, particularly longer dated lifetime annuities.

¹ APRA Superannuation Statistics – June 2013.

Funds Management



Rob Woods

Chief Executive,
Funds Management

Rob Woods

Chief Executive, Funds Management

Challenger's Funds Management business comprises Fidante Partners and Aligned Investments. It is one of the fastest growing Australian investment managers and is the 7th largest, up from 19th two years ago.

Funds Management has been growing quickly, with Funds under Management (FUM) increasing by 33% in 2013 to \$41.1 billion. The strong growth has been driven by a clear business strategy focused on investor alignment, which has helped deliver strong investment performance for both Fidante Partners and Aligned Investments.

Fidante Partners' multi boutique platform comprises co-owned, separately branded, active boutique investment managers. The Fidante Partners model aligns the interests of investors, boutique investment managers and Fidante Partners. The success of the model is evident with Fidante Partners growing substantially faster than its competitors.

Fidante Partners is now the pre-eminent multi boutique group in Australia. We continue to seek further opportunities to expand the business by adding new boutiques and new investment strategies for existing boutiques. During 2013, we conducted a global search to identify additional boutiques to partner with. As a result, we recently announced the addition of two new boutiques, River & Mercantile and WyeTree Asset Management, both United Kingdom-based investment managers. This brings our stable of co-owned and separately branded boutiques to 13 and we expect to increase the number over the coming years.

Aligned Investments originates and manages assets under Challenger's brand for the Life Company and third party institutional investors. Aligned Investments includes the ASX-listed Challenger Diversified Property Group (CDI) as well as a number of unlisted mandates for institutional clients.

In 2013, Aligned Investments appointed an executive to lead the business who is responsible for building out the client base and expanding the product offering. We are having success in attracting new institutional clients and executed a \$600 million retail property transaction for a new sovereign wealth fund client. We also launched a Relative Value Debt Strategy during

the year, which provides investors with the ability to invest in loans to the property, infrastructure and private equity sectors.

CDI continues to deliver on its strategy and provide investors with earnings and distribution growth. The fund delivered a total unit holder return of 18% for the year.

During the year, the Challenger Infrastructure Fund (CIF) was wound up and capital returned to unit holders. The wind up followed the conclusion of a strategic review, which determined the most appropriate way to address the gap between CIF's unit price and its net asset value, was to sell the assets, wind up the fund and return capital to unit holders. The return of capital to investors represented a substantial premium (54%) to CIF's unit price prior to the announcement of the strategic review.

The Australian funds management market is an attractive market underpinned by compulsory superannuation contributions, which are legislated to increase from 9.25% to 12% of gross employee salaries. While the new Coalition Government's policy is to delay these staged increases for a period of two years for budget reasons, with increases in contributions and earnings, the Australian superannuation market is forecast to grow from \$1.6 trillion today to over \$6 trillion¹ by 2030.

Challenger's Fidante Partners business model has widespread support from investors and asset consultants. Opportunities exist to expand both our existing boutique partners as well as adding new partners, which will provide further growth opportunities.

Aligned Investments will continue to build out its client base, with significant opportunities to add new domestic and international institutions, superannuation funds and sovereign wealth funds. Aligned Investments has a strong pipeline of new business opportunities with approximately \$1 billion of mandates won but yet to be funded.

¹ Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2011-2030 – November 2011.

Distribution Product and Marketing



Paul Rogan

Chief Executive,
Distribution, Product
and Marketing

Paul Rogan

Chief Executive, Distribution, Product and Marketing

Our vision is to provide Australians with financial security in retirement. Having quality brands, products, service and platforms is essential in order to achieve this vision.

The Distribution, Product and Marketing team is responsible for:

- distribution of Challenger's retirement income and funds management products;
- increasing brand and consumer awareness;
- ensuring Challenger's product offering is innovative, contemporary and relevant; and
- enhancing customer and adviser experiences.

Distribution

Sales have continued to benefit from the creation of specialist Life and Funds Management distribution teams. The Life team is focused on stable, secure retirement income products aimed at retirees. The Funds Management distribution team is focused on products providing superior investment returns across an array of investment classes.

In 2013, record sales were achieved for both our Life and Funds Management businesses.

Total Life annuity sales were \$3.1 billion in 2013, up 18%, and comprised retail sales of \$2.1 billion and institutional sales of \$1.0 billion. Annuity sales continue to benefit from favourable demographic trends as Australia's baby boomers commence retirement and they become more aware of the financial risks they face. Since 2009, annuity sales have increased by a compound growth rate of 43% each year.

The mix of annuity sales continues to evolve, with retirees' increased demand for longevity and inflation protection propelling lifetime annuity sales. Lifetime annuity sales increased strongly to \$257 million and represented 12% of total retail annuity sales, up from 2% in 2012.

We have also been successful in establishing new sales channels. During the year, we entered into an agreement with Bendigo and Adelaide Bank for the

sale of our Liquid Lifetime product and signed a white label agreement with QSuper.

Funds Management generated \$7.0 billion of net flows in 2013, up from \$4.2 billion in 2012. This strong result was driven by Fidante Partners, which continues to benefit from strong investment performance with all boutique flagship funds outperforming their benchmarks over a five-year period.

Challenger's distribution capability is highly regarded by financial advisers and has been benchmarked against Australian wealth management peers. Wealth Insights, a leading provider of wealth management industry research, ranked our business development managers number one and our technical and adviser services number two. This is an outstanding result and demonstrates the strength of our distribution teams.

Product

Challenger has a proven track record in product innovation. We continue to lead the market in retirement income product innovation, which is reigniting Australia's long-term annuities market.

In July 2012, we launched the Challenger Care Annuity, which is a new and superior solution for customers requiring aged care facilities. The Care Annuity provides regular guaranteed payments for life, can reduce or eliminate income-tested aged care fees and is treated beneficially for social security purposes.

Following the launch of the Care Annuity there has been strong demand from financial advisers and customers, with \$99 million of sales in 2013.

The success of the Care Annuity has been externally recognised, winning the 2012 Association of Financial Advisers/Plan for Life income stream innovation award and the Canstar 2012 innovation excellence award. The Canstar award was open to all financial products, with the Care Annuity beating 43 other financial products by scoring highly on the criteria of uniqueness, market impact and potential customer base.

In April 2013, the Federal Government announced it would encourage the take-up of Deferred Lifetime Annuities (DLAs) and remove the impediments that currently restrict the issuing of these annuities. DLAs will fill a significant gap in the retirement income market and will assist retirees in managing their longevity risk.

DLAs are supported by both major Australian political parties and we are well advanced in our product design and testing. We expect to be able to provide DLAs from 1 July 2014, regulatory reforms permitting.

Marketing

Challenger's vision is to be recognised as the leader in retirement incomes. Having a strong and respected brand is critical to achieving this.

In early 2011, Challenger launched a major consumer advertising campaign on national television, cinema, radio, print and online. The campaign, in conjunction with our broader distribution and marketing efforts, has resulted in 85% of advisers recognising Challenger as the leader in retirement incomes, up from 64% two years ago. The campaign has also led to a significant increase in consumer awareness of Challenger's brand.

In 2013, we have developed the next phase of our advertising campaign, which was launched in September 2013. The new campaign seeks to further strengthen adviser and consumer brand awareness, whilst also improving the understanding of the benefits of annuities as part of the retirement income solution.

Challenger's leadership in retirement income education is a key driver in differentiating our brand. Our retirement income research team, led by Jeremy Cooper, issued 10 research papers during the year, covering a wide range of retirement income issues. We are also assisting the University of NSW and the Australian School of Business to enhance their Masters of Financial Planning, and are partnering with our largest distributors to provide retirement income master classes. Our aim is to educate advisers and their customers that they should be taking a different approach to investing in retirement.



Corporate



Andrew Tobin and Blair Beaton

Chief Financial Officer
and Head of Strategy
and M&A

Andrew Tobin

Chief Financial Officer

2013 has been a very successful year for Challenger, with our operating performance remaining strong and we have met or exceeded all key financial targets.

We achieved record flows into both our Life and Funds Management businesses, resulting in total Assets Under Management (AUM) rising by 34% to \$44.8 billion. The strong growth in AUM drove earnings higher, with normalised earnings before interest and tax increasing by 8% to \$365 million. Normalised profit after tax, Challenger's preferred measure of profitability as it better reflects the underlying operating performance of the business, increased by 4% to \$309 million.

Normalised earnings per share increased by 2% to 58.6 cps. The increase in normalised earnings per share reflects higher normalised profit after tax (up 4%), partly offset by a higher weighted average number of shares on issue. The weighted average number of shares on issue increased following the exercise of 60 million options in October 2011, which have been partly offset by shares bought back under Challenger's on-market share buy-back program. A total of 14 million shares were bought back in 2013. There were no external options outstanding over Challenger's shares at 30 June 2013.

Statutory net profit after tax increased strongly to \$417 million, up from \$149 million in 2012 as a result of positive investment experience. Positive investment experience for the year was largely due to reduced volatility in credit markets. Challenger is required to value all assets and liabilities supporting the life business at fair value, despite generally being a hold to maturity investor, and so volatility can result in significant positive or negative investment experience.

Challenger's business is highly scalable, resulting in Challenger being one of Australia's most efficient financial services companies. Total expenses in 2013 were \$192 million and increased by only 2% for the year. Over the past five years, total expenses have increased by 3%, whilst revenues have increased by 50%, resulting in the cost to income ratio falling by 16 percentage points to 34.4%. Reflecting the scale

and leverage in the business, we have lowered our medium-term cost to income ratio target to a range of 32% to 36%.

Challenger Life held \$897 million of surplus capital above APRA's regulatory requirements at the end of 2013, up from \$719 million in 2012. Challenger Life has transitioned to APRA's new Life and General Insurance Capital (LAGIC) standards, with Life's surplus capital including an allowance of \$323 million in respect of LAGIC transition. APRA has provided Challenger with a three-year transition period, resulting in the increased capital requirement phasing in by \$108 million each year from 1 January 2014. Life's capital position as measured by the prescribed capital ratio is within the Board's targeted range at 30 June 2013 excluding the full LAGIC transition balance of \$323 million.

In addition to Challenger Life's surplus capital, Challenger also held Group cash at the end of the year of \$177 million and had no outstanding Group recourse debt.

Challenger's financial strength was confirmed during the year by Standard & Poor's, which reaffirmed Challenger Life's 'A' rating with a stable outlook under its new revised global insurance criteria.

Total dividends declared in 2013 were 20.0 cents per share (unfranked), representing an increase of 11% on 2012. The dividend payout ratio was 34.1% and was in line with our targeted dividend payout ratio. We have announced that for 2014 the dividend payout ratio will be increased to a range of 35% to 40% of normalised profit and we expect to recommence partial dividend franking for the final 2014 dividend.

Life's normalised earnings before income tax increased by 4% to \$452 million, predominantly due to growth in AUM which was partially offset by a reduction in margin. Life's average AUM was 13% higher in 2013 as a result of strong annuity sales which were \$3.1 billion, representing an 18% increase on 2012. The increase in sales is a direct result of our key focus on distribution, product and marketing and capitalising on the structural market change that is underway in retirement incomes.

Funds Management normalised earnings before income tax increased by \$13 million (62%) to \$34 million. Earnings benefited from a \$16 million increase in fee income, whilst expenses increased by only \$3 million. Fee income increased as a result of higher Funds Under Management (FUM) and higher performance fees due to strong investment performance by both Fidante Partners and Aligned Investments. Funds Management FUM increased by 33% for the year to \$41.1 billion, due to strong net flows and the positive impact from investment markets.

Blair Beaton

Head of Strategy and Mergers and Acquisitions

The Head of Strategy and Mergers and Acquisitions (M&A) reports directly to the Chief Executive Officer, reflecting the importance strategy plays in our decision making.

The Strategy and M&A team works closely with both the Chief Executive Officer and the Board to establish the strategic direction of our business over the medium to long term. This includes setting strategies to achieve our vision of providing Australians with financial security in retirement.

The Strategy and M&A team has been responsible for some of the key transactions to position Challenger as a leader in retirement incomes. The Strategy and M&A team also plays a key role in growing the Fidante Partners business by seeking new investment managers to complement our Funds Management offering.

Risk and Human Resources



**Angela Murphy and
Richard Willis**

Executive General Manager,
Human Resources
and Chief Risk Officer

Richard Willis

Chief Risk Officer

The Chief Risk Officer is accountable for the implementation of Challenger's Risk Management Framework, which covers all categories of risks. Challenger places a high level of importance on risk management with the Chief Risk Officer reporting to the Chief Executive Officer.

The Chief Risk Officer also has direct interaction with the Board and Board subcommittees, including the Group Risk and Audit Committee. The Board is fully engaged on all risk matters and treats risk management very seriously. Reflecting this, the Board conducted a dedicated risk workshop to review the Risk Management Framework. Challenger continues to evolve its Risk Management Framework to ensure it remains best practice.

Challenger maintains a Risk Management Framework, which ensures all risks are managed and reported across the organisation and remain within the Board's risk appetite. The Board's Risk Appetite Statement outlines the level of risk that is acceptable in seeking to achieve Challenger's strategic goals and financial objectives. This has a direct impact on the culture within the organisation and provides clear boundaries on acceptable risk-taking activities across Challenger.

Challenger has a strong risk management culture with compliance obligations a key focus for all employees, which includes undertaking regular online compliance education and training.

The Chief Risk Officer is also responsible for oversight of regulatory engagement, including APRA and ASIC. During the year, Challenger transitioned to the new Life and General Insurance Capital (LAGIC) standards, which were implemented as required on 1 January 2013. Challenger is fully compliant with the LAGIC standards, including providing APRA with a Board approved Internal Capital Adequacy Assessment Process summary statement. During the year, Challenger also implemented the Stronger Super reforms and procedures to comply with the Future of Financial Advice reforms which were effective from 1 July 2014.

Angela Murphy

Executive General Manager, Human Resources

Challenger's employees are core to our success. We continue to invest in attracting and developing a talented, flexible and diverse group of people who are engaged and committed to achieving Challenger's vision.

Key areas of focus in building employee engagement, leadership capability and a supportive culture include:

- Diversity – Challenger values independent thinking and opinions. We are committed to fostering a workplace in which employees with diverse backgrounds, beliefs, preferences, skills and experiences are able to contribute and succeed. A number of initiatives were undertaken across the year to support this commitment. These initiatives included maintaining Challenger's diversity networking series, making investments in training and support to maximise diversity outcomes, and continuing to increase the gender diversity of potential successors for senior leadership roles.
- Leadership capability – Over the year, Challenger continued our partnership with the Australian Graduate School of Management to develop and commence the roll-out of a leadership program for mid-level leaders. This program is aimed at supporting individual leadership development as well as building Challenger's leadership bench strength.
- Employee engagement survey – Challenger again surveyed employees to gain an insight into our people's experiences working at Challenger. Our engagement score was five percentage points above the financial services benchmark. The survey results will contribute to people related planning and initiatives, which will be undertaken over the next 18 months.

Additional details on Challenger's approach to diversity, leadership and employee engagement are contained in the Sustainability Report, which forms part of Challenger's 2013 Annual Report.

Challenger is committed to making a positive and meaningful contribution to the community. Challenger operates a Community Giving Program allowing employees to make regular or pre-tax salary donations to one of our community partners, with contributions matched by Challenger up to \$500 per employee per year. Challenger currently has six community partners including Alzheimer's Australia, Barnardos, Bear Cottage, Beyondblue, National Seniors Foundation Trust and Meals on Wheels.

Through these programs, Challenger and our people have contributed nearly \$21,000 to our Community Partners. Challenger has also provided a total of \$212,000 to our Community Partners via sponsorship of key research and events.



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Corporate governance

The Company's approach to corporate governance

The Board of Directors and management of Challenger Limited (the Company) recognise their duties and obligations to stakeholders to implement and maintain a robust system of corporate governance. The Company believes that the adoption of good corporate governance adds value to stakeholders and enhances investor confidence.

The Board of Directors of the Company (the Board) determines the most appropriate corporate governance arrangements for the Company and its controlled entities (the Group or Challenger), taking into consideration Australian and international standards and the prudential requirements of regulators such as the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC). This statement reflects the Company's corporate governance arrangements as at the date of signing this report.

This statement reports against the ASX Corporate Governance Council's 'Corporate Governance Principles and Recommendations' as amended in 2010.

As required by the ASX Listing Rules, this statement sets out the extent to which Challenger has followed the Principles or, where appropriate, indicates a departure from them with an explanation. This report applies to Challenger; however, some controlled entities have adopted additional policies and procedures to deal with specific issues relevant to their business, for instance Australian Financial Services Licence compliance. Where such policies and procedures have been adopted, they have been developed in line with the standards referred to throughout this report.

Principle 1 – Lay solid foundations for management and oversight

The role of the Board and delegations

The Board is accountable to shareholders for the activities and performance of the Company by overseeing the development of sustainable shareholder value within an appropriate framework of risk and regard for all stakeholder interests.

The Board has identified the key functions which it has reserved for itself. These duties include those outlined below. Full details are set out in the Board Charter, a copy of which is available on the Company's website. The duties include:

- establishment, promotion and maintenance of the strategic direction of the Company;
- approval of business plans, budgets and financial policies;
- consideration of management recommendations on strategic business matters;
- establishment, promotion and maintenance of proper processes and controls to maintain the integrity of accounting and financial records and reporting;
- fairly and responsibly rewarding executives, having regard to the interests of shareholders, the performance of executives, market conditions and the Company's performance;
- adoption and oversight of implementation of appropriate corporate governance practices;
- oversight of the establishment, promotion and maintenance of effective risk management policies and processes;
- determination and adoption of the Company's dividend policy;
- review of the Board's composition and performance;
- appointment, duration, evaluation and remuneration of the Chief Executive Officer (CEO) and approval of the appointment of the Chief Financial Officer (CFO), the Chief Risk Officer, the General Counsel and the Company Secretary; and
- determination of the extent of the CEO's delegated authority.

The Board has established Committees to assist in carrying out its responsibilities and to consider certain issues and functions in detail. The Board Committees are discussed in Principle 2 on page 18.

Non-Executive Directors are issued with formal letters of appointment governing their role and responsibilities. The responsibilities of the Chairman and the Directors are also set out in the Board Charter.

Management responsibility

The Board has delegated to the CEO the authority and powers necessary to implement the strategies approved by the Board and to manage the business affairs of the Company within the policies and specific delegation limits specified by the Board from time to time. The CEO may further delegate within those specific policies and delegation limits, but remains accountable for all authority delegated to management.

Executive performance assessment

The performance of senior executives is reviewed at least annually against appropriately agreed and documented performance objectives and measures, consistent with the Performance Management framework that applies to all Challenger employees. All employees at Challenger are also assessed against the Challenger Principles (refer to Principle 3).

The Remuneration Committee is responsible for reviewing the performance of the CEO at least annually, including setting the CEO goals for the coming year and reviewing progress in achieving those goals and making recommendations to the Board. The CEO is responsible for setting performance objectives and reviewing the performance of his direct reports.

Performance evaluations for the CEO and senior executives have taken place in respect of the 2013 reporting period in accordance with the above process.

Principle 2 – Structure the Board to add value

Membership of the Board

The Board comprises Directors who possess an appropriate range of skills, experience and expertise to:

- have a proper understanding of, and competence to deal with, the current and emerging issues of the business;
- exercise independent judgement;
- encourage enhanced performance by the Company; and
- effectively review and challenge the performance of management.

Name	Position	Independent	Appointed
Peter Polson	Chairman	Yes	2003
Brian Benari	Managing Director and CEO	No	2012
Graham Cubbin	Non-Executive Director	Yes	2004
Steven Gregg	Non-Executive Director	Yes	2012
Jonathan Grunzweig	Non-Executive Director	Yes	2010
Russell Hooper	Non-Executive Director	Yes	2003
Brenda Shanahan	Non-Executive Director	Yes	2011
JoAnne Stephenson	Non-Executive Director	Yes	2012
Leon Zwier	Non-Executive Director	Yes	2006

The Chairman is selected by Non-Executive Directors of the Board. The roles of Chairman and Chief Executive Officer (CEO) are not held by the same person. The Board has a majority of Independent Directors.

Nominations and appointment of new Directors

The Board has established a Nomination Committee comprised of a majority of independent Directors, having at least three members and chaired by an independent Director.

Recommendations for nominations of new Directors are made by the Nomination Committee and considered by the Board as a whole. If a new Director is appointed during the year, that person will stand for election by shareholders at the next annual general meeting. Shareholders are provided with appropriate information to judge the adequacy of candidates. All new Directors are provided with an appropriate induction into Challenger's business. A copy of the Nomination Committee Charter can be found on the Company's website.

The Nomination Committee conducts periodic assessments of the Board's competencies. This assists the Nomination Committee in determining the appropriate composition of the Board and to consider the desirable depth and range of skills and diversity required for any new Board members. The Nomination Committee will draw on industry contacts and, where appropriate, will engage external consultants to assist with the identification and selection of a diverse range of candidates which meet the Nomination Committee's desired competencies. The Nomination Committee will also have regard to such criteria as independence, outstanding commercial capability, cultural fit and time availability to meet the commitment required.

The Nomination Committee makes an assessment of potential new Directors on the above criteria and makes recommendations to the Board for consideration and approval.

Retirement and re-election of Directors

The Company's constitution requires that, excluding the CEO, one third of the remaining Directors must retire each year. In addition, any Director who is appointed during the year must retire and be put up for re-election at the next annual general meeting.

Succession planning

In conjunction with the Nomination Committee, the Board considers the succession of its members, the CEO, the CFO, and the Chief Executives of each of the business divisions, as required.

Review of Board performance

The Board Charter sets out the requirement for a formal review of the Board's performance at least annually. A review of the Board's performance was conducted in June 2013.

The review of the Board's performance is conducted by the Chairman with all Board members. The review involves consideration of the effectiveness of the Board and its Committees having regard to the knowledge, skills and experience of the Directors. The review involves considering the weighting of attributes, culture and capabilities of the Board.

Director independence

The Board has adopted an Independence Policy that states that an independent Director should be independent of management and free from any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the independent exercise of their judgement.

The Board regularly considers and assesses the independence of each Director in light of the interests and information that Directors disclose. In accordance with the Corporations Act 2001, Directors are required to advise the Company of any material personal interests they have in a matter.

In assessing independence, the Board will have regard to whether the Director has any of the following relationships with the Company or any Group company:

1. Is a substantial shareholder (as defined by section 9 of the Corporations Act 2001) of the Company, or is a director or officer of, or otherwise associated directly with, a substantial shareholder of the Company;
2. Is employed, or has previously been employed, in an executive capacity by the Company or the Group, and there has not been a period of at least three years between ceasing such employment and serving on the Board;
3. Has, within the last three years, been a principal of a material professional adviser or a material consultant to the Company or the Group, or an employee materially associated with the service provided;
4. Is a material supplier or customer of the Company or the Group, or an officer of or otherwise associated directly or indirectly with a material supplier or customer; and
5. Has a material contractual relationship with the Company or the Group other than as a Director.

The Board will state its reasons if it considers a Director to be independent notwithstanding the existence of a relationship of the kind referred to in points 1 to 5 above.

Determination of materiality in assessing independence

The materiality of a relationship is assessed on a case-by-case basis after having regard to each Director's individual circumstances.

Conflicts of interest

In accordance with the Board Charter and the Corporations Act 2001, any Director with a material personal interest in a matter being considered by the Board must declare such an interest and may only be present when the matter is being considered at the Board's discretion. Directors with a material interest may not vote on any matter in which they have declared a personal interest.

Meetings of the Board

The Board meets formally approximately every six weeks. In addition, the Board may meet whenever necessary to deal with specific matters needing attention between scheduled meetings.

The CEO, in consultation with the Chairman, establishes the meeting agendas to ensure adequate coverage of strategic, financial and material risk areas throughout the year. Senior executives are invited to attend Board meetings and are available for contact by Non-Executive Directors between meetings. The Non-Executive Directors often hold a private session without any executive involvement in conjunction with scheduled Board meetings.

Corporate governance

Board access to information and advice

All Directors have unrestricted access to the Company records and information. The Company Secretary provides Directors with guidance on corporate governance issues, developments and on all other matters reasonably requested by the Directors, and monitors compliance with the Board Charter.

The Board or each individual Director has the right to seek independent professional advice to assist them in discharging their duties. The Company will meet the cost of the advice provided the Chairman's prior approval is obtained and such approval is not to be unreasonably withheld or delayed.

Board Committees

To assist it in undertaking its duties, the Board has established the following standing Committees:

- the Group Risk and Audit Committee (GRAC);
- the Remuneration Committee (RemCo); and
- the Nomination Committee (NomCo).

Each Committee has its own Charter, copies of which are available on the Company's website. The Charters specify the composition, responsibilities, duties, reporting obligations, meeting arrangements, authority and resources available to the Committees and the provisions for review of the Charter. Details of Directors' membership of each Committee and those eligible members' attendance at meetings throughout the period from 1 July 2012 to 30 June 2013 are set out below.

Directors' meetings

Director	Board		Group Risk and Audit Committee		Remuneration Committee		Nomination Committee	
	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended
P Polson	10	9	4	4	5	5	3	3
B Benari ¹	10	9	–	–	–	–	–	–
G Cubbin	10	10	4	4	5	5	3	3
S Gregg	8	6	–	–	–	–	1	1
J Grunzweig	10	9	–	–	–	–	3	3
R Hooper	10	9	4	4	5	5	3	2
B Shanahan	10	10	4	4	–	–	3	3
J Stephenson	8	8	–	–	–	–	1	1
L Zwier	10	9	–	–	–	–	3	2

¹ Mr Benari did not attend a Board meeting held on 4 October 2012 to establish a Committee of Independent Directors with authority to approve the final appointment of new Independent Directors, Mr Gregg and Ms Stephenson.

Principle 3 – Promote ethical and responsible decision-making

The Board and the Company's commitment to ethical and responsible decision-making is reflected in the internal policies and procedures, underpinned by the Challenger Principles of:

- Commercial Ownership;
- Compliance;
- Creative Customer Solutions;
- Working Together; and
- Integrity.

Code of Conduct

The Board has adopted a Corporate Code of Conduct ('Code') which applies to all Directors, executives, management and employees of the Company and the Group. The Code articulates the standards of honest, ethical and law-abiding behaviour expected by the Company. Employees are actively encouraged to bring any problems to the attention of management or the Board, including activities or behaviour which may not comply with the Code, other policies and procedures in place, or other regulatory requirements or laws. A copy of the Code can be found on the Company's website.

Political donations policy

The Board has adopted a policy of not making political donations in any country or jurisdiction in which it operates. Representatives of the Company may on occasion attend political functions. This attendance is strictly for commercial reasons and is predicated on the price charged not being in excess of commercial value (in terms of access) of the function.

Directors' and staff trading policy

The Board has approved a Staff Trading Policy which prescribes the manner in which Directors and staff can trade in the Company's shares. A copy of the policy is available on the Company's website.

Objectives for achieving gender diversity

The Board is committed to promoting a corporate culture that embraces diversity across the organisation. The Board has adopted a Diversity Policy, available on the Company's website, which has measurable objectives for achieving gender diversity. The Remuneration Committee is responsible for the regular review of and reporting on the relative proportion of women employed at all levels of the Company and the regular review of and reporting on the measurable objectives set on an annual basis pursuant to the Diversity Policy. The current objectives and progress towards achieving them, and the details of the proportion of women employed at all levels of the organisation are discussed in detail in the Sustainability section on page 24.

Principle 4 – Safeguard integrity in financial reporting

Integrity of financial reporting

The Board has the responsibility to ensure truthful and factual presentation of the Company's financial position. The Board has established a Group Risk and Audit Committee to assist the Board to focus on issues relevant to the integrity of the Company and the Group's financial reporting. In accordance with its Charter, the Group Risk and Audit Committee must have at least three members, be comprised of all Non-Executive Directors and have a majority of independent members. The Committee must be chaired by an independent Director, who is not Chair of the Board.

The background details of the Group Risk and Audit Committee members are described in the Directors' report. The Committee typically meets four times a year, and additional meetings are scheduled as required. The members' names and attendance at meetings are set out on page 20 of this report.

The Committee makes recommendations to the Board in relation to the appointment, review and removal of an external auditor, assessment of the external auditor's independence and the appropriateness of non-audit services that the external auditor may provide. A copy of the Group Risk and Audit Committee Charter is available on the Company's website.

Declaration by the Chief Executive Officer and the Chief Financial Officer

The CEO and CFO periodically provide formal assurance statements to the Board that:

- the Group's financial report presents a true and fair view of the Group's financial condition and performance; and
- the risk management and internal compliance and control systems are sound and operating effectively.

Independent external audit

The Company requires its independent external auditor to:

- provide stakeholders with assurance as to whether the Group's financial reports are true and fair; and
- ensure Group accounting policies comply with applicable accounting standards and guidance.

The Company's independent external auditor is Ernst & Young (EY). EY was appointed upon constitution of the Company in November 2003, and this appointment was ratified by members at the annual general meeting held in November 2004.

External auditors are required to rotate the engagement partner assigned to the Company on a five-year basis. Under this policy, the lead audit engagement partner assigned to the Company was rotated following the conclusion of the 2012 financial reporting period.

The Board has requested that EY attend the Company's annual general meeting, and that EY be available to answer any questions arising in relation to the conduct of its audit.

Principle 5 – Make timely and balanced disclosure

Continuous Disclosure Policy

The Company is committed to ensuring all investors have equal and timely access to material information concerning the Company and that Company announcements are factual and presented in a clear and objective manner.

The Board has approved and implemented a Continuous Disclosure Policy. A summary of the policy can be found on the Company's website. The policy is designed to ensure compliance with the Corporations Act 2001 and the ASX Listing Rules continuous disclosure requirements. The Company has a Continuous Disclosure Committee which is responsible for:

- making decisions on what should be disclosed publicly under the Continuous Disclosure Policy;
- maintaining a watching brief on information; and
- ensuring disclosure is made promptly and without delay.

Principle 6 – Respect the rights of shareholders

The Company recognises the importance of enhancing its relationship with investors by:

- communicating effectively;
- providing ready access to clear and balanced information about the Company; and
- encouraging participation at general meetings.

As set out in Principle 5, it is Company policy that material information concerning the Company will be announced to the market in a timely, clear, balanced and objective manner. Following release of information to the market, the Company publishes annual and half-yearly reports, announcements, media releases and other relevant information on its website.

Internet web-casting and teleconferencing facilities are provided for market briefings to encourage participation from all stakeholders, regardless of their location. The Company also encourages greater use of electronic media by providing shareholders with greater access to the electronic receipt of reports and meeting notices.

The Company also provides a facility to ask questions about the Company via its website and have them answered directly via electronic means.

All major and price sensitive announcements by the Company are lodged with the ASX and made publicly available via the ASX's website before being discussed with, or disseminated to members, of the investment community.

Principle 7 – Recognise and manage risk

Risk management and compliance

The management of risks is fundamental to the Group's business and to building shareholder value. The Board recognises the broad range of risks that apply to the Group as a participant in the financial services industry, including, but not limited to, funding and liquidity risk, investment and pricing risk, counterparty risk, strategic, business and reputational risk, operational risk, licence and regulatory risk. The Board is responsible for determining the Group's risk management strategy and appetite. Management is responsible for implementing the Board's strategy and for developing policies and procedures to identify, manage and mitigate risks across the whole of the Group's operations in line with risk appetite.

The key design component of the Group's approach to risk management is that the heads of the business units have accountability for the risks within their divisions, with oversight, analysis, monitoring and reporting of these risks by the Executive Risk Management Committee (ERMC) chaired by the Chief Risk Officer (CRO). The CRO is independent of the business units and responsible to the CEO and the Board and its Committees.

The framework and policies are developed by the CRO, reviewed and approved by the Group Risk and Audit Committee (GRAC), and then made available to all staff of the Group. The Group's risk management function has day-to-day responsibility for monitoring the implementation of the framework and policy, with regular reporting provided to the GRAC, via the ERMC, on the adequacy and effectiveness of management controls for material business risk.

The GRAC reports to the Board on the effectiveness of the framework, internal controls and policies, with a detailed review undertaken on an annual basis. A summary of Challenger's risk management framework can be found on the Company's website.

Internal audit

Internal audit services for the Group were provided by KPMG during the period. The GRAC oversees the scope of internal audit and monitors the progress of the internal audit work program. The GRAC receives reports from internal audit at each meeting and monitors management's responsiveness to internal audit findings and recommendations. The internal audit function is independent of the external auditor. The internal audit function reports directly to the GRAC.

Assurance

In respect of the financial report for the year ended 30 June 2013, the Board has received formal assurance from the CEO and the CFO that:

- the Group's financial report presents a true and fair view of the Group's financial condition and performance; and
- the risk management and internal compliance and control systems are sound and operating effectively.

This assurance forms part of the process by which the Board determines the effectiveness of its risk management and internal control systems in relation to financial reporting risks.

Principle 8 – Remunerate fairly and responsibly

The Board Remuneration Committee (RemCo)

The Board has established a RemCo comprised of a majority of independent Directors, having at least three members and chaired by an independent Director.

The background details of the RemCo members are set out in the Directors' report. RemCo usually meets at least five times during the year, and additional meetings are scheduled as required. The members' names and attendance at meetings are set out in Principle 2 of the corporate governance statement.

RemCo is responsible for reviewing and recommending to the Board on:

- the Company's remuneration, recruitment, retention and termination policies and procedures for senior executives;
- senior executives' remuneration and incentives;
- superannuation arrangements;
- the remuneration framework for Directors; and
- remuneration by gender.

Remuneration

The remuneration details for key executives and Non-Executive Directors are reported in the remuneration report. Non-Executive Directors are not entitled to participate in incentive plans.

There are no termination payments to Non-Executive Directors on their retirement from office other than payments accruing from superannuation contributions comprising part of their remuneration.

Challenger's staff trading policy prohibits any executive or staff member from entering into a transaction that is designed or intended to hedge that component of their unvested remuneration which is constituted by the Company's shares or options.

It is also Company policy to prohibit margin lending over Company shares by Directors, senior executives and staff members.

Sustainability

Sustainability commitment

Challenger fosters a culture of compliance with a focus on ethics and corporate governance. Our people are critical to our success and it is therefore incumbent on us to foster and promote a work environment where diversity is embraced and people are recruited and promoted on their merits and treat each other with mutual respect and dignity.

We proactively minimise our carbon footprint and consider environmental, corporate governance and social issues when making investment decisions.

Employee engagement

In March 2013, Challenger again conducted an employee survey to gain insight into our people's experiences working at Challenger. The survey was administered by Aon Hewitt and was designed to help us understand our strengths as an organisation as well as ways in which we can enhance our culture and working environment.

Challenger's engagement score was five points above the Financial Services benchmark. Key areas of focus identified for the next 12 to 18 months to enhance employee engagement include:

- defining and embedding a consistent employment promise;
- continuing to focus on leadership, talent and development;
- enhancing performance management processes and performance management outcomes; and
- continuing efforts towards gender diversity across all levels of the organisation.

Challenger intends to conduct an employee survey every second year to monitor progress in key areas and continue to seek ways to improve.

Challenger Principles

Challenger has five principles that are integral to our culture and linked to everything we do. These principles are:

- Commercial Ownership – achieving the best for the client, the business and employees;
- Compliance – being responsible for how and what we do;
- Creative Customer Solutions – superior customer service and providing innovative solutions to clients;
- Working Together – true collaboration and embracing diversity; and
- Integrity – being authentic and being accountable for what we say and do.

The Challenger Principles are emphasised on commencement at Challenger to ensure our people understand them and the expectations they set for the way in which we work. Through a behavioural assessment, the principles also form part of employee performance reviews. In this way we promote the importance of not just achieving our goals, but the way in which we achieve them.

Based on the recent engagement survey a high proportion of employees (81%) continue to feel that their personal values match the Challenger Principles.

Whistleblower policy

All policies at Challenger include a Whistleblower provision and clear instructions on how individuals can raise concerns in a confidential and non-threatening manner. Challenger strongly encourages employees to act on any concerns and actively fosters an open culture where issues can be raised and addressed.

Diversity

Challenger seeks to provide a diverse and inclusive workplace and values the capability and experience that a wide variety of people bring to the organisation. We recognise that a high performing, diverse and inclusive workplace will increase Challenger's ability to attract and retain the best talent from the widest pool of candidates, while increasing our ability to innovate as well as respond to the needs of clients and other stakeholders. Challenger is committed to ensuring not only relevant regulatory compliance, but also a deeper commitment to the principles of diversity.

The Challenger executive team are accountable for promoting and fostering an environment where there is equal access to opportunities and growth. It is also the responsibility of all employees to treat people with fairness and respect. These expectations are captured in our Code of Conduct as well as the Challenger Principles of 'Working Together' and 'Integrity' and are reinforced through the annual performance assessment process.

Challenger has a formal diversity policy which provides Board oversight of Challenger's commitment to employees at all levels being treated fairly, equally and with respect when employment and career decisions are made. The Board also commits to measurable diversity objectives each year. For the 2013 financial year, these included:

- maintaining Challenger's diversity networking series to raise awareness of diversity related workplace issues and providing opportunities for diverse participants to network with and learn from each other;
- maintaining Challenger's 'keep in touch' initiative for employees on parental leave with the aim of maintaining connection to the workplace and improving the return to work experience;
- making investments in training or other support to maximise diversity outcomes;
- continuing to identify and promote the development of talented women and increase the gender diversity of the pipeline of potential successors for senior leadership roles; and
- ensuring equal average market pay competitiveness for men and women as part of the annual remuneration review.

The following initiatives were implemented and/or outcomes achieved across the year:

- Challenger's internal diversity networking series continued with presentations and discussions on diversity related topics. This series has contributed to a climate of change, particularly around gender diversity, within the organisation;
- Challenger's 'keep in touch' initiative was maintained to ensure employees on extended leave continue to feel connected to the workplace. Under the initiative, employees on extended leave were invited to participate in staff updates, the diversity networking series, and the 2013 engagement survey. The engagement score for employees who had taken parental leave increased by 15 points from the 2011 survey to the 2013 survey;
- Challenger also introduced a gift voucher for individuals on parental leave inviting them to attend a seminar or a one-on-one coaching session on managing the transition back to work and balancing work, family and career;
- 'Unconscious Bias' training was piloted with a senior leadership team to assess the benefits of rolling out the training to a broader employee group;
- as a result of the 2013 remuneration review, gender pay equity for market competitiveness was achieved in line with Challenger's Remuneration Policy; and
- Challenger's efforts in relation to diversity were recognised by our people with a seven point increase from the 2011 to 2013 engagement survey for the following question: 'I see examples of Challenger's commitment to creating a work environment that values diversity'.

The executive team and the Board continue to review gender diversity across the organisation and in senior management and discuss whether gender targets are appropriate or required.

Board diversity

The Board has a policy on Board Renewal as detailed earlier in the Corporate Governance report. Two new Board members, one male and one female, were appointed in October 2012. Women now represent 22% of the Challenger Board.

Gender diversity outcomes

Based on numerous research findings, both within Australia and across the world, the Challenger Board and leadership team acknowledge that progress on gender diversity will require continued effort over a sustained period. As outlined, considerable effort and focus is being given to a range of diversity initiatives and gender diversity outcomes are monitored, in terms of proportional representation of women across the organisation and in management roles, by the Board on a monthly basis.

Over the last year, whilst there has been a material uplift in female representation at the Board level, there has been a slight decline in the number of women in senior leadership roles in the organisation. This has been the result of parental leave being taken and role changes at the senior leadership level as well as changes in the number of male leaders in the organisation.

Challenger remains committed to gender diversity and to ensuring our processes and practices support diversity at all levels of the organisation. The executive team and the Board continue to review gender diversity across the organisation and in senior management and discuss whether gender targets are appropriate or required.

Role	2012		2013		Net movement	
	By number	By percentage	By number	By percentage	By number	By percentage
Board	1	14%	2	22%	1	50%
Senior management	14	29%	13	25%	(1)	(7)%
Management	30	29%	35	34%	5	17%
Non-management	148	45%	143	42%	(5)	(3)%

Figures provided are as at the end of the reporting period and include employees on parental leave.

Leadership

Across 2011 and 2012 Challenger successfully rolled out our Leadership Perspectives Program, which was developed in conjunction with the Australian Graduate School of Management, and focused on developing the core leadership capabilities reflected in our leadership capability framework. With almost all senior leaders having completed the program, in 2013 we have continued to invest in leadership development of the next layer of leaders in the organisation with the creation of a Leadership Foundations program. This program was also developed in conjunction with the Australian Graduate School of Management and is aimed at supporting individual leadership development as well as building Challenger's leadership bench strength.

Mentoring

The Challenger Mentoring Program, now in its fourth year, provides selected employees with the opportunity to learn from senior managers within Challenger, and thereby assist them develop new skills and knowledge to apply to their role or career and support them in their professional development. The program also provides a development opportunity for mentors, by building on the capability of senior managers.

Feedback from both mentees and mentors since the program's inception has been extremely positive and the program will continue as an ongoing element of our investment in people development.

Supporting family and other personal commitments

Challenger recognises there are times when a balance is needed between work and external responsibilities. To support our people with these commitments, Challenger offers a range of flexible work opportunities including changes in hours of work, work patterns and work location. Those employees who are new parents are also supported through our parental leave policy, with primary care givers receiving the benefit of 12 weeks pay during a period of parental leave. The policy also provides for two weeks of paid leave for secondary care givers.

Community giving

We value a sense of community in our workplace and provide financial support for a range of fundraising and social activities and events which are coordinated by an employee-run 'Our Community' Committee. During the year 'Our Community' events included a movie night, a trivia night, a comedy night and an end of financial year celebration for employees. During the year 'Our Community' raised over \$23,000 for different charities through events such as Jeans for Genes Day, DisabiliTEA, Movember and the World's Greatest Shave.

Challenger also seeks to contribute to the growth and sustainability of the communities in which we operate. We have partnered with a range of charitable and not-for-profit organisations which support a broad demographic of Australians: Alzheimer's Australia, Barnardos, Bear Cottage, beyondblue, Meals on Wheels and National Seniors Foundation Trust.

Through Challenger's Community Giving Program, employees can make regular pre-tax donations direct from their salary to one of our Community Partners. These contributions are matched by the Company up to \$500 per employee per year. Through these programs Challenger and our people have contributed nearly \$21,000 to our Community Partners. Challenger has also provided a total of \$212,000 to our Community Partners via sponsorship of key research and events. In addition to our Community Partners our people were touched during the year by two worthy charities, namely Finnan's Gift and the Homicide Victims Support Unit. A number of individuals made donations to these charities, which were also matched by Challenger.

Challenger's shareholders are also invited to support our Community Partners by donating some or all of their dividends through its dividend donation program.

Challenger recognises that supporting these worthwhile organisations and our communities requires more than just a financial contribution. Challenger also provides paid volunteer leave and actively encourages employees to give their time and skills to help our community partners or another charity of their choice.

Environment

Property environmental performance

Challenger aims to minimise our impact on the environment by raising awareness with our people, employing technologies that minimise our use of resources and occupying sustainable places of work. When leasing premises we seek accommodation in buildings which are National Australian Built Environment Rating System (NABERS) energy-accredited to a rating of 3.5 stars or higher. We also seek to maximise the NABERS energy accreditation of our tenancies.

Our workspace at 255 Pitt Street, Sydney has an occupancy NABERS rating of 3.5 stars and was designed for sustainable business practices and includes technology such as:

- energy efficient and computer-controlled lighting;
- time-controlled room heating, ventilation and air-conditioning;
- recycling facilities;
- Virtual Desktop Infrastructure which are more energy efficient and longer lasting than traditional desktop computers;
- multi-function devices utilising destination print; and
- LCD monitors.

Waste management

Changes to our Waste Management system have seen a significant reduction by 17% in the volume of waste sent to landfill. The new waste system includes separated recyclable, non-recyclable and compostable green waste at desks, common kitchens and the on-site commercial Café.

Our carbon impact

Through continued focus on our environmental impact we reduced the electricity consumption of our Sydney office by 45MWh or 4% in 2013.

We also continued our partnership with Climate Friendly to reduce our carbon footprint by offsetting 100% of the carbon emissions generated by our power usage. In 2013, Challenger has invested in environmental projects with total CO₂ emission reductions of 1,030.9 tonnes.

Market recognition of sustainability achievements

In 2013, Challenger was recognised as a member of the FTSE4Good Index. The FTSE4Good Index has been designed to measure the performance of environmental, social and governance (ESG) practices of companies. The FTSE4Good Index includes companies that have met or exceeded globally recognised ESG standards. It is a valuable tool for fund managers, investment banks, stock exchanges and brokers when assessing or creating responsible investment products.

Directors' report

The Directors of Challenger Limited (the Company) submit their report, together with the financial report of the Company and its controlled entities (the Group or Challenger), for the year ended 30 June 2013.

1. Directors

The names and details of the Directors of the Company holding office during the financial year and up to the date of this report are listed below. Directors were in office for this entire period unless otherwise stated.

Peter L Polson

Independent Chairman

Experience/qualifications

Mr Polson holds a Bachelor of Commerce degree from the Witwatersrand University in South Africa, a Master of Business Leadership from the University of South Africa and has completed the Harvard Management Development program.

Mr Polson retired from the Commonwealth Bank in October 2002, where he had held the position of Group Executive, Investment and Insurance Services. Mr Polson joined the Colonial group in 1994, where he became Chief Executive of Colonial First State Limited, which was subsequently acquired by the Commonwealth Bank. Previously, Mr Polson was Managing Director of National Mutual Funds Management (International) Limited. Mr Polson has been a Director of the Company since 6 November 2003.

Special responsibilities

Mr Polson is Chairman of the Nomination Committee, and a member of the Group Risk and Audit Committee and the Remuneration Committee.

Directorships of other listed companies

Mr Polson was Chairman of Customers Limited (appointed as a director on 23 November 2010) and ceased to be Chairman and director on 4 July 2012 when the company was acquired by DirectCash Payments Inc. Mr Polson was previously the Chairman of AWB Limited (appointed 31 March 2003) and ceased to be Chairman and director on 3 December 2010 following the acquisition of AWB Limited by Agrium Inc.

Brian R Benari

Managing Director and Chief Executive Officer

Experience/qualifications

Mr Benari commenced in the role of Managing Director and Chief Executive Officer on 17 February 2012, having previously been Challenger's Group CFO/Group COO for over three years. Joining Challenger in March 2003 Mr Benari established and was founding Chief Executive of Challenger's Mortgage Management (CMM) division. In this role he oversaw the development of the business to include residential and commercial mortgage lending arms, as well as acquiring three of the four largest mortgage distribution broker platform businesses in Australia. Over a period of five years, CMM grew its mortgage lending assets to in excess of \$23 billion and was Australia's largest independent mortgage lender. Through its platforms, the business managed over \$110 billion of mortgages under administration. The business was sold in 2009 to the National Australia Bank.

Having originally qualified as a chartered accountant, Mr Benari joined Challenger with many years of finance industry experience, both offshore and onshore. He has held senior executive roles with institutions including JP Morgan, Bankers Trust, Macquarie Bank and Zurich Capital Markets.

Directorships of other listed companies

Mr Benari was a director of Homeloans Limited from 3 May 2007 until 17 February 2012.

Graham A Cubbin

Non-Executive Director

Independent

Experience/qualifications

Mr Cubbin holds a Bachelor of Economics (Hons) from Monash University and is a Fellow of the Australian Institute of Company Directors.

Mr Cubbin was a senior executive with CPH Investments Management Pty Limited (CPH) from 1990 until September 2005, including Chief Financial Officer for 13 years. Prior to joining CPH, Mr Cubbin held senior finance positions with a number of major companies including Capita Financial Group and Ford Motor Company. Mr Cubbin has been a Director of the Company since 6 January 2004.

Special responsibilities

Mr Cubbin is Chairman of the Remuneration Committee, and a member of the Group Risk and Audit Committee and the Nomination Committee.

Directorships of other listed companies

Mr Cubbin is a non-executive director of Bell Financial Group Limited (appointed 12 September 2007), STW Communications Group Limited (appointed 20 May 2008), White Energy Company Limited (appointed 17 February 2010) and McPherson's Limited (appointed 28 September 2010).

Steven Gregg

Non-Executive Director

Independent

Experience/qualifications

Mr Gregg holds a Bachelor of Commerce from the University of NSW. Mr Gregg has had an extensive executive career in management consulting and investment banking. His more recent senior executive roles included Partner and Senior Adviser at McKinsey & Company and Global Head of Investment Banking at ABN AMRO. His experience has spanned both domestic and international arenas, having worked in the USA and UK.

Special Responsibilities

Mr Gregg is a member of the Nomination Committee. Subsequent to 30 June 2013, Mr Gregg became a member of the Remuneration Committee on 1 July 2013.

Directorships of other listed companies

Mr Gregg is the Chairman of Goodman Fielder Limited, a non-executive director of Tabcorp Holdings Limited and a non-executive director of William Inglis & Son Limited. Mr Gregg was a director of Austock Group Limited until May 2012.

Jonathan Grunzweig

Non-Executive Director

Independent

Experience/qualifications

Jonathan Grunzweig was appointed as a Director of the Company on 6 October 2010. Mr Grunzweig holds a Bachelor of Arts Degree from Cornell University, USA and a Juris Doctor in Law from Harvard University. Mr Grunzweig is Principal and Chief Investment Officer (CIO) of Colony Capital, LLC. As CIO, Mr Grunzweig oversees the sourcing, structuring, execution and management of all investments and divestments on a global basis. Prior to joining Colony in 1999, Mr Grunzweig was a partner with the law firm of Skadden, Arps, Slate, Meagher & Flom LLP, where he specialised in corporate finance and mergers and acquisitions.

Special responsibilities

Mr Grunzweig is a member of the Nomination Committee.

Russell R Hooper

Non-Executive Director

Independent

Experience/qualifications

Mr Hooper is a Fellow of the Australian Institute of Company Directors, a Fellow of the Australian Society of Practising Accountants and a Fellow of the Financial Services Institute of Australasia, and has completed the Advanced Management Program, Harvard Business School.

He has experience at chief executive level in life insurance, wealth management and listed investment trusts. Mr Hooper has been a Director of the Company since 6 November 2003.

Special responsibilities

During the year ended 30 June 2013, Mr Hooper was Chair and member of the Group Risk and Audit Committee, member of the Remuneration Committee and a member of the Nomination Committee. Mr Hooper stepped down as Chair and member of the Group Risk and Audit Committee, and member of the Remuneration Committee on 1 July 2013. He continues to be a member of the Nomination Committee.

Directorships of other listed companies

Mr Hooper was a director of Century Australia Investments Limited until 17 June 2013.

Directors' report

Brenda M Shanahan

Non-Executive Director

Independent

Experience/qualifications

Ms Shanahan is a Graduate of Melbourne University in Economics and Commerce and a Fellow of the Australian Institute of Company Directors. Ms Shanahan has a research and institutional background in finance in Australia and overseas economies and equity markets. She has held executive positions in stock broking, investment management and an actuarial firm. Ms Shanahan was appointed as a Director of the Company on 1 April 2011.

Special responsibilities

Ms Shanahan is a member of the Group Risk and Audit Committee and the Nomination Committee. Subsequent to 30 June 2013, Ms Shanahan was appointed a member of the Remuneration Committee on 1 July 2013.

Directorships of other listed companies

Ms Shanahan is a non-executive director of Clinuvel Pharmaceuticals Limited (appointed 6 February 2007) and of Bell Financial Group Limited (appointed 5 June 2012).

JoAnne M Stephenson

Non-Executive Director

Independent

Experience/qualifications

Ms Stephenson holds a Bachelor of Commerce and a Bachelor of Laws (Honours) from the University of Queensland. She is a member of both the Institute of Chartered Accountants in Australia and the Australian Institute of Company Directors. Ms Stephenson has extensive experience in financial services both in Australia and the United Kingdom. She was previously a partner with KPMG and has significant experience in internal audit, risk management and consulting.

Special responsibilities

Ms Stephenson is a member of the Nomination Committee. Subsequent to 30 June 2013, Ms Stephenson was appointed the Chair of the Group Risk and Audit Committee on 1 July 2013.

Leon Zwier

Non-Executive Director

Independent

Experience/qualifications

Mr Zwier is a partner in the law firm Arnold Bloch Leibler. Mr Zwier holds a Bachelor of Laws from the University of Melbourne. Mr Zwier has been a Director of the Company since 15 September 2006.

Special responsibilities

Mr Zwier is a member of the Nomination Committee.

2. Company secretary

Mr Michael Vardanega, B Comm LL.B, is a qualified solicitor and was appointed to the position of General Counsel and Group Company Secretary on 1 March 2011. In this role, he is responsible for the legal and company secretariat teams within Challenger. Since joining Challenger in 2006, he has been extensively involved in the general management of corporate actions, public entity compliance and governance matters for Challenger and its subsidiaries. Prior to joining Challenger, Mr Vardanega was a member of the corporate advisory practice at commercial law firm Ashurst (formerly Blake Dawson).

Mr Andrew Brown has over 20 years' experience in the financial services industry and was appointed to the position of Company Secretary on 25 October 2012. Mr Brown is responsible for all corporate secretarial matters including ASIC regulatory and ASX listing rule compliance. Since joining Challenger in 2003, Mr Brown has been involved in funds management product marketing, compliance and governance. Prior to joining Challenger, Mr Brown held senior compliance management positions at MLC.

3. Principal activities and changes in the state of affairs

The principal activity of Challenger during the year was the provision of investment management activities. The following operating segments are responsible for delivering Challenger's principal activities:

Life – The Life division includes Challenger Life Company Limited (CLC). CLC is the leading provider of annuities and guaranteed retirement income solutions in Australia. Products appeal to investors seeking the security and certainty of guaranteed cash flows with protection against market, inflation and longevity risks. Products are distributed via financial institutions, financial adviser groups, and independent financial advisers. Being an independent provider, CLC has distribution representation on all major hubs and platforms.

Funds Management business – Challenger's Funds Management business comprises Fidante Partners and Aligned Investments. Fidante Partners comprises a number of associate boutique investment managers. Challenger provides administration and distribution services to the boutiques and shares in the profits of these businesses through its equity ownership. Aligned Investments develops and manages assets under Challenger's brand for the Life business and third party institutional investors.

There have been no significant changes in the nature of these principal activities or state of affairs of Challenger during the year.

4. Operating and financial review

Strong retail sales of annuities and growing funds under management in financial year 2013 (FY13) have continued to build on the leading retirement income platform that Challenger has developed over the past few years.

Challenger's statutory profit attributable to equity holders of \$416.8 million for the year ended 30 June 2013 represents a \$268.3 million, or a 180.7%, increase compared to \$148.5 million for the year ended 30 June 2012. The increase in statutory net profit after tax reflects higher normalised profit after tax (up \$11.7 million), a significant improvement in investment experience after tax (up \$248.1 million), and FY13 significant items (\$8.5 million).

Key performance indicators for the year ended 30 June 2013 include:

- Normalised EBIT was \$364.8 million, up \$26.5 million (7.8%).
- Normalised net profit after tax increased 3.9% to \$308.5 million, compared to the prior year.
- Normalised earnings per share increased 1.1 cents (1.9%) to 58.6 cents per share and statutory earnings per share increased 50.4 cents (175.0%) to 79.2 cents, compared to the prior year.
- The normalised cost to income ratio was lower at 34.4%, compared to 35.9% in 2012, reflecting Challenger's scalable business model.
- Final dividend was 10.5 cents per share, taking the total 2013 dividend to 20.0 cents, up from 18.0 cents in 2012.
- Total Life business retail sales were \$2,179.2 million, representing growth of 11.5% for the year.
- Life retail net book growth was \$598.1 million (9.1%).
- Total Funds Management net inflows were \$6,978.6 million, up from \$4,226.0 million in 2012.
- Total assets under management increased by \$11.4 billion to \$44.8 billion.
- Challenger's normalised and statutory return on equity after tax for 2013 was 16.8% and 22.7% respectively.

Normalised profit and investment experience

Challenger Life Company Limited (CLC), and its consolidated entities, are required by the Life insurance accounting standards to value all assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on assets and liabilities being recognised in the profit and loss in CLC and on consolidation in Challenger Limited. As CLC is generally a long-term holder of assets, due to them being held to match the term of life contract liabilities, 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 long-term expected returns. Investment experience also includes any economic and actuarial assumption changes, arising from changes in market conditions.

A reconciliation between statutory 'revenue' and management's view of normalised revenue, 'net income', is included in the financial report as part of the Segment information note on page 80. This note also includes a reconciliation of statutory profit before tax and normalised net profit before tax. The application of the normalised profit framework has been reviewed by Challenger's independent auditor to ensure that the reported results are in accordance with the methodology described in Note 2 to the financial report.

Directors' report

Challenger's normalised profit after tax was \$308.5 million for the year ended 30 June 2013, an increase of \$11.7 million (3.9%) on the prior year. Normalised profit after tax increased as a result of higher net income (up \$29.0 million), partly offset by higher expenses (up \$2.5 million), higher interest and borrowing costs (up \$1.3 million) and higher normalised tax (up \$13.5 million).

Total net income increased by \$29.0 million (5.5%) due to:

- higher Life cash operating earnings (up \$16.5 million) as a result of growth in the annuity book;
- higher Funds Management net fee income (up \$16.4 million) due to higher Funds Under Management (FUM); partly offset by
- lower corporate income (down \$3.9 million) due to lower interest income.

The management view of operating expenses is \$191.7 million for the year ended 30 June 2013 which is up \$2.5 million on the prior year. Life expenses and Funds Management expenses increased by \$2.3 million and \$3.3 million respectively, and were partly offset by a \$3.1 million reduction in Corporate costs. Challenger's business is highly scalable resulting in Challenger being one of the most efficient Australian financial services companies. Since FY09, total expenses have increased by 3%, whilst absorbing the cost of growth initiatives, and revenues have increased by 50%.

The scale and operating leverage in Challenger's business has resulted in the normalised cost to income ratio falling by 16 percentage points over the last five years to 34.4% in 2013. Reflecting the scale and leverage, Challenger's future normalised cost to income ratio target has been reduced to a range of between 32% and 36% (down from 34% and 38%).

Normalised EBIT for 2013 was \$364.8 million, up 7.8% from \$338.3 million in 2012. The normalised EBIT increase in both Life and Funds Management reflects growth in these businesses and higher assets and funds under management. The slight decrease in Corporate normalised EBIT reflects lower interest income, partly offset by lower expenses.

The 2013 effective normalised tax rate was 14%, which is up from 11% in 2012. The normalised tax expense in 2012 and 2013 includes a benefit as a result of receiving a private tax ruling in February 2012 from the Australian Taxation Office in relation to the application of Taxation of Financial Arrangements (TOFA). The TOFA private ruling is expected to reduce normalised tax by approximately \$30 million for each of the three financial years 2012 to 2014. Excluding the \$30 million TOFA tax benefit, the 2013 effective normalised tax rate was 23%.

The investment experience after tax profit of \$99.8 million for the year compares to a loss of \$148.3 million for 2012. The investment experience in 2013 was primarily due to a contraction in credit spreads due to improved global market sentiment.

2013 significant items after tax was \$8.5 million and mainly reflects a gain on the sale of Challenger's investment in Homeloans Limited. Following the sale of Challenger's Mortgage Management business in 2009, Challenger retained a residual investment in Homeloans Limited, an Australian non-bank provider of home loans.

The following tables provide an overview of Challenger's normalised results and components of investment experience:

Management analysis¹

	30 June 2013 \$M	30 June 2012 \$M	Change %
Cash earnings	416.2	392.0	6.2
Normalised capital growth	36.0	43.7	(17.6)
Normalised cash operating earnings	452.2	435.7	3.8
Net fee income	99.4	83.0	19.8
Other income	4.9	8.8	(44.3)
Net income	556.5	527.5	5.5
Operating expenses	(191.7)	(189.2)	1.3
Normalised EBIT	364.8	338.3	7.8
Interest and borrowing costs	(4.6)	(3.3)	39.4
Normalised net profit before tax	360.2	335.0	7.5
Tax on normalised net profit ²	(51.7)	(38.2)	35.3
Normalised net profit after tax	308.5	296.8	3.9
Investment experience after tax	99.8	(148.3)	Large
Significant items after tax ³	8.5	–	n/a
Statutory net profit after tax attributable to equity holders	416.8	148.5	180.7
Normalised EBIT by division			
Life	381.9	367.7	3.8
Funds Management	34.1	21.0	62.4
Corporate	(51.2)	(50.4)	(1.6)
Total	364.8	338.3	7.8

¹ 'Net income' and 'operating expenses' are internal classifications and are defined in Note 2 Segment information in the financial report. These differ from the statutory 'revenue' and 'expenses' classifications, as certain direct costs (including commissions and management fees) are netted off against gross revenues and special purpose vehicle revenues, expenses and finance costs are netted and included in aggregate for net income, or management view of revenue. These classifications have been made in the Directors' report, and the segment information note, as they reflect metrics used by management to measure the business performance of Challenger. Whilst the allocation of amounts to the above items and investment experience differs to the statutory view, both approaches result in the same net after tax profit due to the shareholders of the Company.

² In February 2012, a private binding ruling was received from the Australian Taxation Office (ATO) confirming the application of the Taxation of Financial Arrangements (TOFA) on certain historical transaction elections. This results in a net reduction of tax expense of circa \$30 million for each of the three financial years 2012 to 2014.

³ Primarily relates to the sale of Homeloans Limited.

Components of investment experience

	30 June 2013 \$M	30 June 2012 \$M
Actual capital growth¹		
Cash, fixed interest and debt	154.1	(82.2)
Infrastructure	16.3	31.2
Property (net of debt)	20.3	(25.6)
Equity and other investments	16.0	(15.2)
Total actual capital growth	206.7	(91.8)
Normalised capital growth²		
Cash, fixed interest and debt	(27.6)	(23.2)
Infrastructure	20.1	22.1
Property (net of debt)	30.9	30.9
Equity and other investments	12.6	13.9
Total normalised capital growth	36.0	43.7
Investment experience		
Cash, fixed interest and debt	181.7	(59.0)
Infrastructure	(3.8)	9.1
Property (net of debt)	(10.6)	(56.5)
Equity and other investments	3.4	(29.1)
	170.7	(135.5)
Actuarial assumption changes ³	(32.6)	(59.6)
Investment experience before tax	138.1	(195.1)
Tax benefit	(38.3)	46.8
Investment experience after tax	99.8	(148.3)

¹ Actual capital growth represents net realised and unrealised capital gains or losses and includes the attribution of interest rate and foreign exchange derivatives that are used to hedge volatility.

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 growth rates represent Challenger's long-term capital growth expectations for each asset class over the investment cycle. The normalised growth rate for each asset class is 6.0% for equity and other investments, 4.0% for infrastructure, 2.0% for property and (0.35%) for cash, fixed interest and debt. The rates have been set with reference to medium to long-term market growth rates and are reviewed to ensure consistency with prevailing medium to long-term market conditions. For example, the normalised growth assumption for property was amended in January 2010 from 2.5% to 2.0%. This was as a result of the privatisation of CKT increasing Challenger's exposure to Japanese property assets which have a lower expected long-term capital growth rate than the rest of the property portfolio. No other changes have been made to the normalised capital growth rates since they were first introduced in June 2008.

³ Actuarial assumption changes represents the impact of changes in macroeconomic variables, including bond yields and inflation factors, expense assumptions, losses on new business and other factors applied in the valuation of life contract liabilities. It also includes the attribution of interest rate derivatives used to hedge interest rate volatility.

Earnings per share (EPS)

As shown in the table below, the normalised and statutory basic and diluted EPS figures increased from 2012.

Normalised basic EPS increased by 1.1 cents (1.9%) to 58.6 cents per share compared to 57.5 cents per share for the prior year. The increase in normalised EPS primarily reflects higher normalised profit after tax.

Statutory basic and diluted EPS experienced large increases compared to the prior year, driven primarily by the increase in statutory profit.

	30 June 2013 cents	30 June 2012 cents	Change %
For the year ended			
Basic – normalised	58.6	57.5	1.9
Diluted – normalised	58.0	55.7	4.1
Basic – statutory	79.2	28.8	Large
Diluted – statutory	78.3	27.8	Large

Life financial results

The Life division's EBIT was \$381.9 million in 2013, up from \$367.7 million in 2012.

The Life division achieved record total sales of \$3,130.0 million for the year compared to \$2,657.8 million in 2012. Retail annuity sales were \$2,179.2 million for the year, representing an 11.5% increase compared to \$1,954.3 million in the prior year. Life net retail flows of \$598.1 million contributed to a total annuity retail book of \$7,123.3 million and represents net book growth of 9.1% on 2012.

Annuity sales continue to benefit from Challenger's product, distribution and marketing initiatives which are leveraging the commencement of the baby boomer retirement phase. Retail annuity sales continue to benefit from high reinvestment rates, with around 80% of maturities (with a residual capital value of 50% or more) reinvested for a further term.

New business sales tenor was 6.2 years in 2013, up from 5.4 years in 2012. Tenor is lengthening due to an increase in demand for longer-dated products. The launch of new products such as the Care Annuity and increased volumes in Liquid Lifetime are assisting to lengthen the tenor of new business. A lengthening of tenor assists the future rate of net book growth, enables investment in longer-dated assets which earn higher illiquidity premiums, and is more efficient in terms of distribution and administration.

In addition, there were institutional sales of \$951.8 million, compared to \$703.5 million in 2012. The 2013 sales mainly represent the reinvestment of maturities in Challenger's Guaranteed Index Return (GIR) product.

The increase in average investment assets of the Life division, from \$8,963 million in 2012 to \$10,161 million in 2013, was driven by the annuity sales noted above. Challenger has continued to invest in product development, marketing and increased distribution capability during the year.

Funds Management financial results

Funds Management EBIT was \$34.1 million in 2013, up from \$21.0 million in 2012.

Challenger's Funds Management business comprises Fidante Partners and Aligned Investments and is one of Australia's fastest growing active investment managers and the ninth largest¹, up from the 19th largest two years ago. The strong growth has been driven by a clear business strategy focused on investor alignment which has helped deliver strong investment performance in both Fidante Partners and Aligned Investments.

The Funds Management division, particularly through Fidante Partners, experienced positive funds flow of \$6,978.6 million during the year. Fidante Partners now has \$29.8 billion funds under management (FUM) at 30 June 2013, up from \$19.3 billion at 30 June 2012. Total FUM of the Funds Management division totals \$41.1 billion at 30 June 2013, up from \$31.0 billion at 30 June 2012, representing growth of \$10.1 billion (32.6%) over the year.

Corporate financial results

The Corporate division comprises central functions such as the Group Executives, finance, treasury, legal, human resources, risk management, and strategy. The Corporate division financial results also include interest received on Group cash balances and any interest and borrowing costs associated with Group debt facilities and the expenses of the long-term incentives plan for the total Group.

Corporate's EBIT was a loss of \$51.2 million in 2013, compared to a loss of \$50.4 million in 2012.

Challenger Life Company Limited capital position

Challenger Life Company Limited (CLC) holds capital in order to ensure that under a range of adverse scenarios, CLC can continue to meet its regulatory and contractual obligations to its customers. CLC is regulated by the Australian Prudential Regulation Authority (APRA) and is required to hold a minimum level of regulatory capital.

LAGIC transition arrangements

Life and General Insurance Capital (LAGIC) standards were issued by APRA in October 2012, with the new standards effective from 1 January 2013.

Prescribed capital amount (PCA)

The introduction of the new LAGIC standards on 1 January 2013 increased CLC's regulatory capital requirement by \$322.8 million. APRA has confirmed that transition arrangements will apply, resulting in the increase in prescribed capital occurring over a three-year period.

The initial LAGIC transition balance (\$322.8 million) will amortise over a three-year period, so that the increase in capital will be phased in by \$107.6 million each year with the first increase being on 1 January 2014. The entire transition balance will be amortised by 1 January 2016.

¹ Rainmaker Roundup – March 2013.

Subordinated debt

CLC's regulatory capital base includes \$488.8 million of admissible subordinated debt. APRA has advised that existing subordinated debt tranches will continue to be fully eligible as Tier 2 regulatory capital until each tranche's first call date after 1 January 2013, and will then amortise over four years.

CLC's subordinated debt includes \$129.0 million which had a call date on 7 June 2013. As a result, under APRA's transition arrangements, only \$103.2 million (i.e. 80% of the total amount) is eligible as Tier 2 regulatory capital on 30 June 2013.

The largest tranche of CLC's existing subordinated debt is a \$357.6 million tranche with a call date in November 2017. As such, this tranche will continue to be fully eligible as Tier 2 regulatory capital until its call date in November 2017 and will continue to be partially eligible until November 2021.

Tier 1 and Tier 2 regulatory capital

Under APRA's transition arrangements, CLC's statutory funds have three years to transition to the minimum requirement of Tier 1 capital, representing 80% of the prescribed capital amount. At a CLC consolidated level, APRA has provided an 18-month transition period to meet the 80% Tier 1 requirement. CLC is currently meeting these requirements at both the statutory and consolidated level.

CLC's target surplus

CLC maintains a target level of capital representing APRA's prescribed capital amount (PCA) plus a target surplus. The target surplus is a management guide to the level of excess capital that CLC seeks to carry 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's 30 June 2013 excess regulatory capital, as calculated under LAGIC, was \$897.4 million, and includes an allowance of \$322.8 million in respect of the initial transition balance.

While CLC does not target a specific PCA ratio, CLC's internal capital models result in a PCA ratio under current circumstances in the range of 1.4 times to 1.6 times. This range can change over time and is dependent on a number of factors. CLC's PCA ratio at 30 June 2013 (based on LAGIC capital standards) was 1.8 times higher than the 1.4–1.6 range, reflecting strong earnings of CLC during the period and contemplates the amortisation of the transition balance over the next two and half years. Excluding the full LAGIC transition balance (\$322.8 million), CLC's PCA ratio at 30 June 2013 was 1.4 times, which is within CLC's target PCA range.

Challenger Limited capital position

Challenger's capital position is managed at both the Group and the prudentially regulated, Challenger Life Company Limited (CLC) level with the objective of maintaining the financial stability of the Group and CLC whilst ensuring that shareholders earn an appropriate risk adjusted return. Net shareholder funds were \$1,947.4 million at 30 June 2013, up from \$1,692.2 million at June 2012, representing \$3.78 per share (2012: \$3.20 per share). At 30 June 2013 there was \$177.1 million of available Group cash (30 June 2012: \$93.8 million) and the Group corporate debt facilities of \$250 million were undrawn at 30 June 2013 (30 June 2012: undrawn), providing additional financial flexibility.

The Company continued its on-market share buy-back activity during the year. The Company acquired 13.8 million shares during the year at an average price of \$3.62 per share and a total cost of \$50.0 million. From the commencement of the program in July 2008 to the date of this report, a total of 149.5 million shares have been acquired at an average price of \$3.34 per share.

In 2007, Colony Marlin-Holdings (Colony) paid \$63 million for an option to purchase 57.1 million Challenger Limited ordinary shares, exercisable up to November 2012 at \$7.00 per share. These options expired in November 2012.

APRA's Level 3 (conglomerate) proposals

APRA is currently developing a supervisory framework for Level 3 groups which will be effective from 1 January 2015. Level 3 groups are groups of companies that perform material activities across one or more APRA regulated industries and/or in one or more non-APRA regulated industries.

Draft Level 3 standards were issued by APRA in mid-May 2013. APRA is still consulting with industry and seeking submissions on the draft standards before finalising the standards. Based on the draft standards, Challenger expects to be fully compliant on 1 January 2015.

Following finalisation of the Level 3 capital standards by APRA, Challenger will determine an appropriate PCA target surplus range, based on both LAGIC and Level 3 capital standards, which will apply to the Challenger Group.

Credit ratings

Challenger Limited and Challenger Life Company Limited (CLC) are rated by Standard & Poor's (S&P). In May 2013, S&P reaffirmed both CLC and Challenger Limited's ratings under S&P's new revised global insurance ratings criteria. Ratings were confirmed as:

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

The S&P ratings reflect the financial strength of Challenger Limited and CLC. In particular, they demonstrate Challenger's strong business profile, earnings and capital position.

Likely developments and expected results

Details on likely developments and expected results are given in section 6 below.

5. Dividends

On 19 August 2012, the Directors of the Company declared a final dividend on ordinary shares in respect of the year ended 30 June 2012 of 10.5 cents per share. The final dividend, of \$55.7 million, unfranked, was paid on 28 September 2012.

On 27 February 2013, the Directors of the Company declared an interim unfranked dividend of 9.5 cents per share in respect of the half-year ended 31 December 2012 (31 December 2011: 7.5 cents per share, unfranked). The interim dividend of \$49.9 million, unfranked, was paid on 28 March 2013.

On 16 August 2013, the Directors of the Company declared a final dividend on ordinary shares in respect of the year ended 30 June 2013 of 10.5 cents per share. The final dividend is estimated to be \$54.8 million, will be unfranked, is payable on 27 September 2013 and has not been provided for in the 30 June 2013 financial report.

The final unfranked dividend brings the total dividend per security for the 2013 financial year to 20.0 cents (2012: 18.0 cents – unfranked), an increase of 11.1% on the prior year.

In order to provide a more even distribution of dividends across the year, beginning with the 2013 interim dividend the payout ratio for both the interim and final dividends were aligned to the targeted 30% to 35% of normalised profit after tax.

Dividend and share buy-back policy

The Challenger Board reviews the dividend policy on a regular basis as part of the Group's capital management plan. Challenger targets a dividend payout ratio in the range of 30% to 35% of normalised net profit after tax.

Challenger intends to frank dividends to the maximum extent possible. However, Challenger is unable to frank dividends at present due to carried forward tax losses which need to be utilised before franking credits can be generated. Challenger expects to commence partial dividend franking in FY14, subject to future earnings and market conditions.

Given the current inability to frank dividends, Challenger operates an on-market share buy-back program to enhance shareholder returns. Challenger's on-market buy-back program operates under Section 257B of the Corporations Act, which allows up to 10% of the smallest number of shares on issue during the previous 12 months to be bought back. Challenger initiated its buy-back program in 2008 and has bought back 149.5 million shares since it initiated the program.

As announced to the market on 26 November 2012, Challenger committed \$50 million to the buy-back program during the period, acquiring 13.8 million shares. Challenger is committed to maintaining its on-market share buy-back program over the medium term to enhance shareholder returns and expects to commit between \$35 million and \$45 million to its on-market buy-back program in FY14, subject to prevailing market conditions, capital allocation priorities, the FY14 normalised dividend payout ratio and FY14 normalised profit after tax. Challenger targets a combined dividend and buy-back payout ratio of approximately 50% of normalised profit after tax over the medium term.

6. Likely developments and expected results

Challenger intends to continue with its current strategy to provide Australians with financial security in retirement. To achieve this vision we are focused on the following three core strategic objectives:

1. To be recognised as the leader in retirement income solutions in Australia;
2. To increase the portion of the Australian retirement pool allocated to secure and lifetime income products; and
3. Within our Funds Management business, to provide superior returns through active investment management.

Life division outlook

The Australian retirement incomes market is expected to grow strongly over the next 20 years as Australia's baby boomers (born 1943–1960) move from retirement savings to retirement spending. Baby boomers control approximately two thirds of Australia's \$1.6 trillion of superannuation assets. As a result of these demographic trends, approximately \$66 billion¹ will move from the accumulation phase to retirement phase in 2013. In addition to these demographic trends, Life is well positioned to benefit from changes in consumer risk preferences. Many retirees are risk averse² and are focused on longevity risk and the need for regular and dependable income in retirement, which is linked to inflation. Annuities address these concerns, and this is resulting in increased demand for Life's products, particularly longer-dated lifetime annuities.

In summary, the Life division is well placed to drive business growth through:

- strong retirement incomes brand recognition;
- leading product innovation and development;
- thought leadership in retirement incomes research and strategies; and
- a highly regarded distribution team.

Funds Management outlook

The Australian funds management market is an attractive market underpinned by compulsory superannuation contributions. Compulsory superannuation contributions are gradually increasing from 9.25% (from 1 July 2013) to 12% of gross employees' salaries (by 1 July 2019). As a result, the Australian superannuation market is forecasted to grow from \$1.6 trillion today to over \$6.0 trillion by 2030³.

Challenger's Fidante Partners business model has widespread support from investors and asset consultants, due to its alignment of investor, investment manager and Fidante Partners. Fidante Partners has a track record of achieving strong net flows, which are a result of the quality of the investment managers, strong investment performance, the institutional platform and Fidante Partners' distribution reach and capability.

Opportunities exist to expand the number of Fidante Partners boutiques and its offering. Since 30 June 2013, Fidante Partners acquired an interest in WyeTree Asset Management and formed an Australian partnership with River & Mercantile Asset Management. These new boutique partners provide further opportunities for business growth.

Aligned investments will continue to build out its client base, offering products across fixed income, property and infrastructure. Aligned investments has a strong pipeline with approximately \$1 billion of mandates which were unfunded at 30 June 2013.

Risks

The outlook above is subject to the following business risks:

- regulatory and political changes impacting financial services participants;
- demand and competition for our products including annuities and managed funds;
- market volatility; and
- general uncertainty around the global economy and its impact on markets in which we operate and invest in.

These could have a positive or negative impact on the outlook provided above.

Guidance for 2014

As a result of our belief in the success of our strategy, Challenger is providing normalised cash operating earnings guidance for the year ended 30 June 2014 of between \$465 million and \$475 million, up from \$452 million in 2013.

The Life division retail annuity net book is targeted to grow by 8% (~\$570 million) in FY14. The retail net book growth guidance excludes any impact from the High Yield Fund maturity. In February 2011, the \$444 million Challenger High Yield Fund was converted to a three-year annuity, with approximately \$300 million maturing in March 2014. FY14 retail net book growth guidance excludes the High Yield Fund maturity as reinvestment rates are difficult to determine.

Life institutional maturities of ~\$790 million are expected in the September 2013 quarter. This maturity will reduce the size of the Guaranteed Index Return (GIR) assets under management, and has been considered in determining the 2014 Life cash operating margin⁴ for 2014, which is unchanged at 4.5%.

¹ Source: Rice Warner Actuaries.

² Source: Senior Sentiment Index – retiree risk aversion report February 2013.

³ Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2011-2030 – November 2011.

⁴ COE margin (normalised COE to average assets under management).

7. Significant events after the balance date

At the date of this report and other than as disclosed in this report or the financial report, no matter or circumstance has arisen that has affected, or may significantly affect, the Group's operations, the results of those operations or the Group's state of affairs in future years.

8. Indemnification and insurance of officers and Directors

In accordance with its Constitution, and where permitted under relevant legislation or regulation, the Company indemnifies the Directors and officers against all liabilities to another person that may arise from their position as Directors or officers of the Company and its subsidiaries, except where the liability arises out of conduct involving lack of good faith, wilful default, fraud, criminal or dishonest behaviour.

To facilitate this, in accordance with the provisions of the Corporations Act 2001, the Company has insured the Directors and officers against liabilities incurred in their role as Directors and officers of the Company and its subsidiaries. The terms of the insurance policy, including the premium, are subject to confidentiality clauses and as such the Company is prohibited from disclosing the nature of the liabilities covered and the premium. The Company has not given, nor agreed to give, any indemnity to an auditor of the Group for any matters not permissible under the Corporations Act, and has not paid any premium for insurance against that auditor's liabilities for legal costs.

9. Environmental regulation and performance

Challenger acts as a trustee or responsible entity for a number of trusts that own assets both in Australia and overseas. These assets are subject to environmental regulations under both Commonwealth and State legislation. The Directors are satisfied that adequate systems are in place for the management of its environmental responsibilities and compliance with various legislative, regulatory and licence requirements. Further, the Directors are not aware of any breaches of these requirements, and to the best of their knowledge all activities have been undertaken in compliance with environmental requirements.

10. Remuneration report

Letter from the Chairman

Dear Shareholders,

On behalf of your Board, I am very pleased to present Challenger's 2013 Remuneration Report.

Our underlying business performance remains strong as demonstrated in our results outlined over the following pages. In line with 2012 outcomes, all key business metrics have been achieved in 2013. Challenger's 2013 Total Shareholder Return (TSR) was 27% which is substantially higher than the TSR achieved by the Australian equities market (17%) over the same period. On a five-year basis, Challenger's TSR was 150%, significantly outperforming the Australian equities market.

Your Board recognises that an important and necessary step in formulating our remuneration strategy is to proactively engage with our key shareholders and external stakeholders. Between May and July this year, I personally attended numerous meetings with institutional shareholders, retail shareholder representatives and proxy advisers. These meetings provide valuable insights into the various views regarding Challenger's remuneration practices and represent an important opportunity to discuss business performance. External feedback continues to provide a strong level of support for our remuneration practices and emphasises the importance of consistency in Challenger's approach to remuneration.

During 2013, the Board undertook a detailed review of the design of Challenger's Long Term Incentive (LTI) structure. This review considered the terms of LTI awards including the appropriateness of the current absolute TSR performance measure. Your Board validated the current structure other than a minor change to threshold vesting for future awards to align with market practice as outlined in this report.

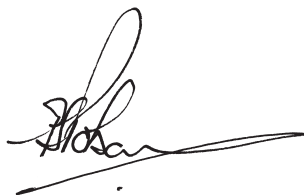
Your Board is confident that Challenger's remuneration framework and principles remain appropriate. In this year's report, additional disclosure is included regarding performance assessment, market competitiveness, remuneration governance, risk management and the Challenger Performance Plan Trust.

Your Board will continue to:

- drive appropriate alignment between shareholders and employees;
- demonstrate a clear link between performance and remuneration outcomes;
- ensure that remuneration policies and practices are consistent with Challenger's short and long-term objectives and are focused on sustained performance over the long term; and
- maintain a focus on the ever changing regulatory environment in which we operate and respond quickly to developments as they emerge.

Thank you for taking the time to review the 2013 Remuneration Report. Your Board remains confident that Challenger's remuneration practices are aligned with shareholder interests and are well designed to drive and reward sustained, long-term performance.

Yours sincerely



Peter Polson
Chairman

10.1 Performance and remuneration snapshot

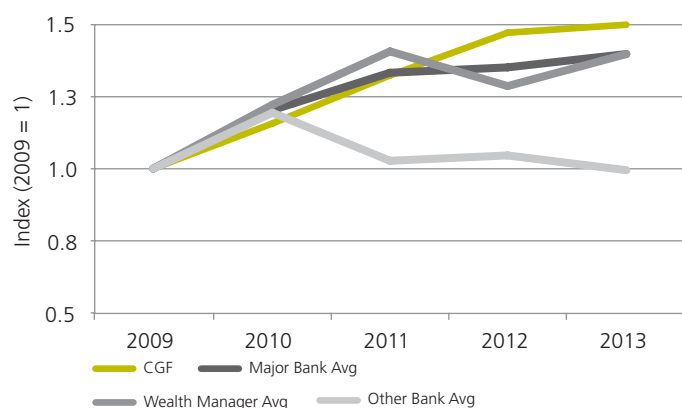
Performance outcomes

Over the last five years, Challenger has increased normalised Net Profit After Tax (NPAT) by 41% from \$218.9 million to \$308.5 million in 2013. Normalised Earnings Per Share (EPS) has increased by 50% over the same period, from 39.2 cents per share in 2009 to 58.6 cents per share in 2013. The table below summarises key financial metrics.

Year ended 30 June	2009	2010	2011	2012	2013
Normalised NPAT (\$m)	218.9	232.5	248.0	296.8	308.5
Normalised EPS (cents)	39.2	45.5	51.7	57.5	58.6
Closing share price (\$)	2.24	3.52	4.89	3.25	4.01
Dividends per share (cents)	12.5	14.5	16.5	18.0	20.0

Normalised EPS versus other financials

(Source: Company data and Bloomberg)



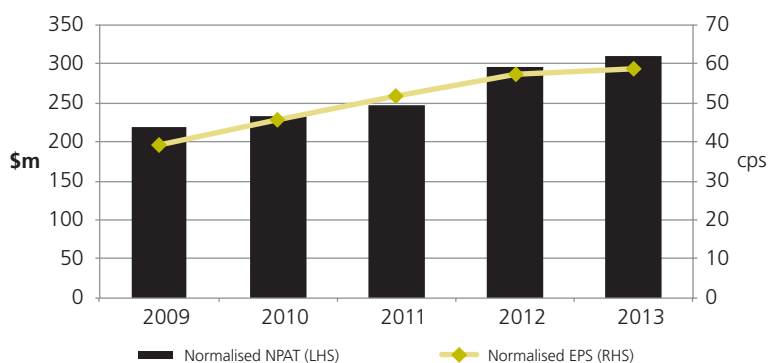
Significant EPS outperformance.

Challenger's EPS has increased by 50% since 2009, outperforming the major banks and wealth managers.

Major Bank Avg – Cash EPS (ANZ, CBA, NAB, WBC); Other Bank Avg – Cash EPS (BEN, BOQ, MQG, SUN)
Wealth Manager Avg – Normalised EPS (AMP, IOOF, PPT)

Normalised NPAT and Normalised EPS

(Source: Company data)



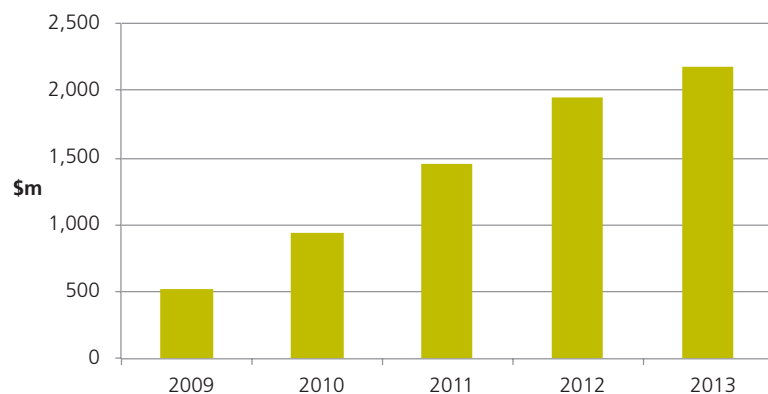
Sustained growth in Normalised NPAT and EPS.

Normalised NPAT has increased by 41%, and normalised EPS has increased by 50% since 2009.

Directors' report

Life – Retail annuity sales

(Source: Company data)



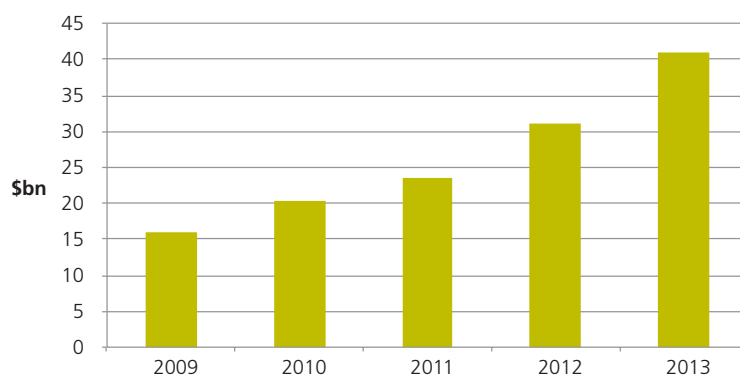
Life retail annuity sales exclude the High Yield Fund conversion (\$0.4 billion in 2011).

Strong growth in retail annuity sales.

Retail annuity sales have increased by 324% since 2009.

Funds Management – Funds Under Management (FUM)

(Source: Company data)

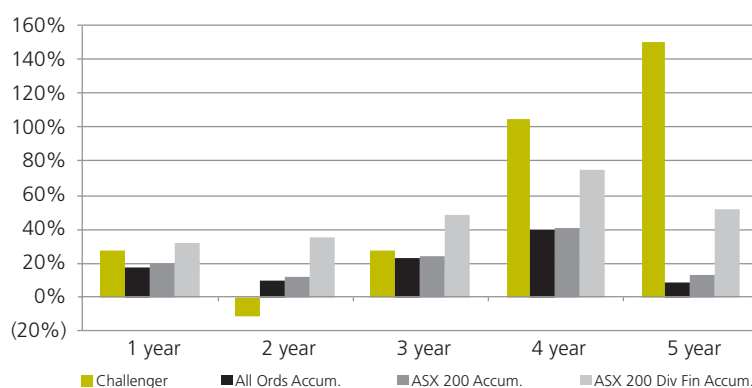


Significant growth in FUM.

FUM has increased by 156% since 2009.

Total Shareholder Return (TSR)

(Source: Bloomberg)



Significant long-term TSR outperformance.

Challenger's TSR was 150% over the last five years.

Remuneration strategy and principles

Challenger's remuneration strategy aims to attract, motivate and retain the talent capable of delivering the business strategy. Guiding principles are used to support the implementation of the remuneration strategy, shape remuneration policies and practices, align risk and remuneration and ensure that effective governance is exercised.

The guiding principles of Challenger's remuneration strategy are to ensure remuneration is market competitive, performance-based, aligned with creating value for shareholders and takes account of risk.

Remuneration components

Key components of Challenger's remuneration structure for Key Management Personnel (KMP) remain unchanged, and 2013 remuneration outcomes have been determined using the same remuneration principles as applied in recent years. Remuneration components comprise fixed remuneration, Short Term Incentive (STI) and Long Term Incentive (LTI) awards as summarised in the table below.

	Component	Overview	Link to business strategy
Fixed	Fixed remuneration	Base salary, salary sacrificed benefits and applicable fringe benefits tax. Employer superannuation contributions.	Positioned at a market competitive level reflecting the size and complexity of role, responsibilities, experience and skills.
Variable	STI	Annual 'at risk' remuneration. Rewards Challenger, business unit and individual performance. 50% of STI awards are deferred into Deferred Performance Share Rights (DPSRs) vesting in equal tranches over two years.	Supports Challenger's remuneration strategy by clearly linking remuneration outcomes with performance and contribution against annual KPIs. Balances risk management and governance considerations by deferring a significant portion of STI to support shareholder alignment.
	LTI	Long-term 'at risk' remuneration. Awarded in the form of Hurdled Performance Share Rights (HPSRs) vesting over a four-year period whereby 1/3 of the award is eligible to commence vesting on the second, third and fourth anniversary following grant subject to continued employment and satisfying the absolute TSR performance targets.	Typically awarded annually based on a range of criteria including current year performance, potential, retention and ability to materially influence long-term performance and strategy. Motivates KMP to pursue Challenger's long-term growth and success supporting shareholder alignment.

Deferred STI and LTI awards are subject to forfeiture and clawback provisions under the Challenger Performance Plan (CPP). Please refer to section 10.5 'Other remuneration arrangements' for further information.

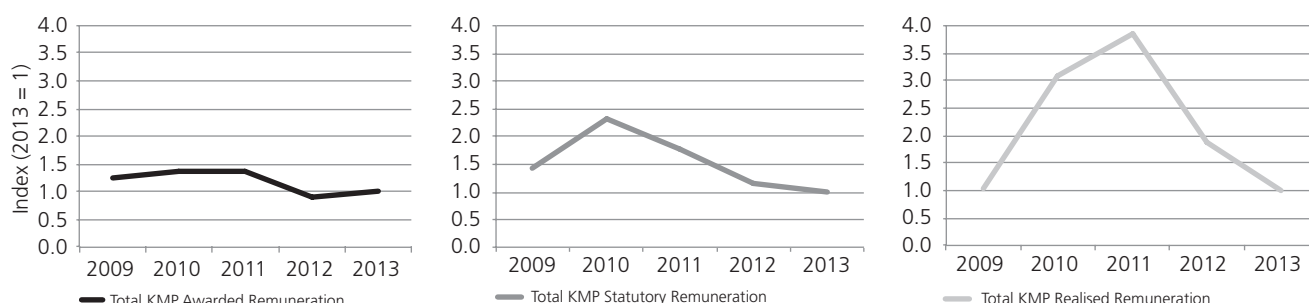
Directors' report

Remuneration outcomes

To help provide clarity and transparency on the quantum of KMP remuneration, Challenger discloses three remuneration tables (awarded, statutory and realised) as provided in section 10.6 '2013 remuneration tables'. The Board considers awarded remuneration to be the most relevant disclosure. In summary:

- **Awarded Remuneration:** Represents the value of remuneration that has been awarded for the financial year as determined by the Board. This includes fixed remuneration, STI (both cash and deferred) and LTI awards.
- **Statutory Remuneration:** Represents the accounting expense of remuneration in the financial year. This includes fixed remuneration, cash STI awards and the amortisation expense of deferred STI and LTI awards granted in prior years.
- **Realised Remuneration:** Represents the actual benefit realised during the financial year. This includes fixed remuneration, cash STI awards and the vesting of deferred STI and LTI awards granted in prior years.

The following charts summarise movements in total KMP awarded, statutory and realised remuneration between 2009 and 2013. The charts are based on the data contained in the corresponding remuneration tables in section 10.6 '2013 remuneration tables'.

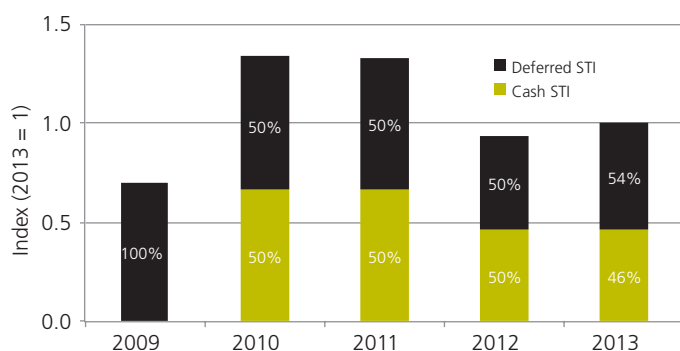


Fixed remuneration

With the exception of role changes, fixed remuneration for each KMP has not increased since October 2008.

Short Term Incentive

STI awards to KMP over the past five years are outlined in the following chart.

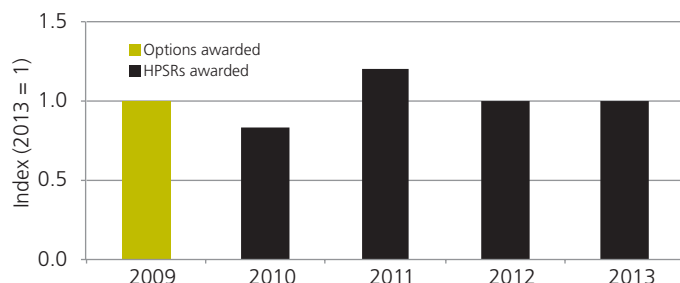


In setting the STI pool, the Board has continued to use a funding range of between 8% and 12% of Normalised Profit Before Bonus and Tax (NPBBT).

For 2013, the Board approved a total group STI pool of 9.1% of NPBBT with a minimum deferral requirement of 50% of STI awards for KMP deferred over at least two years. The Board sets the STI pool on an annual basis giving consideration to a number of factors, including Challenger's performance across the period and the amount required to meet Challenger's target remuneration positioning against the external market, whilst ensuring an appropriate balance between shareholder returns and remuneration is maintained.

Long Term Incentive

LTI awards to KMP over the past five years are outlined in the following chart.



LTI is awarded in the form of HPSRs. The terms and conditions of LTI awards are consistent with the information contained in section 10.4 'Key Management Personnel remuneration arrangements'.

HPSRs awarded in 2010 and 2011 that were eligible to vest in September 2013 did not achieve the required level of absolute TSR performance. These awards did not vest in 2013 but have the opportunity to vest in 2014 subject to higher absolute TSR performance requirements which reflect another year of compound growth. Any unvested awards will lapse at the end of the fourth anniversary following grant.

10.2 Remuneration strategy and principles

Challenger's remuneration strategy aims to attract, motivate and retain the talent capable of delivering the business strategy.

The remuneration strategy supports the delivery of strategic business objectives, including effective remuneration governance and prudent risk management practices.

The remuneration strategy is supported by a set of guiding principles as outlined in the following table.

Remuneration Strategy		
To attract, motivate and retain the talent capable of delivering the business strategy		
↓		
Guiding principles		
Market competitive	Performance-based and equitable	Aligned with shareholders and takes account of risk
<ul style="list-style-type: none"> Designed to attract and retain KMP and employees with required capabilities and experience. Benchmarking remuneration structure and quantum to the external market via relevant remuneration surveys and publicly disclosed data as appropriate. Independent review of remuneration benchmarking data for KMP by Challenger's remuneration adviser (KPMG). A balance between fixed, short-term and long-term remuneration appropriate to individual roles. 	<ul style="list-style-type: none"> Designed to motivate KMP to pursue Challenger's long-term growth and success. Provide appropriate remuneration for superior individual contribution to business unit and Challenger performance, aligning performance and remuneration outcomes. Reward behaviour consistent with the Challenger Principles by including behavioural assessment in the performance management process and linking to remuneration outcomes. Rigorous peer review through an annual calibration process to ensure internal equity and fairness. 	<ul style="list-style-type: none"> Significant portion of STI subject to deferral and linked to Challenger's future share price performance. LTI vesting subject to satisfying a shareholder return performance measure as well as time-based vesting conditions. Deferred STI and LTI awards subject to clawback and forfeiture provisions. Remuneration processes and governance to ensure remuneration arrangements do not encourage excessive risk taking.

10.3 Remuneration governance and risk management

Challenger operates a number of remuneration governance structures to support the delivery of robust oversight of remuneration practices and policies.

The table below provides an overview of the remuneration related responsibilities of key bodies at Challenger. Detailed information concerning the scope of the Board and Remuneration Committee's responsibilities and its controlled entities can be found on the Challenger website (www.challenger.com.au).

Board	<ul style="list-style-type: none"> The Board is the main body responsible for the implementation of effective remuneration governance and related risk management practices. The Board is responsible for approving remuneration principles and structures, ensuring that they are competitive and equitable and that they support the long-term interests of Challenger. The Board receives recommendations from the Remuneration Committee and approves these remuneration recommendations where appropriate.
Remuneration Committee	<ul style="list-style-type: none"> The Board convenes a Remuneration Committee comprising independent Directors with at least three members to assist the Board discharge its responsibilities. The Remuneration Committee meets at least four times during the year, with additional meetings scheduled as required. For the year ended 30 June 2013, five meetings were held. Amongst other activities, the Remuneration Committee determines and recommends to the Board various principles and policies (including remuneration, recruitment, retention, termination and diversity), Managing Director and Chief Executive Officer (CEO) and KMP remuneration, incentives, superannuation and life insurance arrangements and the Directors' remuneration framework.
Independent remuneration adviser	<ul style="list-style-type: none"> The Board, independently of management, appoints an adviser to the Remuneration Committee. During 2013, the Board renewed its engagement with KPMG. This engagement is based on a defined set of protocols. The Board is satisfied with KPMG's remuneration structure and quantum advice and that such advice is free from undue influence. For 2013, KPMG made recommendations in respect to KMP remuneration recommendations. Fees paid or payable to KPMG in respect of these activities was \$25,476 (inclusive of GST). KPMG further provided internal audit, tax, accounting, actuarial and transaction services and general remuneration factual information in 2013. Fees paid or payable to KPMG in respect of these activities was \$741,675 (inclusive of GST).

Remuneration governance arrangements promote compliance with the provisions of the ASX Listing Rules, the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations, the Corporations Act and, in respect of Challenger Life Company Limited and Challenger Retirement & Investment Services Limited, the principles contained in the Australian Prudential Regulation Authority Prudential Standards CPS 510 and SPS 510 respectively.

Risk management

The Board seeks to align remuneration with effective risk management, the generation of appropriate risk-based returns and Challenger's risk profile.

The Board has agreed a Risk Management Framework which sets out the Board's tolerance to risk exposures and the management of risk in general. During the year, the risk profile of Challenger is continuously monitored and managed against agreed risk limits. Any divergence from set limits is resolved within Challenger through a series of escalations and delegated authorities culminating with the Board. All business activities are carried out in accordance with this Risk Management Framework regardless of potential remuneration outcomes.

The Risk and Audit Committee provides an annual report to the Remuneration Committee and Board prior to various remuneration decisions being finalised. These reports summarise any breaches of the Risk Management Framework or other compliance policies. The Remuneration Committee and Board consider these reports when finalising variable remuneration pools and individual allocations thereof.

All employees are required to comply with Challenger's policies and other risk management and regulatory requirements as they apply to their particular role and business area. Breaches of compliance with these policies and other requirements are taken seriously and may result in disciplinary action and termination of employment. In addition, such breaches are considered when determining STI and LTI awards each year.

All employees are assessed against the Challenger Principles and behaviours as part of the annual performance review process and this outcome contributes to the overall performance rating and remuneration outcomes. Satisfactory assessment against the 'Compliance' and 'Integrity' principles are treated as gate-openers for individual participation in STI and LTI arrangements.

10.4 Key Management Personnel remuneration arrangements

This audited remuneration report describes Challenger's KMP and Non-Executive Director remuneration arrangements as required by the Corporations Act 2001.

Composition

Challenger's KMP for 2013 are detailed in the table below.

Name	Role	Term as KMP in 2013
Brian Benari	Managing Director and CEO	Full year
Richard Howes	Chief Executive, Life	Full year
Paul Rogan	Chief Executive, Distribution Product and Marketing	Full year
Andrew Tobin	Chief Financial Officer	Full year
Robert Woods	Chief Executive, Funds Management	Full year

Remuneration benchmarking

The objective of Challenger's remuneration strategy is to attract, retain and motivate the talent capable of delivering the business strategy. The remuneration strategy is supported by a strong focus on benchmarking remuneration to the external market.

Annually the Board approves the peer groups to be used when benchmarking KMP remuneration. In May 2013, the Board approved the following peer groups to be used when benchmarking KMP remuneration in 2013, namely:

- 1. Financial Industry Remuneration Group survey:** This peer group is used as the primary source of remuneration benchmark data at Challenger. Roles covered include both publicly disclosed and undisclosed remuneration data. The use of this peer group supports consideration of roles with comparable financial services, banking, insurance and capital markets skills to Challenger's KMP and comparability outside of publicly disclosed remuneration data (peer groups 2 and 3 below).
- 2. Financial services publicly disclosed data:** This peer group is used as a secondary source of remuneration benchmark data. Roles covered include publicly disclosed KMP remuneration data for select financial services companies. The use of this peer group supports consideration of roles with comparable capital markets skills to Challenger's KMP albeit that significant variation in company size and complexity exists between companies included in this peer group.
- 3. General industry publicly disclosed data:** This peer group is used as a secondary source of remuneration benchmark data. Roles covered include publicly disclosed KMP remuneration data for general industry companies with a market capitalisation between one half and two times that of Challenger. The use of this peer group supports consideration of similarities and differences in remuneration arrangements between Challenger KMP and executives in similarly sized companies in the wider market.

In August 2013, the Board considered remuneration benchmark data for the above peer groups as a key input when determining 2013 remuneration outcomes for KMP. The Board is confident that KMP remuneration reflects performance and is positioned and structured at a market competitive level reflective of the markets in which Challenger competes for talent and the specialist nature of the skills and experience of Challenger KMP.

Remuneration components

The key components of Challenger's remuneration structure for KMP remain unchanged in 2013 and remuneration outcomes have been determined using the same principles as applied in recent years. Remuneration components comprise fixed remuneration, STI and LTI awards as summarised below.

Fixed remuneration

Fixed remuneration comprises base salary and employer superannuation. When determining fixed remuneration for KMP, the Board considers the size and complexity of role, responsibilities, experience and skills. With the exception of role changes, fixed remuneration for KMP has not increased since October 2008.

Directors' report

Short Term Incentive

Overview

STI awards are used to reward KMP and employees for significant contributions to Challenger's results over the course of the prior financial year. There is a strong link between STI awards and Challenger's performance.

The Board considers that formulaic and targeted incentive arrangements may lead to unintended outcomes. As such, the application of target and maximum STI award limits are not supported at Challenger and STI awards are provided on a discretionary basis. KMP and employees have no contractual right to receive a STI award. The Board retains discretion to amend or withdraw the STI at any point.

STI pool

In setting the STI pool for the group, the Board continues to use a funding range of between 8% and 12% of NPBBT. Whilst the funding formula sets a range for the size of the STI pool, the Board considers a number of financial and non-financial factors when determining the size of the STI pool.

Examples of factors that the Board considers include overall business results, external remuneration levels and movements, capacity to pay, the cost and amount of capital employed, factors beyond management's control, quality of financial results and the management of risk.

For 2013, the Board approved a STI pool of 9.1% of NPBBT. The Board considers that the 2013 STI pool reflects a reasonable and equitable distribution between shareholders and employees and provides a clear line of sight to, and strong relationship between, performance and remuneration outcomes. STI pool allocations at a business unit level are determined by the Managing Director and CEO based on contribution to business performance.

Individual awards

The Board sets objectives for each KMP on the basis of a balanced scorecard. Individual STI awards for KMP are based on the achievement of specific objectives contained in balanced scorecards, including Financial, Growth, Risk & Compliance, Customer, and People & Community objectives as well as behaviours which support the Challenger Principles. For 2013, objectives were set and agreed with KMP in July 2012.

In July 2013, the Board assessed the performance of each KMP against their balanced scorecard. In August 2013, the Board determined individual STI awards for KMP as outlined in section 10.6 '2013 remuneration tables'.

Deferral policy and instrument

The Board reserves the right to deliver any STI award as a cash payment, partially deferred or wholly deferred. The Board considers that STI deferral provides a retention mechanism and links deferred STI awards with shareholder returns.

The Board reviews the STI deferral practice annually. KMP are advised of the deferral arrangement at the time they are notified of any STI award. For 2013, the Board determined 50% of STI awards for KMP excluding the Managing Director and CEO will be deferred over two years. In addition, the Board determined that the 2013 STI award for the Managing Director and CEO will be subject to a higher deferral requirement over three years. Please refer to section 10.6 '2013 remuneration tables' for further information.

Deferred STI awards are delivered as DPSRs under the CPP. DPSRs represent the right to receive a fully paid ordinary Challenger share for zero consideration subject to continued employment at the time of vesting. DPSRs do not provide an entitlement to vote or a right to dividends.

A 90-day Volume Weighted Average Price (VWAP) is used to determine the number of DPSRs issued per dollar of deferred STI. The use of a 90-day VWAP results in less risk of erroneous price movements or price manipulation that could advantage or disadvantage employees.

Forfeiture and clawback

Deferred STI awards are subject to forfeiture and clawback provisions under the CPP. Please refer to section 10.5 'Other remuneration arrangements' for further information.

2013 balanced scorecard outcomes

For 2013, the Board considered the following performance measures and associated targets to be critical indicators of Challenger's performance and shareholder value creation. Performance outcomes for these measures are reflected in KMP remuneration outcomes.

Objective	Performance measure	Measurement approach	Actual outcome
Financial	Normalised NPAT	Delivery against budget	\$308.5 million – exceeded target.
	Normalised EPS	Delivery against budget	58.6 cps – exceeded target.
	Normalised Return on Equity (ROE)	Delivery against hurdle	21% – exceeded target.
Growth	Implementation of key growth initiatives	Growth in Life retail annuity sales and net book Growth in FUM and Funds Management fiduciary capability	Growth in Life retail annuity sales of 11% (\$2,179 million in 2013; \$1,954 million in 2012). Growth in Life retail annuity net book of 9.1%. Launch of the Care Annuity in 2013. Significant growth in sales from lifetime annuity products (\$257 million in 2013; \$46 million in 2012). Growth in Funds Management FUM of 33% (\$41.1 billion in 2013; \$31.0 billion in 2012). Growth in Fidante Partners (the boutique funds management business) FUM of 55%, up from \$19.2 billion to \$29.8 billion.
Risk & Compliance	Effective risk management and compliance	Board assessment of compliance with Risk Appetite Statement	Compliance with Board Risk Appetite Statement for 2013 included the following: <ul style="list-style-type: none"> • Effective transition to new LAGIC capital framework and excess capital position maintained. • Credit ratings affirmed. • Liquidity policy ratios maintained. • Compliance with market risk and credit policy limits. • Level of reported incidents and breaches within acceptable tolerance levels. • Acceptable internal audit, external audit and regulatory review outcomes.
Customer	Increase brand awareness and value	Brand effectiveness measures Implementation of thought leadership and education initiatives Construction and promotion of retirement income planning strategies for financial planners	Significant improvement in the recognition of Challenger's brand amongst both financial advisers and consumers. 85% of advisers surveyed recognise Challenger as the leader in retirement incomes, up from 64% in 2010. Challenger's distribution capability is also highly regarded by advisers. An independent survey ranking financial services distribution capabilities, ranked Challenger number 1 for Business Development Manager support, and number 2 for technical and adviser support. Amongst consumers there has also been a significant increase in brand awareness. For Challenger's target market, recognition of Challenger's brand by consumers increased from 20% in 2011 to 36% in 2013.
People & Community	Employee engagement and diversity Contribution to community and the environment	Employee engagement against the financial services benchmark Implementation of diversity initiatives and diversity metrics Impact on community and the environment	Challenger was positioned five percentage points ahead of the Australian financial services benchmark in the employee engagement survey conducted by Aon Hewitt in March 2013. Unconscious Bias training was piloted as a diversity initiative, and Challenger's 'Keep in Touch' program was maintained and extended. The 'Keep in Touch' program engages with employees on parental leave and facilitates their return to work. The employee engagement score for employees who have taken parental leave increased by 14 points compared to the survey undertaken in 2011. Challenger continued to provide support to our Community Partners, including sponsorship of research into volunteer trends across Australia. Challenger's head office energy consumption decreased with a reduction of approximately 48 tonnes of carbon emissions.

Directors' report

Long Term Incentive

Overview

LTI awards are linked to the long-term performance of Challenger. LTI awards are granted to KMP and employees whose responsibilities provide them with the opportunity to materially influence long-term performance, strategy and shareholder value.

The Board considers that formulaic and targeted incentive arrangements may lead to unintended outcomes. As such, the application of target and maximum LTI award limits are not supported at Challenger and LTI awards are provided on a discretionary basis. KMP and employees have no contractual right to receive a LTI award. The Board retains discretion to amend or withdraw the LTI at any point.

LTI grants

When determining LTI grants each year, the Board takes into account a range of factors. Major considerations include Challenger performance, retention risk, and the proportion of total remuneration that should be deferred over a longer period for good governance and alignment with shareholders.

LTI instrument

LTI awards are delivered as HPSRs under the CPP. HPSRs represent the right to receive a fully paid ordinary Challenger share for zero consideration subject to continued employment and satisfying the absolute TSR performance targets. HPSRs do not provide an entitlement to vote or a right to dividends. The number of HPSRs awarded to KMP and employees is calculated by reference to the estimated fair value of the LTI award approved by the Board.

Performance measurement

The Board considers that TSR is an effective way to both incentivise and measure whether Challenger has created shareholder value. In August 2010, the Board approved the implementation of absolute TSR as the measure of long-term performance. The Board believes that an absolute rather than relative TSR performance measure is appropriate for the following reasons:

- there are no other listed companies in the Australian market with a retirement income business which is directly comparable to Challenger;
- comparing Challenger's TSR to a broader index can provide outcomes that may not be indicative of Challenger's performance given its differentiated position in the retirement income sector;
- key stakeholders, shareholders and proxy advisers have indicated a broader index is generally not considered an appropriate peer group as the outcome can result in a misalignment between KMP and employee remuneration and shareholder value creation; and
- if the absolute TSR threshold performance target is set at a level that is above average market returns over the long term, then LTI vesting will be directly linked to the superior returns achieved by shareholders.

As outlined in the following table, threshold vesting (33%) occurs when an absolute TSR of 8% compounded annually is achieved. Full vesting (100%) occurs when absolute TSR of 12% compounded annually is achieved. The TSR performance targets reflect what the Board considers to be appropriate long-term outcomes required for LTI awards to vest.

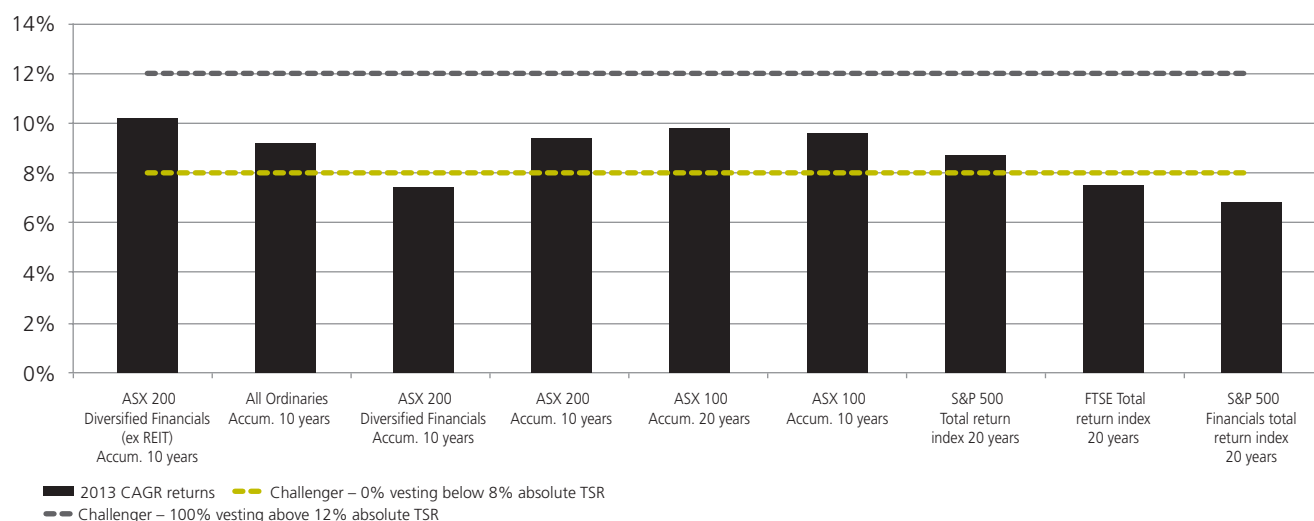
Absolute TSR compounded annually	% of HPSRs that vest
Less than 8% p.a.	0%
Above 8% but less than 12% p.a.	Straight line vesting between 33% and 100%
Above 12% p.a.	100%

In line with the determination of the number of DPSRs (from deferred STI awards), the calculation of the start and end price for absolute TSR performance testing is calculated using a 90-day VWAP leading up to the final date of the relevant performance period. The use of a 90-day VWAP results in less risk of erroneous price movements or price manipulation that could advantage or disadvantage employees.

The absolute TSR performance targets were set following significant research into:

- long-term (10 and 20 years) returns of listed equities;
- long-term (10 and 20 years) returns of listed financial services firms in general, and with reference to insurance companies and diversified financial companies;
- the importance of risk management and the negative consequences of higher TSR performance targets that over the longer term could encourage imprudent risk taking;

- an objective to move from cliff vesting to a structure that can gradually vest over a range of performance outcomes and periods; and
- an objective to produce long-term sustainable outcomes such that:
 - Zero vesting would occur if the return was below a minimum level (8% absolute TSR compounded annually; an outcome lower than long-term averages of a selection of equities indices).
 - Full vesting would occur if the return was above a level (12% absolute TSR compounded annually; an outcome higher than the long-term averages of a selection of equity indices).
 - Partial vesting between these two levels.



As an example, a share worth \$4 today and paying a 20 cent dividend each year would need to produce a total return (i.e. share price appreciation and dividends) of \$2.14 per share (a 53% return) over four years to achieve a 12% per annum compound return and for LTI awards to vest in full.

During 2013, the Board undertook a detailed design review of the LTI which included consideration of the appropriateness of the current absolute TSR performance measure and associated targets and proportion of award vesting for a given level of performance.

The Board is confident that while the performance targets attached to absolute TSR remain challenging, particularly in a low interest and capital constrained market, this performance measure continues to be the most appropriate way to incentivise and measure shareholder value creation at Challenger.

In addition, the Board determined that the level of threshold vesting of LTI awards at 8% absolute TSR compounded annually will be increased from 33% to 50% for any future awards. This change recognises the level of stretch inherent in the current absolute TSR performance targets and aligns with market practice.

Vesting periods

In 2011, the Board extended the LTI vesting period from three to four years.

One third of an LTI award is eligible to commence vesting on the second, third and fourth anniversary following grant subject to continued employment and satisfying the absolute TSR performance targets.

To the extent that the absolute TSR performance targets are not satisfied for a particular tranche of award, unvested HPSRs have the opportunity to vest at the end of the following tranche's vesting period subject to higher absolute TSR performance requirements which reflect another year of compound growth. Any unvested awards will lapse at the end of the fourth anniversary following grant. This approach is applied to ensure that KMP and employees are motivated to deliver strong performance over a longer term period.

Forfeiture and clawback

LTI awards are subject to forfeiture and clawback provisions under the CPP. Please refer to section 10.5 'Other remuneration arrangements' for further information.

10.5 Other remuneration arrangements

Challenger Performance Plan Trust

Overview

The CPP Trust is an employee share trust established to satisfy Challenger's employee equity obligations arising from DPSRs (from deferred STI awards) and HPSRs (from LTI awards).

Shares are acquired by the CPP Trust to mitigate dilution and provide a mechanism to hedge the cash cost of acquiring shares in the future to satisfy vested equity awards. The CPP Trust acquires physical shares on market or via forward share purchase agreements entered into by Challenger. The use of forward share purchase agreements was implemented in 2013 to support increased capital efficiency.

The number of shares held by the CPP Trust and the delivery of shares via forward share purchase agreements is closely aligned with the expected vesting of equity awards over future periods.

Hedging and governance arrangements

The hedging position of the CPP Trust is continually monitored and reported to the Board.

As at 30 June 2013, 35% and 26% of Challenger's employee equity obligations are satisfied by shares currently held by the CPP Trust and forward share purchase agreements respectively. It is anticipated that this proportion will adjust over time so that forward share purchase agreements become the primary method of satisfying employee equity obligations relating to HPSRs. This will further decrease net income in the CPP Trust.

Trust distributions

Challenger shares held by the CPP Trust generate dividend income. The CPP Trust does not receive dividends from forward share purchase agreements.

The Trustee of the CPP Trust has absolute discretion to determine whether any net income earned from shares held by the CPP Trust is distributed to beneficiaries. Any undistributed income at the end of the year is taxed at the top marginal tax rate (which exceeds the company tax rate) and carries no franking credits. Distributions are generally made by the Trustee annually in the following manner:

- DPSRs receive preference in regard to the distribution of net income from the CPP Trust on the basis that the incentive is already earned and vesting is not subject to the achievement of absolute TSR performance targets. Providing there is sufficient net income in the CPP Trust and a distribution is approved by the Trustee, each DPSR receives a maximum distribution equal to Challenger dividends paid in the relevant financial year; and
- any remaining income in the CPP Trust following distributions relating to DPSRs is allocated to holders of unvested HPSRs based on the likelihood of the LTI award vesting.

Any income distributed to KMP and employees from the CPP Trust is taken into account by the Remuneration Committee and Board when considering STI awards and total remuneration.

The Board considers that the distribution of net income from the CPP Trust further aligns KMP, employee and shareholder interests. CPP Trust distributions to KMP are disclosed within the remuneration tables in section 10.6 '2013 remuneration tables'.

Change of control

The Board retains discretion regarding the treatment of unvested equity.

Forfeiture and clawback provisions

Under the terms of the CPP, both DPSRs (from deferred STI awards) and HPSRs (from LTI awards) may be reduced or forfeited should the Board determine a KMP or employee:

- has committed an act of dishonesty;
- is ineligible to hold their office for the purposes of Part 2D.6 of the Corporations Act 2001; or
- is found to have acted in a manner that the Board considers to be gross misconduct or is dismissed with cause.

In addition, the Board may resolve that an award of DPSRs or HPSRs should be reduced or forfeited in order to:

- protect financial soundness; or
- respond to unexpected or unintended consequences that were significant and unforeseen by the Board (such as material risk management breaches, unexpected financial losses, reputational damage or regulatory non-compliance).

Employee share ownership

The Board encourages employee share ownership because it believes greater employee ownership increases alignment with shareholders.

The Tax Exempt Share Plan provides permanent employees a means by which to acquire Challenger shares at no cost, and in so doing, participate in the future growth and performance of Challenger. Provided certain requirements are met, eligible employees are offered \$1,000 worth of fully paid Challenger ordinary shares on an annual basis. These shares are subject to a three-year minimum holding period.

As at 30 June 2013, 82% of permanent employees hold unvested Challenger equity.

Furthermore, employee share ownership levels by way of unvested equity instruments are formally reviewed by the Board on a regular basis. As at 30 June 2013, employee ownership, by way of unvested equity, has increased from 4% in 2012 to 5% in 2013. The Board continues to target employee ownership below 10%.

Minimum shareholding guidelines

In July 2010, Challenger introduced KMP and Non-Executive Director minimum shareholding guidelines in order to promote alignment with shareholders.

KMP are expected to maintain a minimum holding of Challenger shares equal to 100,000 shares. Non-Executive Directors are expected to maintain a minimum holding of 20,000 shares. Transition arrangements are in place for KMP and Non-Executive Directors. The Board retains discretion to allow KMP and Non-Executive Directors to vary from this guideline.

Employee share trading policy

KMP and employees must comply with Challenger's employee share trading policy and are required to obtain pre-approval from the Company Secretary if they wish to trade in Challenger shares. KMP and employees are prohibited from trading during specified black-out periods, including prior to the release of Challenger's financial results.

KMP and employees are prohibited from hedging their unvested equity awards. Employees hedging unvested awards would not be consistent with Challenger's remuneration strategy or appropriate governance outcomes and would be contrary to the intention of equity-based remuneration arrangements. Where a KMP and an employee are found to have breached this requirement, it will be regarded as serious misconduct and may be grounds for dismissal.

Challenger prohibits KMP and employees from taking out margin loans on Challenger shares with any exceptions to this rule requiring Board approval. There have been no requests for exceptions to this policy for the year ended 30 June 2013.

10.6 2013 remuneration tables

KMP receive a mix of remuneration, with a portion received during the year and the balance vesting over the following four years depending on service and long-term performance.

The Board continues to provide clarity and transparency regarding the quantum of KMP remuneration by disclosing three different remuneration tables as outlined below.

Awarded Remuneration	<ul style="list-style-type: none">• Represents the value of remuneration that has been awarded for the financial year as determined by the Board.• Includes fixed remuneration, STI (both cash and deferred) and LTI awards.• The Board considers awarded remuneration to be the most relevant remuneration table.
Statutory Remuneration	<ul style="list-style-type: none">• Represents the accounting expense of remuneration in the financial year.• Includes fixed remuneration, cash STI awards and the amortisation expense of prior year deferred STI and LTI awards.• May bear little relationship to the awarded remuneration and/or business performance in the current financial year.
Realised Remuneration	<ul style="list-style-type: none">• Represents the actual benefit realised during the financial year.• Includes fixed remuneration, cash STI awards and the vesting of deferred STI and LTI awards granted in prior years.• May bear little relationship to awarded remuneration and/or business performance in the current financial year; influenced by the vesting dates of deferred STI and LTI awards and Challenger's share price performance following issuance.

Table 1 – Awarded Remuneration

KMP	Year	Short-term employee benefits			Superannuation \$	Share-based payments ² (LTI) \$	Other ³ \$	Total \$
		Salary ¹ \$	Cash STI \$	Deferred STI \$				
B Benari ⁴	2013	1,238,143	900,000	1,400,000	16,470	1,734,000	226,638	5,515,251
	2012	859,173	900,000	900,000	15,775	925,000	329,364	3,929,312
R Howes	2013	634,662	637,500	637,500	16,470	1,071,000	212,729	3,209,861
	2012	635,534	675,000	675,000	15,775	1,224,000	213,403	3,438,712
P Rogan	2013	639,893	650,000	650,000	16,470	1,020,000	167,467	3,143,830
	2012	634,443	612,500	612,500	15,775	1,008,000	224,227	3,107,445
A Tobin ⁵	2013	583,530	412,500	412,500	16,470	612,000	77,258	2,114,258
	2012	213,897	128,142	128,142	5,776	576,000	14,775	1,066,732
R Woods ⁶	2013	497,118	350,000	350,000	13,725	1,071,000	209,171	2,491,014
	2012	638,466	625,000	625,000	15,775	1,224,000	209,330	3,337,571

¹ Includes the cost of death, total permanent disability and salary continuance insurances.

² Determined with reference to the estimated fair value of the number of HPSRs approved by the Board on 15 August 2013. HPSRs will be formally granted in September 2013 and consequently the fair value estimate for these awards is subject to change depending on the Challenger share price at the time of grant.

³ 2013 values represent distributions from the CPP Trust. 2012 values represent distributions from the CPP Trust and interest amounts accrued in the year on loans taken out by KMP to acquire Challenger shares under the Long Term Incentive Plan which ceased in 2012.

⁴ Mr Benari was appointed as Managing Director and Chief Executive Officer on 17 February 2012. The Board determined that Mr Benari's 2013 STI award will be subject to a higher deferral requirement vesting over three years.

⁵ Mr Tobin became a KMP on 17 February 2012. Salary and STI for 2012 reflects remuneration on a pro-rata basis since 17 February 2012.

⁶ 2013 values for Mr Woods are pro-rated where relevant to reflect the period of time Mr Woods was on long service leave during the year.

Table 2 – Statutory Remuneration

KMP	Year	Short-term employee benefits		Superannuation \$	Share-based payments ² (LTI) \$	Other ³ \$	Total \$
		Salary ¹ \$	Cash STI \$				
B Benari ⁴	2013	1,238,143	900,000	16,470	1,992,916	226,638	4,374,167
	2012	859,173	900,000	15,775	2,036,296	329,364	4,140,608
R Howes	2013	634,662	637,500	16,470	1,596,377	212,729	3,097,738
	2012	635,534	675,000	15,775	1,751,019	213,403	3,290,731
P Rogan	2013	639,893	650,000	16,470	1,251,215	167,467	2,725,045
	2012	634,443	612,500	15,775	1,167,426	224,227	2,654,371
A Tobin ⁵	2013	583,530	412,500	16,470	492,892	77,258	1,582,650
	2012	213,897	128,142	5,776	123,501	14,775	486,091
R Woods ⁶	2013	497,118	350,000	13,725	1,548,096	209,171	2,618,110
	2012	638,466	625,000	15,775	1,687,898	209,330	3,176,469
D Stevens ⁷	2013	–	–	–	–	–	–
	2012	629,482	640,000	9,999	1,427,289	123,910	2,830,680

¹ Includes the cost of death, total permanent disability and salary continuance insurances.

² Calculated on the basis outlined in Note 1 (xxxiii) to the financial statements and reflects the fair value of the benefit derived at the date at which they were granted. Fair value is determined using an option pricing model and is undertaken by an independent third party. The majority of share-based payments are subject to market-based performance conditions; consequently no adjustment to the fair valuation following grant date is permitted to be made for the likelihood of performance conditions not being met. As such, the value of the share-based payment included in the table may not necessarily have vested during the financial year.

³ 2013 values represent distributions from the CPP Trust. 2012 values represent distributions from the CPP Trust and interest amounts accrued in the year on loans taken out by KMP to acquire Challenger shares under the Long Term Incentive Plan which ceased in 2012.

⁴ Mr Benari was appointed as Managing Director and CEO on 17 February 2012.

⁵ Mr Tobin became a KMP on 17 February 2012. Salary and STI for 2012 reflects remuneration on a pro-rata basis since 17 February 2012.

⁶ 2013 values for Mr Woods are pro-rated where relevant to reflect the period of time Mr Woods was on long service leave during the year.

⁷ Mr Stevens ceased to be a KMP on 17 February 2012. 2012 values represent the period when he was a KMP.

Table 3 – Realised Remuneration¹

KMP	Year	Short-term employee benefits		Superannuation \$	Share-based payments		Other ⁵ \$	Total \$
		Salary ² \$	Cash STI \$		Value of prior year's equity settled options, shares and rights at issue ³ \$	Value due to share price appreciation of prior year's equity settled options, shares and rights ⁴ \$		
B Benari⁶	2013	1,238,143	900,000	16,470	899,996	545,831	226,638	3,827,078
	2012	859,173	900,000	15,775	962,498	4,170,382	329,364	7,237,192
R Howes	2013	634,662	637,500	16,470	749,997	566,168	212,729	2,817,526
	2012	635,534	675,000	15,775	524,999	3,792,089	213,403	5,856,800
P Rogan	2013	639,893	650,000	16,470	487,498	192,861	167,467	2,154,189
	2012	634,443	612,500	15,775	485,969	2,154,086	224,227	4,127,000
A Tobin⁷	2013	583,530	412,500	16,470	128,749	76,873	77,258	1,295,380
	2012	213,897	128,142	5,776	–	–	40,356	388,171
R Woods⁸	2013	497,118	350,000	13,725	674,998	575,245	209,171	2,320,257
	2012	638,466	625,000	15,775	474,998	3,779,119	209,330	5,742,688

¹ No formal accounting standards provide guidance regarding the disclosure, measurement and classification of realised remuneration. Share-based payments and other award values have been prepared with consideration of announcements made by the Productivity Commission's inquiry into Executive Remuneration in Australia (released 4 January 2010) and the Corporations and Markets Advisory Committee Executive Remuneration Report (released 25 May 2011).

² Includes the cost of death, total permanent disability and salary continuance insurances.

³ Represents the value of DPSRs, HPSRs and options vesting during the financial year at the original grant price.

⁴ Represents the share price appreciation on DPSRs options and cash LTIP that vested during the financial year based on the value at vesting date. The value shown is net of exercise costs where applicable.

⁵ 2013 values represent distributions from the CPP Trust. 2012 values represent distributions from the CPP Trust and interest amounts accrued in the year on loans taken out by KMP to acquire Challenger shares under the Long Term Incentive Plan which ceased in 2012.

⁶ Mr Benari was appointed as Managing Director and CEO on 17 February 2012.

⁷ Mr Tobin became a KMP on 17 February 2012. Salary and STI for 2012 reflects remuneration on a pro-rata basis since 17 February 2012.

⁸ 2013 values for Mr Woods are pro-rated where relevant to reflect the period of time Mr Woods was on long service leave during the year.

10.7 2013 Deferred Short Term Incentive and Long Term Incentive awards

Deferred Performance Share Rights granted to Key Management Personnel during year ended 30 June 2013

DPSRs granted in September 2012 represent deferred STI awards (50% of total STI) for the 2012 financial year. These awards vest in equal tranches over a two-year period subject to continued employment at the time of vesting.

KMP	Compulsory deferral from 2012 \$	Allocation price \$	Total no. of DPSRs granted	Date of grant	Tranche 1 1 September 2013		Tranche 2 1 September 2014	
					Number vesting	Fair value at grant \$	Number vesting	Fair value at grant \$
B Benari	900,000	3.4475	261,058	12 Sep 12	130,529	3.18	130,529	3.02
R Howes	675,000	3.4475	195,794	12 Sep 12	97,897	3.18	97,897	3.02
P Rogan	612,500	3.4475	177,664	12 Sep 12	88,832	3.18	88,832	3.02
A Tobin¹	128,142	3.4475	37,169	12 Sep 12	18,584	3.18	18,585	3.02
R Woods	625,000	3.4475	181,290	12 Sep 12	90,645	3.18	90,645	3.02

¹ Mr Tobin became a KMP on 17 February 2012. Compulsory deferral and DPSR values are pro-rated for the period as a KMP.

Directors' report

Hurdled Performance Share Rights granted to Key Management Personnel during year ended 30 June 2013

HPSRs granted in September 2012 represent LTI awards for the 2012 financial year. These awards vest over a four-year period subject to continued employment and satisfying the absolute TSR performance targets.

KMP	Compulsory deferral from 2012 \$	Allocation price \$	Total no. of DPSRs granted	Tranche 1 1 September 2014		Tranche 2 1 September 2015		Tranche 3 1 September 2016	
				Number vesting	Fair value at grant \$	Number vesting	Fair value at grant \$	Number vesting	Fair value at grant \$
B Benari ¹	–	–	–	–	–	–	–	–	–
R Howes	12 Sep 12	3.4475	850,000	283,333	1.42	283,333	1.42	283,334	1.42
P Rogan	12 Sep 12	3.4475	700,000	233,333	1.42	233,333	1.42	233,334	1.42
A Tobin	12 Sep 12	3.4475	400,000	133,333	1.42	133,333	1.42	133,334	1.42
R Woods	12 Sep 12	3.4475	850,000	283,333	1.42	283,333	1.42	283,334	1.42

¹ Mr Benari's most recent HPSR grant was made on 16 March 2012.

10.8 Contractual arrangements

Brian Benari – Managing Director and Chief Executive Officer

Mr Benari was appointed Managing Director and Chief Executive Officer effective 17 February 2012. The terms of his appointment and termination arrangements were approved at the Extraordinary General Meeting on 28 February 2012. The following table summarises the notice periods and payments which apply to Mr Benari upon termination.

	Notice period	Payment in lieu of notice	Treatment of STI	Treatment of LTI
Employer initiated termination				
Poor performance	12 months	12 months	Lapse	Lapse
Misconduct or other circumstances justifying summary dismissal	None	None	Lapse	Lapse
Employee initiated termination				
With Board approval	6 months	The Board may elect to make a payment of Salary Package in lieu of notice	Eligible for a pro-rata STI payable at the usual payment date. Unvested DPSRs fully vest	Continued vesting ¹
Without Board approval	6 months	The Board may elect to make a payment of Salary Package in lieu of notice	Lapse	Lapse
Due to material change ²	One month	12 months	Unvested DPSRs fully vest	Board discretion ³

¹ HPSRs continue to be held by Mr Benari subject to the original vesting conditions.

² Represents a substantial diminution of Mr Benari's duties, status, responsibilities and/or authority without his agreement.

³ The Board may in its absolute discretion determine the extent to which Mr Benari's unvested HPSRs will vest.

Key Management Personnel (excluding Managing Director and Chief Executive Officer) employment agreements and notice periods

KMP do not have fixed terms of employment. The notice period by Challenger and the KMP is 26 weeks unless terminated for cause.

Upon termination, if the KMP is considered a good leaver such as cessation of employment due to redundancy, the KMP will be entitled to a pro-rata STI award. Board discretion applies in relation to unvested awards under the CPP.

10.9 Non-Executive Director disclosures

Composition

Challenger's Non-Executive Directors for 2013 are detailed in the table below.

Name	Term as Non-Executive Director in 2013
Peter Polson (Chairman)	Full year
Graham Cubbin	Full year
Steven Gregg	Partial year – appointed on 8 October 2012
Jonathan Grunzweig	Full year
Russell Hooper	Full year
Brenda Shanahan	Full year
JoAnne Stephenson	Partial year – appointed on 8 October 2012
Leon Zwier	Full year

Fee pool

The maximum aggregate amount of annual fees is approved by shareholders in accordance with the requirements of the Corporations Act 2001.

The current fee pool of \$2,000,000 was approved by shareholders in 2007. No increase to the fee pool will be sought for 2014.

Fee framework and review

Challenger aims to attract and retain suitably skilled and experienced Non-Executive Directors to serve on the Board and to reward them appropriately for their time and expertise. Non-Executive Directors are remunerated by way of fees paid in recognition of membership of the Board and its committees. Additional fees are paid to the Chairman of the Board and its committee to reflect the additional responsibilities.

The Board is committed to periodically reviewing the fee framework in order to ensure that fees remain appropriate against the external market and support the attraction and retention of high quality Non-Executive Directors. On recommendation from the Remuneration Committee, the Board approves the fee structure within the bounds of the overall maximum fee pool.

The following table summarises the fees applicable to membership and chairmanship of the Board and its sub-committees for the year ended 30 June 2013.

Board/Committee	Role	Annual Fee \$
Board¹	Chairman ^{1,2}	200,000
	Member	150,000
Group Risk and Audit	Chairman ²	20,000
	Member	23,000
Remuneration	Chairman ²	13,000
	Member	17,000

¹ Board fees include Nomination Committee fees.

² Chairman fees are in addition to Member fees.

Directors' report

Non-Executive Director fees for the year ended 30 June 2013

The following table summarises Non-Executive Director fees for the year ended 30 June 2013.

Non-Executive Director	Year	Director fees \$	Superannuation \$	Total \$
P Polson ¹	2013	373,530	16,470	390,000
	2012	367,451	15,775	383,226
G Cubbin ²	2013	203,000	–	203,000
	2012	181,083	–	181,083
S Gregg ³	2013	100,718	9,065	109,783
	2012	–	–	–
J Grunzweig ⁴	2013	–	–	–
	2012	–	–	–
R Hooper ²	2013	210,000	–	210,000
	2012	197,000	–	197,000
B Shanahan	2013	158,716	14,284	173,000
	2012	149,541	13,459	163,000
J Stephenson ³	2013	100,718	9,065	109,783
	2012	–	–	–
L Zwier ²	2013	150,000	–	150,000
	2012	140,000	–	140,000
Total	2013	1,296,682	48,884	1,345,566
	2012	1,035,075	29,234	1,064,309

¹ Includes the cost of death, total permanent disability and salary continuance insurances.

² Mr Cubbin, Mr Hooper and Mr Zwier provide services through service companies. Fees exclude GST.

³ Mr Gregg and Ms Stephenson were appointed as directors on 8 October 2012. 2013 reflects remuneration earned on a pro-rata basis.

⁴ Mr Grunzweig acts as a nominee director of Colony Capital LLC and does not accept fees for his service.

Superannuation

Non-Executive Directors receive superannuation contributions where required by Superannuation Guarantee legislation.

Equity participation

Non-Executive Directors do not receive equity as part of their remuneration and do not participate in any incentive arrangements.

10.10 Summary of key terms

To assist shareholders, key terms and abbreviations used in the 2013 remuneration report are set out below.

Key term	Description
Awarded remuneration	Represents the value of remuneration that has been awarded for the financial year. This includes fixed remuneration, STI (both cash and deferred) and LTI awards.
Board	The Board of Directors of Challenger Limited. The Board is the main body responsible for the implementation of effective remuneration governance and related risk management practices at Challenger.
CPP	Challenger Performance Plan. Deferred STI and LTI awards are issued under the CPP.
CPP Trust	Challenger Performance Plan Trust. The CPP Trust was set up in 2007 for the purpose of acquiring, holding and transferring shares to employees upon the vesting of their equity awards.
DPSR	Deferred Performance Share Right. Deferred STI awards are delivered as DPSRs under the CPP. DPSRs represent the right to receive a fully paid ordinary Challenger share for zero consideration subject to continued employment at the time of vesting. DPSRs do not provide an entitlement to vote or a right to dividends.
Fair value	The number of HPSRs awarded to KMP and employees is calculated by reference to the estimated fair value of the LTI award approved by the Board. Fair value is calculated on the basis outlined in Note 1 (xxxiii) to the financial statements and reflects the fair value of the benefit derived at the date at which they were granted. Fair value is determined using an option pricing model and is undertaken by an independent third party.
HPSR	Hurdled Performance Share Right. LTI awards are delivered as HPSRs under the CPP. HPSRs represent the right to receive a fully paid ordinary Challenger share for zero consideration subject to continued employment and satisfying the absolute TSR performance targets. HPSRs do not provide an entitlement to vote or a right to dividends.
KMP	Key Management Personnel. Persons having authority and responsibility for planning, directing and controlling the activities of an entity, directly or indirectly, including any director (whether executive or otherwise) as defined in AASB 124 Related Party Disclosures.
LTI	Long Term Incentive. LTIs are linked to the long-term performance of Challenger. LTI awards are provided to KMP and employees whose responsibilities provide them with the opportunity to materially influence long-term performance, strategy and shareholder value. LTI awards, provided on a discretionary basis and the Board has discretion to amend or withdraw the LTI at any point. LTIs are awarded in the form of HPSRs.
Normalised NPAT	Normalised Net Profit After Tax. Excludes any asset or liability valuation movements that are above or below expected long-term trends and any significant items that may positively or negatively impact the financial results. Please refer to the Operating and Financial Review section of the Directors' report for further information.
Normalised ROE	Normalised Return on Equity. Normalised Profit Before Tax divided by average Net Assets.
NPBBT	Normalised Profit Before Bonus and Tax. Excludes any asset or liability valuation movements that are above or below expected long-term trends and any significant items that may positively or negatively impact the financial results, and excludes bonus and tax.
Realised remuneration	Represents the actual benefit realised during the financial year. This includes fixed remuneration, cash STI awards and the vesting of deferred STI and LTI awards granted in prior years.
Remuneration Committee	The Board convenes a Remuneration Committee comprising independent Non-Executive Directors. The Remuneration Committee is a delegated sub-committee of the Board established to assist the Board in discharging its responsibilities.
Statutory remuneration	Represents the accounting expense of remuneration for the financial year. This includes fixed remuneration, cash STI awards and the amortisation expense of deferred STI and LTI awards granted in prior years.

Directors' report

Key term	Description
STI	Short Term Incentive. STIs are used to reward KMP and employees for significant contributions to Challenger's results over the course of the financial year. STI awards are provided on a discretionary basis and the Board has discretion to amend or withdraw the STI at any point. STIs may be awarded in the form of cash and/or DPSRs.
TSR	Total Shareholder Return. TSR represents the change in share price plus dividends received over a given timeframe. Challenger uses absolute TSR as the measure of performance under the LTI.
VWAP	Volume Weighted Average Price. Ratio of the value of shares traded to total volume traded over a particular time horizon. A 90-day VWAP is used to calculate the number of DPSRs per dollar of deferred STI. A 90-day VWAP is also used for absolute TSR performance testing (start and end price).

11. Rounding

The amounts contained in this report and the financial report have been rounded off to the nearest \$100,000 under the option available to the Group under Australian Securities and Investments Commission (ASIC) Class Order 98/100. The Group is an entity to which the class order applies.

12. Auditor's independence declaration

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



Ernst & Young
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Auditor's independence declaration to the Directors of Challenger Limited

In relation to our audit of the financial report of Challenger Limited for the year ended 30 June 2013, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the Corporations Act 2001 or any applicable code of professional conduct.

Ernst & Young

D N Jewell
Partner
16 August 2013

Liability limited by a scheme approved under Professional Standards Legislation.

13. Authorisation

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

G A Cubbin
Director
Sydney
16 August 2013

B R Benari
Director
Sydney
16 August 2013

Financial report

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

Income statement

For the year ended 30 June	Notes	2013 \$M	2012 \$M
Revenue	3	1,598.4	1,441.0
Expenses	4	(775.8)	(770.1)
Finance costs	5	(290.4)	(524.7)
Share of profits of associates	35	13.4	8.3
Profit before tax		545.6	154.5
Income tax (expense)/benefit	6	(84.3)	12.2
Profit for the year		461.3	166.7
Profit attributable to non-controlling interests	26	44.5	18.2
Profit attributable to equity holders		416.8	148.5
Earnings per share		cents	cents
Basic earnings per share	8	79.2	28.8
Diluted earnings per share	8	78.3	27.8

The income statement should be read in conjunction with the accompanying notes.

Statement of comprehensive income

For the year ended 30 June	Notes	2013 \$M	2012 \$M
Profit for the year		461.3	166.7
Other comprehensive (expense)/income net of tax from			
– translation of foreign entities	24	(4.3)	15.3
– hedge of net investment in foreign entities	24	10.7	(10.6)
– cash flow hedges	24	4.5	4.5
Other comprehensive income, net of tax, for the year		10.9	9.2
Total comprehensive income for the year		472.2	175.9
Comprehensive income attributable to non-controlling interests		44.5	18.2
Comprehensive income attributable to equity holders		427.7	157.7

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

Statement of financial position

As at 30 June	Notes	2013 \$M	2012 \$M
Assets			
Cash and cash equivalents	9	1,030.6	795.5
Cash and cash equivalents – SPV ¹	22	278.7	364.1
Receivables	10	333.4	114.5
Mortgage assets – SPV	22	4,039.4	5,347.7
Derivative assets	28	328.0	502.6
Financial assets – fair value through profit and loss	11	8,599.2	7,334.6
Investment property held for sale	12	–	141.2
Investment and development property	12	2,431.4	2,427.0
Plant and equipment	13	137.6	124.3
Investment in associates	35	40.0	51.2
Other assets	14	45.4	56.5
Goodwill	15	506.8	505.7
Other intangible assets	15	14.3	13.7
Total assets		17,784.8	17,778.6
Liabilities			
Payables	17	207.8	303.4
Derivative liabilities	28	381.4	148.5
Interest bearing financial liabilities	18	2,035.7	1,567.5
Interest bearing financial liabilities – SPV	22	3,825.8	5,248.2
External unit holders' liabilities	19	1,751.4	1,851.2
Provisions	20	27.0	27.4
Current tax liability	6	2.3	2.3
Deferred tax liabilities	6	135.9	32.6
Life contract liabilities	21	7,123.3	6,553.0
Total liabilities		15,490.6	15,734.1
Net assets		2,294.2	2,044.5
Equity			
Contributed equity	23	1,271.9	1,313.1
Reserves	24	49.8	109.0
Retained earnings	25	625.7	270.1
Total equity attributable to equity holders		1,947.4	1,692.2
Non-controlling interests	26	346.8	352.3
Total equity		2,294.2	2,044.5

¹ SPV = Special Purpose Vehicles.

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

Statement of changes in equity

For the year ended 30 June		Attributable to equity holders				Non-controlling interests	Total
		Contributed equity	Reserves	Retained earnings	Total		
Equity	Notes	\$M	\$M	\$M	\$M	\$M	\$M
At 1 July 2012		1,313.1	109.0	270.1	1,692.2	352.3	2,044.5
Profit for the period		–	–	416.8	416.8	44.5	461.3
Other comprehensive income		–	10.9	–	10.9	–	10.9
Total comprehensive income		–	10.9	416.8	427.7	44.5	472.2
Other equity movements							
Shares purchased and cancelled under share buy-back	23	(50.0)	–	–	(50.0)	–	(50.0)
Vested shares released from the CPP Trust	23	32.2	–	–	32.2	–	32.2
Share-based payment expense less releases	24	–	(7.3)	–	(7.3)	–	(7.3)
Change in holding in adjusted controlling interest reserve	24	–	0.5	–	0.5	–	0.5
Dividends paid	25	–	–	(105.6)	(105.6)	–	(105.6)
CPP deferred share purchases	23	(23.4)	–	–	(23.4)	–	(23.4)
Transfer from equity option reserve on expiry of share options, net of tax	24/25	–	(63.3)	44.4	(18.9)	–	(18.9)
Consolidation of new controlled entities		–	–	–	–	9.5	9.5
Other non-controlling interest movements		–	–	–	–	(59.5)	(59.5)
At 30 June 2013		1,271.9	49.8	625.7	1,947.4	346.8	2,294.2
At 1 July 2011		1,101.1	179.8	207.4	1,488.3	311.1	1,799.4
Profit for the period		–	–	148.5	148.5	18.2	166.7
Other comprehensive income		–	9.2	–	9.2	–	9.2
Total comprehensive income		–	9.2	148.5	157.7	18.2	175.9
Other equity movements							
Transfer from equity option reserve on exercise of share options	23/24	60.4	(60.4)	–	–	–	–
Additional proceeds on the exercise of share options	23	187.0	–	–	187.0	–	187.0
Shares purchased and cancelled under share buy-back	23	(53.0)	–	–	(53.0)	–	(53.0)
Treasury shares purchased and held in trust, net of forfeitures	23	(61.7)	–	–	(61.7)	–	(61.7)
Vested shares released from the CPP Trust	23	77.4	–	–	77.4	–	77.4
Vested shares released from the Long Term Incentive Plan	23	1.9	–	–	1.9	–	1.9
Share-based payment expense less releases	24	–	(27.1)	–	(27.1)	–	(27.1)
Change in holding in adjusted controlling interest reserve	24	–	5.9	–	5.9	–	5.9
Impairment loss taken to income statement	24	–	1.6	–	1.6	–	1.6
Dividends paid	25	–	–	(85.8)	(85.8)	–	(85.8)
Consolidation of controlled entities		–	–	–	–	78.0	78.0
Other non-controlling interest movements		–	–	–	–	(55.0)	(55.0)
At 30 June 2012		1,313.1	109.0	270.1	1,692.2	352.3	2,044.5

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

Statement of cash flows

For the year ended 30 June	Notes	2013 \$M	2012 \$M
Operating activities			
Receipts from customers		735.6	878.8
Annuity receipts	21	2,179.9	1,954.2
Annuity payments	21	(1,895.2)	(1,669.3)
Payments to reinsurer	21	(3.9)	(2.3)
Interest paid – external unit holders		(108.6)	(123.7)
Receipts from external unit holders		951.8	703.4
Payments to external unit holders		(993.2)	(239.8)
Payments to vendors and employees		(598.5)	(745.3)
Dividends received		44.2	39.6
Interest received		544.9	487.0
Interest paid		(63.1)	(66.4)
Income tax paid		(4.8)	(1.7)
Net cash inflow from operating activities	32	789.1	1,214.5
Investing activities			
Net payments on purchase of investments		(386.4)	(1,158.0)
Mortgage loans – repaid		1,327.9	1,594.5
Net proceeds from sale of associate		20.1	–
Payments for purchase of plant and equipment		(17.3)	(45.8)
Net cash inflow from investing activities		944.3	390.7
Financing activities			
Proceeds from issue of interest bearing liabilities		79.4	200.1
Repayment of interest bearing liabilities		(1,500.0)	(1,789.9)
(Payments)/receipts from shares issued/bought back and options proceeds		(39.7)	104.4
Payments to non-controlling interests for redemption of units		(1.3)	(31.8)
Dividends paid		(105.4)	(85.6)
Distributions paid		(16.7)	(17.8)
Net cash outflow from financing activities		(1,583.7)	(1,620.6)
Net increase/(decrease) in cash and cash equivalents		149.7	(15.4)
Cash and cash equivalents at the start of period		1,159.6	1,175.0
Cash and cash equivalents at the end of period		1,309.3	1,159.6
Cash	9	1,030.6	795.5
Cash – SPV	22	278.7	364.1
Cash and cash equivalents at the end of period		1,309.3	1,159.6

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

Notes to the financial statements

1. Basis of preparation and accounting policies

Challenger Limited (the Company or the parent entity) is a company limited by shares, incorporated in Australia, whose shares are publicly traded on the Australian Securities Exchange (ASX). The financial report for Challenger Limited and its controlled entities (the Group or Challenger) for the year ended 30 June 2013 was authorised for issue in accordance with a resolution of the Directors of the Company on 16 August 2013.

(i) Basis of preparation

This is a general purpose financial report that has been prepared in accordance with the requirements of the Corporations Act 2001 and Australian Accounting Standards. Unless stated otherwise, the financial report is presented in Australian dollars, has been prepared on the historical cost basis and amounts are rounded to the nearest one hundred thousand dollars. 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) Statement of compliance

The financial report complies with Australian Accounting Standards and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

(iii) New accounting standards and interpretations

Changes in accounting policy or disclosure

There were no changes in accounting policy applied during the period. Amendments to the disclosure requirements of AASB 101 Presentation of Financial Statements applicable for the first time during the period have resulted in a change in the format of the statement of changes in equity so as to show the impact of other comprehensive income on each component of equity.

Accounting standards and interpretations issued but not yet effective

In addition to the changes specifically referred to below, there are a number of amendments to Australian Accounting Standards that are available for early adoption but have not been applied in this financial report. The amendments would have resulted in only minor disclosure impacts if they had been early adopted.

AASB 9 Financial Instruments

AASB 9 Financial Instruments (AASB 9) was issued in December 2009 and is currently mandatory for annual reporting periods beginning on or after 1 January 2013. It provides revised guidance on the classification and measurement of financial instruments and permits more limited criteria for a financial instrument to be measured at amortised cost, with all other financial instruments being measured at fair value. The new standard also limits the ability to recognise fair value movements on financial assets directly in equity.

The Group is currently assessing the impact of this new standard. The classification of a financial instrument will be assessed on the facts at the date of initial application and it is possible that the classification of some financial assets may change upon adoption of the new standard.

AASB 10, 11 and 12

AASB 10 Consolidated Financial Statements, AASB 11 Joint Arrangements and AASB 12 Disclosure of Interests in Other Entities were issued in August 2011 and are mandatory for annual reporting periods beginning on or after 1 January 2013. AASB 10 provides further clarity on the concept of control, AASB 11 updates accounting for joint ventures and AASB 12 enhances disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. Application of AASB 10 does not have any impact on the Group, AASB 11 does not have any impact on the Group and AASB 12 will result in increased disclosure in the 30 June 2014 financial report.

AASB 13

AASB 13 Fair Value Measurement was issued in September 2011 and is mandatory for annual reporting periods beginning on or after 1 January 2013. It establishes a single source of guidance under IFRS for determining the fair value of assets and liabilities. The Group is currently assessing the impact of this new standard and, while it may result in some differences to the fair values determined, it is not expected to have a material impact on profit or equity upon adoption.

AASB 2011-4

Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements effective for annual periods beginning on or after 1 July 2013. This amendment to AASB 124 deletes individual key management personnel disclosure requirements for disclosing entities, which are not companies. Application of this standard will result in the deletion of individual key management personnel disclosures currently included in the Related Party note. The information will continue to be disclosed within the Directors' report.

AASB 2012-2

Amendments to Australian Accounting Standards – Disclosures – Offsetting Financial Assets and Financial Liabilities effective for annual periods beginning on or after 1 January 2013. This amendment to AASB 7 requires disclosure of information that will enable users of the financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities, on the entity's financial position. Initial application is not expected to result in any material impact.

AASB 2012-3

Amendments to Australian Accounting Standards – Offsetting Financial Assets and Financial Liabilities effective for annual periods beginning on or after 1 January 2014. This amendment adds application guidance to AASB 132 to address inconsistencies identified in applying some of the offsetting criteria of AASB 132, including clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. Initial application is not expected to result in any material impact.

(iv) Basis of consolidation

Controlled entities are all those entities over which the Group has the power to govern the financial and operating policies so as to obtain benefits from their activities. The statement of financial position date and the accounting policies of controlled entities are consistent with those of the Company.

All intercompany balances and transactions, including unrealised profits arising from intra-group transactions, are eliminated in full. Unrealised losses are eliminated unless costs cannot be recovered. For controlled entities where the Group owns less than 100% of the issued capital or units, the share of the results and equity attributable to non-controlling interests are shown separately.

The life contract operations of Challenger Life Company Limited are conducted within separate statutory funds as required by the Life Insurance Act 1995. Both the shareholders' and policyholders' interests in these statutory funds are reported in aggregate in the financial report of the Group (see Note 1(xxx) Life contract liabilities).

Controlled entities are consolidated from the date on which control is transferred to the Company and cease to be consolidated from the date on which control is transferred out of the Company. The acquisition method of accounting is applied on acquisition or initial consolidation. This method ascribes fair values to the identifiable assets and liabilities acquired. The difference between the net fair value acquired and the fair value of the consideration paid (including the fair value of any pre-existing investment in the entity) is recognised as either goodwill, on the statement of financial position, or a discount on acquisition, through the income statement.

Goodwill is subject to impairment testing as described in Note 1(xxiii).

Investment in associates

Associates are entities over which the Group has significant influence over the financial and operating policies but not control. Investments in associates, other than those backing life contracts, are accounted for under the equity method whereby investments are carried at cost adjusted for post-acquisition changes in the Group's share of the net assets of the entity. Investments in associates that back life contracts are designated as financial assets at fair value through profit and loss.

Associates' financial reports are used to apply the equity method and both the financial year end and accounting policies of associated entities are consistent with those of the Group. After application of the equity method, the Group determines whether it is necessary to recognise any additional impairment loss in the carrying value of the net investment in associates.

The investments in associates are carried in the statement of financial position at cost plus post-acquisition changes in the Group's share of net assets of the associate, less any impairment in value. The consolidated income statement reflects the share of the results of operations of the associate. Where there has been a change recognised directly in the associate's equity, the Group recognises its share of any changes and discloses this in the statement of changes in equity.

Special Purpose Vehicles (SPV)

The Group manages and services trusts that hold residential mortgage assets and securitised financial liabilities. As the Group retains the right to the residual income of these trusts, it is deemed to control them and, as a result, they are consolidated.

(v) Comparatives

Where necessary, comparative figures have been reclassified to conform to the changes in presentation made in this financial report.

(vi) Rounding of amounts

Amounts in this financial report are rounded to the nearest hundred thousand dollars (\$0.0M), unless otherwise stated, under the option available to the Company under ASIC Class Order 98/100.

Notes to the financial statements

1. Basis of preparation and accounting policies (continued)

(vii) Segment reporting

Operating segments are identified on the basis of internal reports to senior management and comprise component parts of the Group that are regularly reviewed by senior management in order to allocate resources and assess performance.

(viii) Revenue

Revenue is recognised and measured as the fair value of the consideration received or receivable to the extent that it is probable that economic benefits will flow to the Group and the revenue can be reliably measured. Revenues and expenses are generally recognised on an accrual basis. The following specific policies are applied:

- Management fee revenue is derived from the provision of investment management services to the Group's managed investment products and residential mortgage assets. Revenue is recognised when the services are deemed to have been earned using an effective interest rate method over the life of the contract.
- Interest revenue is recognised as it accrues using an effective interest rate, taking into account the effective yield of the financial asset.
- Dividends on listed equity shares are recognised as income on the date the share is quoted ex-dividend. Dividends from unlisted companies are recognised when the dividend is declared.
- Gains or losses arising from changes in the fair value of financial instruments classified as fair value through profit and loss are recognised as revenue in the income statement when the change in value is recognised in the statement of financial position.
- Rental revenue from investment properties is accounted for on a straight line basis over the lease term. Contingent rental income is recognised as income in the period in which it is earned. Lease incentives granted are recognised as an integral part of the total rental income.
- Operating lease rental income is earned on a straight line basis over the life of the contract.
- Life insurance premiums are recognised as revenue when received.
- The portion of the change in life contract liabilities recognised in the income statement that relates to the net deposit component of life investment contracts, changes in discount rates, inflation rates and other assumption changes is classified as revenue. The remaining change is classified as an expense. See Note 1(xxx) for more detail on the recognition and measurement of life contract liabilities.

(ix) Expenses

Expenses are generally recognised on an accrual basis. The following specific policies are applied:

- See Note 1(xxi) for details of how the costs incurred in the establishment of special purpose vehicles and the origination of interest bearing liabilities are recognised in the income statement.
- Expenses incurred under an investment property operating lease are recognised on a straight line basis over the term of the lease.
- Investment property expenditure, including rates, taxes, insurance and other costs associated with the upkeep of a building, are brought to account on an accrual basis. Repair costs are expensed when incurred. Other amounts that improve the condition of the investment are capitalised into the carrying value of the asset.
- Life insurance claims expense is recognised in expenses when the liability to the policyholder under the contract has been established.
- Changes in life contract liabilities recognised as an expense consist of the interest expense on the liability, any loss on the initial recognition of new business less the release of expenses over the period. The interest on the liability represents the unwind of the discount on the opening liability over the period, whereas the impacts of the changes in discount rate applied for the current valuation are included in the change in the life contract liabilities disclosed in revenue. See Note 1(xxx) for more detail on the recognition and measurement of life contract liabilities.

(x) Finance costs

Finance costs represent interest on interest bearing financial liabilities (primarily the securitised residential mortgage-backed securities issued by the special purpose vehicles, bank loans and other borrowings) and are recognised as an expense in the period in which they are incurred.

Finance costs that are directly attributable to the acquisition, construction or production of qualifying property assets (being assets that take a substantial period of time to develop for their intended use or sale) are capitalised as part of the cost of that

asset. Revenue earned on the investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

To the extent that the Group allocates general borrowed funds for the purpose of obtaining a qualifying property asset, the borrowing costs eligible for capitalisation are determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation rate is the weighted average of the borrowing costs applicable to the borrowings that are outstanding during the period, other than borrowing made specifically for the purpose of obtaining the qualifying asset.

(xi) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of the GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of the acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the Australian Taxation Office (ATO) is included as an asset or liability in the statement of financial position.

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from, or payable to, the ATO are classified as operating cash flows.

(xii) Income tax

Income tax on the income statement for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities based on the current period's taxable income. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the statement of financial position date.

Deferred income tax is provided on all temporary differences at the statement of financial position date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences except:

- when the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss in the income statement; or
- when the taxable temporary difference is associated with investments in subsidiaries, associates or interests in joint ventures, and the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forward of unused tax credits and unused tax losses can be utilised, except:

- when the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss in the income statement; or
- when the deductible temporary difference is associated with investments in subsidiaries, associates or interests in joint ventures, in which case a deferred tax asset is only recognised to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilised.

The carrying amount of deferred income tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Unrecognised deferred income tax assets are reassessed at each statement of financial position date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered. Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the statement of financial position date.

Income taxes relating to items recognised directly in equity are recognised in equity and not in profit or loss in the income statement. Deferred income tax assets and liabilities are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to the same taxable entity and the same taxation authority.

Notes to the financial statements

1. Basis of preparation and accounting policies (continued)

(xii) Income tax (continued)

Tax consolidation

Challenger Limited and its 100% owned Australian resident subsidiaries have formed a tax consolidated group with effect from 1 July 2002 and are therefore taxed as a single entity from that date. Challenger Limited is the head entity of the tax consolidated group.

Tax effect accounting by members of the tax group

Members of the tax consolidated group have applied tax funding principles under which Challenger Limited and each of the members of the tax consolidated group agree to pay tax equivalent payments to or from the head entity, based on the current tax liability or current tax asset of the member. Such amounts are reflected in the amounts receivable from or payable to each member and the head entity. The group allocation approach is applied in determining the appropriate amount of current tax liability or current tax asset to allocate to members of the tax consolidated group.

(xiii) Foreign currency

Both the presentation currency and the functional currency of the Company and its controlled Australian entities are Australian dollars. A number of foreign controlled entities have a functional currency other than Australian dollars.

Transactions

Transactions in foreign currency are translated into presentation currency, Australian dollars, at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into Australian dollars at the foreign exchange rate ruling at the statement of financial position date.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the transaction. Non-monetary items measured at fair value in a foreign currency are translated to the functional currency using the exchange rates ruling at the date when the fair value was determined.

Derivatives are used to hedge the foreign exchange risk relating to certain transactions. Refer to Note 1(xvi).

Foreign controlled entities

On consolidation, the assets and liabilities of foreign subsidiaries whose functional currency differs from the presentation currency are translated into Australian dollars at the rate of exchange ruling at the statement of financial position date. Exchange differences arising on the retranslation are taken directly to the foreign currency translation reserve in equity. The change in fair value of derivative financial instruments designated as a hedge of the net investment in a foreign controlled entity is also recognised in the foreign currency translation reserve.

On disposal of a foreign controlled entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the statement of comprehensive income.

(xiv) Cash and cash equivalents

Cash and cash equivalents are financial assets and comprise cash at bank and in hand plus short-term deposits with an original maturity of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents are recognised at the fair value. For the purposes of the statement of cash flows, cash and cash equivalents are stated net of bank overdrafts.

(xv) Receivables

Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They include mortgage assets, trade and other receivables and are recognised at their amortised cost less impairment losses.

Receivables are reviewed at each statement of financial position date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated.

(xvi) Derivative financial instruments and hedging

The Group uses derivative financial instruments to hedge its risks associated with interest rate and foreign currency fluctuations but does not hold derivative financial instruments for trading purposes. All derivative financial instruments are stated at fair value. Gains or losses arising from fair value changes on derivatives that do not qualify for hedge accounting are recognised in the income statement.

For the purpose of hedge accounting, hedges are classified as:

- fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability;

- cash flow hedges when they hedge the exposure to variability in cash flows that is attributable either to a particular risk associated with a recognised asset or liability or to a forecast transaction; or
- hedges of net investments in foreign operations when they hedge the exposure to changes in the value of the assets and liabilities of foreign controlled entity when they are translated from their functional currency to the presentation currency.

At the inception of a hedge relationship to which the Group wishes to apply hedge accounting, the Group formally designates and documents the hedge relationship and the risk management objectives and strategies for undertaking the hedge. The documentation includes: identification of the hedging instrument; the hedged item or transaction; the nature of the risk being hedged; and how the entity will assess the effectiveness of the instrument in offsetting the exposure to changes in the hedged item.

Such hedges are expected to be highly effective in achieving offsetting changes in fair values, cash flows or foreign exchange difference and are assessed on an ongoing basis to determine that they actually have been highly effective over the period that they were designated.

Fair value hedges

Fair value hedges are hedges of the Group's exposure to changes in the fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment that is attributable to a particular risk and could affect profit or loss.

For fair value hedges, the carrying amount of the hedged item is adjusted for gains and losses attributable to the risk being hedged and the derivative is remeasured to fair value. Gains and losses from both are recognised in the income statement.

When an unrecognised firm commitment is designated as a hedged item, the subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognised as an asset or liability with a corresponding gain or loss recognised in the income statement. The changes in the fair value of the hedging instrument are also recognised in the income statement.

The Group discontinues fair value hedge accounting if the hedging instrument expires or is sold, terminated or exercised, the hedge no longer meets the criteria for hedge accounting or the Group revokes the designation. Any adjustment to the carrying amount of a hedged financial instrument for which the effective interest method is used is amortised to the income statement. Amortisation may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged.

Cash flow hedges

Cash flow hedges are hedges of the Group's exposure to variability in cash flows attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecast transaction, and that could affect the income statement. The effective portion of the gain or loss on the hedging instrument is recognised directly in equity, while the ineffective portion is recognised in the income statement.

Amounts taken to equity are transferred to the income statement when the hedged transaction affects profit or loss, such as when hedged income or expenses are recognised or when a forecast sale or purchase occurs. When the hedged item is the cost of a non-financial asset or liability, the amounts taken to equity are transferred to the initial carrying amount of the non-financial asset or liability.

If the forecast transaction is no longer expected to occur, amounts previously recognised in equity are transferred to the income statement. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, amounts previously recognised in equity remain in equity until the forecast transaction occurs.

Hedges of net investments in foreign operations

The gain or loss on the effective portion of the hedging instrument is recognised directly in equity and the gain or loss on the ineffective portion is recognised immediately in the income statement. The cumulative gain or loss previously recognised in equity is recognised in other comprehensive income on disposal or partial disposal of the foreign operation.

(xvii) Other financial assets

The Group classifies its other financial assets into the following categories: financial assets at fair value through profit or loss (being either held for the purposes of trading or initially designated as such); or available-for-sale. The classification depends on the definition and the purpose for which the investments were acquired. The classification of investments is determined at initial recognition and evaluated at each reporting date.

Purchases and sales of other financial assets are recognised on the date on which the Group commits to purchase or sell the asset. Other financial assets are initially recognised at fair value (plus transaction costs for available-for-sale assets). Other financial assets are derecognised when the right to receive cash flows from the asset has expired or when the risks and rewards of ownership have been substantially transferred.

Notes to the financial statements

1. Basis of preparation and accounting policies (continued)

(xvii) Other financial assets (continued)

The fair value of other financial assets that are actively traded in organised financial markets are determined by reference to quoted market bid prices at the close of business on the statement of financial position date.

For assets for which no active market exists, fair values are determined using valuation techniques. Such techniques include: using recent arm's length market transactions; reference to the current market value of another instrument that is substantially the same; discounted cash flow analysis and option pricing models refined to reflect the issuer's specific circumstances, making as much use of available and supportable market data as possible and keeping judgemental inputs to a minimum.

Financial assets at fair value through profit and loss

Financial assets classified in this category are assets either held for the purposes of trading or designated as fair value through profit and loss on initial recognition. Held for trading assets consist of debt or equity securities. They are carried at fair value with unrealised gains and losses being recognised through the income statement. Assets designated as fair value through profit and loss consist of infrastructure and property securities. Assets backing life contract liabilities of the statutory fund are required to be designated as fair value through profit and loss in accordance with AASB 1038 Life Insurance Contracts.

(xviii) Investment property

Investment property is initially recognised at cost, including transaction costs. Subsequent to initial recognition, investment property is recognised at fair value. Independent valuations for all investment properties are conducted at least annually, from suitably qualified valuers, and the Directors make reference to these independent valuations when determining fair value. When a sale price for a property has been agreed prior to the period end for a sale subsequent to the period end, the agreed sale price is taken as the fair value and the property is classified as investment property held for sale.

Gains or losses arising from changes in the fair values of investment properties are included in the income statement in the period in which they arise.

Investment properties are derecognised when they have either been disposed of or when the investment property is permanently withdrawn from use and no future benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognised in the income statement in the year of retirement or disposal.

Investment property under development

When redevelopment of an existing investment property commences, it continues to be classified and measured as investment property when the asset is being redeveloped for continued future use as an investment property.

Investment property under construction is held at cost until an estimate of the fair value can be reliably determined.

Development property held for resale

Development properties held for the purpose of resale are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling costs.

Cost includes cost of acquisition, development costs, holding costs and directly attributable interest on borrowed funds where the development is a qualifying asset. Capitalisation of borrowing costs ceases during extended periods in which active development is interrupted. When a development is completed and ceases to be a qualifying asset, borrowing costs and other costs are expensed as incurred.

(xix) Plant and equipment

Items of plant and equipment are stated at cost, or deemed cost, less accumulated depreciation and impairment losses. Depreciation is calculated on a straight line basis to write off the net cost of each class of fixed assets over its expected useful life. Estimates of remaining useful lives are made on a regular basis for all assets, with annual reassessments for major items. The expected useful life of plant and equipment is three to five years.

Infrastructure fixed assets

Infrastructure fixed assets are stated at cost and amortised on a straight line basis over their estimated useful life of 40 years. This is done on an asset by asset basis with amortisation commencing when the Group starts receiving income from the asset.

The carrying values of plant and equipment and infrastructure fixed assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Impairment losses are recognised in the income statement.

(xx) Operating leases

Leases where the lessor retains substantially all the risk and benefits of ownership are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognised as an expense over the term of the lease on the same basis as the lease income.

Incentives received on entering into operating leases are recognised as liabilities and are amortised over the life of the lease.

Where the Group acquires, as part of a business combination, an operating lease over land, the fair value of the operating lease over land is recognised separately from goodwill. See Note 1(xxii) below. Other operating lease payments are charged to the income statement in the periods in which they are incurred.

Surplus lease space

The present value of future payments for surplus lease space under non-cancellable operating leases, net of sub-leasing revenue, is recognised as a provision in the period in which it is determined that the lease space will be of no future benefit to the Group. See Note 1(xxviii) below.

(xxi) Prepayments

Deferred portfolio costs

Portfolio costs represent the expenses incurred in establishing mortgage trusts. They are recognised as an asset when incurred and subsequently amortised in the income statement as the future economic benefits from the mortgage assets are expected to be received.

Deferred origination costs

Origination costs are expenses incurred as a direct result of the origination of mortgage loans to customers. These costs are recognised as an asset and subsequently amortised through the income statement in line with the pattern of expected future economic benefits arising from the related mortgage asset.

(xxii) Goodwill and other intangible assets

Goodwill

Goodwill acquired in a business combination is initially measured at cost, being the excess of the fair value of the consideration for the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units.

Each unit, or group of units, to which the goodwill is so allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. Impairment is determined by assessing the recoverable amount of the cash-generating unit (or group of cash-generating units), to which the goodwill relates. When the recoverable amount of the cash-generating unit (or group of cash-generating units) is less than the carrying amount, an impairment loss is recognised.

When goodwill forms part of a cash-generating unit (or group of cash-generating units) and an operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this manner is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained. Impairment losses recognised for goodwill are not subsequently reversed.

Other intangible assets

Other intangible assets acquired are recorded at cost less accumulated amortisation and impairment losses. The cost of an intangible asset acquired in a business combination is its fair value as at the date of acquisition.

As stated in Note 1(xx) above, where the Group acquires, as part of a business combination, an operating lease over land, the fair value of this lease is recognised separately from goodwill. This intangible asset is recorded at fair value less accumulated amortisation. Amortisation is calculated using the straight line method over the effective life of the lease, being 25 years.

Certain internal and external software costs directly incurred in acquiring and developing software have been capitalised and are being amortised on a straight line basis over their useful life, usually a period of five years. Useful lives are examined on an annual basis and where applicable, adjustments are made on a prospective basis. Costs incurred on software maintenance are expensed as incurred.

(xxiii) Impairment of assets

At each reporting date, the Group assesses whether there is any indication that an asset not carried at fair value may be impaired. If any such indication exists, the Group makes a formal estimation of the asset's recoverable amount.

An asset's recoverable amount is the greater of the fair value, less costs to sell, and its value in use. It is determined for an individual asset, unless the asset's recoverable amount cannot be estimated as it does not generate cash flows independent of those from other assets or groups of assets. In such cases, the asset is tested for impairment as part of the cash-generating unit to which it belongs. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset.

Notes to the financial statements

1. Basis of preparation and accounting policies (continued)

(xxiii) Impairment of assets (continued)

When the carrying amount of an asset or cash-generating unit exceeds its recoverable amount, the asset or cash-generating unit is considered impaired and is written down to its recoverable amount. Impairment losses are recognised in the income statement, unless an asset has previously been revalued, in which case the impairment loss is recognised as a reversal of that previous revaluation with any excess recognised through the income statement.

Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to that cash-generating unit, then to reduce the carrying amount of the other assets in the unit on a pro rata basis.

An assessment is also made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A reversal of the impairment loss may only increase the asset's value up to its carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement unless the asset is carried at revalued amount, in which case it is treated as a revaluation increase.

(xxiv) Payables

Payables represent unsecured non-derivative, non-interest bearing financial liabilities in respect of goods and services provided to the Group prior to the end of the financial year. They include accruals, trade and other creditors and are recognised at amortised costs.

(xxv) Interest bearing financial liabilities

Capital market issuances of interest bearing liabilities, including property debt issued by controlled property trusts and the subordinated debt issued by the Company, are recognised at fair value with unrealised gains and losses recognised through the income statement.

Other interest bearing financial liabilities are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, other interest bearing financial liabilities are subsequently measured at amortised cost using the effective interest method.

(xxvi) Employee benefits

Superannuation funds

Obligations for contributions to superannuation funds are recognised as an expense in the income statement as incurred. The Group does not hold or pay into any defined benefit superannuation schemes on behalf of employees.

Wages, salaries, annual leave and non-monetary benefits

Liabilities for wages and salaries, including non-monetary benefits and annual leave expected to be settled within 12 months of the reporting date, are recognised in respect of employees' services up to the reporting date. They are measured at the amounts expected to be paid when the liabilities are settled. Liabilities for accumulated sick leave are recognised when the leave is taken and are measured at the rates paid or payable.

Long service leave

A liability for long service leave is recognised as the present value of estimated future cash outflows to be made in respect of services provided by employees up to the reporting date. The estimated future cash outflows are discounted using bond yields from Australian Commonwealth government bonds which have durations to match, as closely as possible, the estimated future cash outflows.

Factors which affect the estimated future cash outflows such as expected future salary increases, experience of employee departures and period of service, are included in the measurement.

(xxvii) External unit holders' liabilities

The Group controls a number of guaranteed index return trusts that contain funds pertaining to fixed term wholesale mandates. The fixed term and guaranteed nature of the mandates effectively places the balance of the risks related to the performance of the trusts with the Group. As a result, the Group is deemed to control these trusts. The contributed funds for these trusts are classed as a liability and external unit holders' liabilities on the statement of financial position represents the funds owing to third parties on these mandates. The liability is recognised at fair value.

(xxviii) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Future operating costs are not provided for.

When the Group expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognised as a separate asset only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement.

Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the statement of financial position date. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects the time value of money and the risks specific to the liability. The increase in the provision resulting from the passage of time is recognised in finance costs.

(xxix) Restrictions on assets

Financial assets held in Challenger Life Company Limited can only be used within the restrictions imposed under the Life Insurance Act 1995. 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 solvency and capital adequacy requirements are met.

(xxx) Life contract liabilities

The operations of the Group include the selling and administration of contracts through Challenger Life Company Limited. 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 using an appropriate discount rate curve as determined by the Appointed Actuary.

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 premium 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. The planned release of this margin is recognised in the income statement 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 (payments, expenses etc.) 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.

Life Insurance premium revenue

Life insurance premiums are recognised as revenue when received.

Life Insurance claims expense

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

Reinsurance

The Group has maintained reinsurance arrangements during the period that meets the definition of a life insurance contract. The Margin on Services (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.

(xxxi) Contributed equity

Ordinary shares are classified as equity. Issued capital in respect of ordinary shares is recognised as the fair value of the consideration received by the parent entity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Notes to the financial statements

1. Basis of preparation and accounting policies (continued)

(xxxi) Contributed equity (continued)

Treasury shares are ordinary shares in the Company held by the employee share trust and those issued in respect of long-term incentive plan awards to employees. Refer to Note 1(xxiii) for further details.

(xxxii) Earnings per share

Basic earnings per share is calculated by dividing the (total and continuing) profit for the year 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 includes any shares granted under the employee share incentive plan which have vested and settled.

Diluted earnings per share is calculated by dividing the (total and continuing) profit attributable to equity holders of the Company by the weighted average number of ordinary shares outstanding during the year (adjusted for the effects of dilutive options and shares granted under the Challenger Performance Plan).

(xxxiii) Share-based payment transactions

Long-term equity-based incentive plan

The Group has an employee share incentive plan for the granting of non-transferable options or rights to executives and senior employees. Shares in the Company held by the employee share trust are classified as treasury shares and presented in the statement of financial position as a deduction from equity.

Employees of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions).

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined using an option pricing model. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company (market conditions).

In accordance with Australian Accounting Standards, the cost of equity-settled transactions is recognised in the income statement, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (vesting date). At the Company level, the cost of the equity shares is recognised as an equity distribution, whereby the investment in subsidiary is increased with a corresponding increase in the share-based equity reserve.

The cumulative expense or investment recognised for equity-settled transactions at each reporting date reflects the extent to which the vesting period has expired and the best estimate of the number of awards that will ultimately vest.

No adjustment is made for the likelihood of market performance conditions being met as the effect of these conditions is included in the determination of fair value at grant date.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any increase in the value of the transaction as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled during the vesting period (other than a grant cancelled forfeiture when the vesting conditions are not satisfied), it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately.

However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

(xxxiv) Employee Share Acquisition Plan

Share-based compensation benefits are provided to employees via the Challenger Performance Plan (CPP). The Group has formed a trust to administer the Group's employee share acquisition plan. This trust is consolidated, as the substance of the relationship is that the trust is controlled by the Group.

Through contributions to the trust, the Group purchases shares in the Company on market. Shares acquired are held by the Challenger Performance Plan Trust, are disclosed as Treasury Shares and deducted from contributed equity.

In addition to shares held by the Trust the Group has entered into forward purchase agreements (CPP deferred share purchases) to hedge unvested performance share rights. The CPP deferred share purchase agreements have exercise dates that match to the vesting dates of the performance rights issued by the CPP and they require the delivery of Challenger Limited shares to the Group, by a third party, for the contracted price. The shares to be purchased under these agreements are treated as treasury shares from the date of the agreement.

In such deferred contracts, changes in the fair value arising from variations in market rates do not affect the amount of cash to be paid or the number of Challenger shares to be received, and are classified as equity instruments. Changes in the fair value of an equity instrument are not recognised in the financial statements. The liability to the third party is recorded on the balance sheet at present value and the discount is unwound through the income statement over the duration of the contract.

(xxxv) 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:

Share-based payments

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the ordinary shares at the date at which they are granted. The fair value is determined using the Black-Scholes formula, taking into account the terms and conditions upon which the equity instruments were granted, as discussed in Note 31. The fair value calculation is performed by an external valuer.

Life insurance contract liabilities

Life insurance contract liabilities are recognised under the MoS methodology described in Note 1(xxx). Significant judgement is applied in the MoS liability valuation as it involves the application of actuarial assumptions.

The key areas of judgement in the determination of the actuarial assumptions are: the duration of claims/policy payments; acquisition and maintenance expense levels; and economic assumptions for discount and inflation rates. Additional information on the life insurance contract liabilities is set out in Note 21 Life Contract Liabilities.

Property valuations

Investment properties are stated at fair value based on valuations performed by independent valuers.

The independent valuer is authorised to practise under the law of the relevant jurisdiction where the valuation takes place and has at least five years of continuous experience in the valuation of property of a similar type to the property being valued. The valuer has no pecuniary interest that could conflict with the valuation of the property and complies with the Australian Property Institute (API) Code of Ethics and Rules of Conduct.

Fair value for the purposes of the valuation is market value as defined by The International Assets Valuation Standards Committee. In determining market value, valuers examine available market evidence and apply this analysis to both the traditional capitalisation and discounted cash flow approach.

Interest bearing financial liabilities

Subordinated debt is recognised at fair value. The determination of fair value includes the assessment of movements in interest rates, credit spreads and foreign exchange. These movements are reviewed at each reporting date to take into account market conditions.

Deferred tax assets

Deferred tax assets are recognised when it is considered probable that future taxable profits will be available to utilise those temporary differences. Factors considered include the ability to offset tax losses against taxable profits between members of the tax consolidated group within an appropriate future timeframe, and whether the level of future taxable profit is expected to be sufficient to allow recovery of deferred tax assets.

Unlisted investment valuations

Investments for which there is no active market or an external valuation available are valued either by reference to the current market value of another instrument that is substantially the same; a discounted cash flow analysis or other methods consistent with market best practice. Refer Note 27 for further disclosure.

Impairment of goodwill

The Group assesses whether goodwill is impaired at least annually in accordance with the accounting policy in Note 1(xxiii). These calculations involve an estimation of the recoverable amount of the cash-generating units to which the goodwill is allocated.

Notes to the financial statements

2. Segment information

Business segments

The reporting segments of the Group have been identified as follows:

	Life	
For the year ended 30 June	2013 \$M	2012 \$M
Net income ¹	452.2	435.7
Operating expenses ¹	(70.3)	(68.0)
Normalised EBIT ¹	381.9	367.7
Interest and borrowing costs ¹	–	–
Normalised net profit before tax/segment profit	381.9	367.7
Tax on normalised profit		
Normalised net profit after tax		
Investment experience after tax ¹		
Significant items after tax		
Profit attributable to equity holders		
As at 30 June		
Segment assets	11,399.70	10,647.7
Segment liabilities	(9,534.4)	(8,987.0)
Net assets	1,865.3	1,660.7

¹ See page 82 for definitions of the terms used in the management view of segments.

² 'Corporate and other' includes corporate companies, corporate SPV, non-controlling interests and group eliminations.

	Funds Management		Total reporting segments		Corporate and other ²		Total	
	2013 \$M	2012 \$M	2013 \$M	2012 \$M	2013 \$M	2012 \$M	2013 \$M	2012 \$M
	99.4 (65.3)	83.0 (62.0)	551.6 (135.6)	518.7 (130.0)	4.9 (56.1)	8.8 (59.2)	556.5 (191.7)	527.5 (189.2)
	34.1 –	21.0 –	416.0 –	388.7 –	(51.2) (4.6)	(50.4) (3.3)	364.8 (4.6)	338.3 (3.3)
	34.1	21.0	416.0	388.7	(55.8)	(53.7)	360.2	335.0
							(51.7)	(38.2)
							308.5 99.8 8.5	296.8 (148.3) –
							416.8	148.5
	144.4 (14.9)	140.4 (13.1)	11,544.1 (9,549.3)	10,788.1 (9,000.1)	6,240.70 (5,941.3)	6,990.5 (6,734.0)	17,784.8 (15,490.6)	17,778.6 (15,734.1)
	129.5	127.3	1,994.8	1,788.0	299.40	256.5	2,294.2	2,044.5

Notes to the financial statements

2. Segment information (continued)

Business segments (continued)

Definitions

Net income and operating expenses differ from revenue and expenses as disclosed in the income statement as certain direct costs (including commissions, property expenses and management fees) included in expenses are netted off against gross revenues in deriving the management view of net income above. In addition, the revenues, expenses and finance costs from special purpose vehicles (SPV) are separately disclosed in the statutory view but are netted off in net income. Revenue also includes investment gains and losses but these are excluded from the management view as they form part of investment experience (see below). Net income consists of the sub-categories of normalised cash operating earnings, being the management view of revenue for the Life segment, net fee income, being the management view of revenue from the Funds Management segment, and other income, being the management view of revenue from Corporate and other.

Normalised cash operating earnings is calculated as normalised capital growth (see below) plus cash earnings. Cash earnings represents the sum of investment yield (being the management view of revenue from investment assets such as net rental income, dividends, and interest), interest expense, commission and fees.

Normalised EBIT

Normalised earnings before interest and tax (EBIT) is the sum of net income and operating expenses, as defined above. It excludes investment experience, corporate interest and borrowing costs, tax and significant items.

Interest and borrowing costs differ from finance costs as disclosed in the income statement for similar reasons to revenue and expenses, with the major difference arising from the netting of SPV finance costs against SPV revenue in net income in the management view.

Tax on normalised profit represents the consolidated statutory tax expense or benefit for the period, less tax attributable to non-controlling interests, less the tax applied to investment experience.

Investment experience after tax

The Group is required by accounting standards to value all assets and liabilities supporting the life insurance business at fair value. This can give rise to fluctuating valuation movements being recognised in the income statement, particularly during periods of market volatility. As the Group is generally a long-term holder of assets, due to them being held to match to 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 remove the volatility arising from asset and liability valuation from 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 plus actuarial assumption changes. Investment experience after tax is investment experience net of tax at the prevailing income tax rate.

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 growth rates represent the Group's medium to long-term capital growth expectations for each asset class over the investment cycle. The normalised growth rates are 6.0% for Equity and Other, 4.0% for Infrastructure, 2.0% for Property and (0.35%) for Cash, Fixed Interest and Debt. The rates have been set with reference to medium to long-term market growth rates and are reviewed to ensure consistency with prevailing market conditions.

Actuarial assumption changes represents the impact of changes in macroeconomic variables, including bond yields and inflation factors, expense assumptions, losses on new business and other factors applied in the valuation of life contract liabilities. It also includes the attribution of interest rate derivatives used to hedge interest rate volatility.

Operating segments

The format of the segment information is the same as that provided to the Chief Executive Officer (the chief operating decision maker) of the Group. The Group operates in the following segments:

Life – includes annuity and life insurance business carried out by Challenger Life Company Limited (CLC). CLC invests in assets providing long-term income streams for customers.

Funds Management – earns fees from its Fidante Partners and Aligned Investments funds management operations, providing an end-to-end funds management business as well as managing one listed fund and a number of unlisted fund mandates.

Corporate and other

Corporate and other 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, Corporate and other also includes eliminations and non-core activities of the Group.

Major customers

The Group does not rely on any large individual customers and so there is no significant concentration risk.

Products and services

The Group's divisional segment split represents the products that the Group supplies.

Life – offers fixed rate retirement and superannuation products that are designed for investors who are seeking a low-risk investment for a period of time and want to protect their capital.

Funds Management – has equity investments in a number of boutique fund managers and, through the Aligned Investments business, offers a range of managed investments across the major asset classes.

Geographical areas

The Group operates predominantly in Australia and so no geographical split is provided to the chief operating decision maker.

	30 June 2013 \$M	30 June 2012 \$M
Reconciliation of management view of revenue to statutory revenue		
Reporting segments	551.6	518.7
Corporate and other	4.9	8.8
Net income – management view of revenue	556.5	527.5
Expenses and finance costs offset against management revenue		
SPV expenses and finance costs offset against SPV income	179.1	320.7
Commission expenses offset against commission income	50.1	53.8
Amortisation of deferred portfolio and origination costs offset against mortgage income	2.6	2.8
Change in life contract liabilities recognised in expenses offset against revenue	376.6	383.6
Property expenses offset against property income	63.0	65.0
Interest and loan amortisation costs	109.2	202.5
Management fees	56.6	49.4
Adjustment for non-controlling interests and other items	66.6	30.8
Difference between management view of investment experience and statutory recognition		
Total actual capital growth	206.9	(91.8)
Normalised capital growth	(36.2)	(43.7)
Actuarial assumption changes	(32.6)	(59.6)
Statutory view – revenue	1,598.4	1,441.0
Reconciliation of management to statutory view of pre-tax profit		
Reportable segment normalised net profit before tax	416.0	388.7
Corporate and other normalised net loss before tax	(55.8)	(53.7)
Normalised net profit before tax – management view of pre-tax profit	360.2	335.0
Investment experience before tax	138.1	(195.1)
Profit attributable to non-controlling interests excluded from management view	44.5	18.2
Other	2.8	(3.6)
Statutory view – profit before tax	545.6	154.5

Notes to the financial statements

3. Revenue

	30 June 2013 \$M	30 June 2012 \$M
Fee revenue		
Management fee revenue	105.0	87.6
Fee revenue – SPV	2.4	5.6
Other fee revenue	10.3	0.8
Investment revenue		
Equity and infrastructure investments		
Dividend revenue	17.1	26.0
Net realised loss on equity investments	(5.3)	(3.3)
Net unrealised gain/(loss) on equity investments	33.8	(21.9)
Net realised gain on infrastructure investments	19.2	–
Net unrealised (loss)/gain on infrastructure investments	(12.7)	76.7
Debt securities and cash		
Interest revenue	540.2	492.2
Net realised gain on debt securities	189.2	67.5
Net unrealised gain on debt securities ¹	29.9	105.0
Investment property and property securities		
Dividend revenue	12.3	4.5
Property rental revenue	228.9	238.9
Net realised loss on investment property and property securities	(1.0)	(1.4)
Net unrealised gain on investment property and property securities	12.6	10.6
Other		
Interest revenue – SPV	331.9	494.4
Net realised (loss)/gain on foreign exchange translation and hedges	(15.9)	15.5
Net unrealised gain on foreign exchange translation and hedges	57.2	29.1
Net realised loss on interest rate derivatives	(6.0)	(25.4)
Net unrealised (loss)/gain on interest rate derivatives	(44.7)	96.6
Impairment loss on equity accounted associates	(5.2)	–
Realised gain on sale of equity accounted associates	12.0	–
Other revenue		
Life insurance premiums and related revenue	257.6	46.9
Change in life insurance contract liabilities ²	(163.2)	(45.3)
Change in life investment contract liabilities ²	(4.9)	(211.9)
Change in reinsurance contract liabilities	(2.3)	(47.7)
Total revenue	1,598.4	1,441.0

¹ Includes fair value movements in subordinated debt (Note 27).

² Changes in life contract liabilities arising from discount rates, inflation rates and other assumptions are recognised as revenue, with other movements being included in Note 4 Expenses.

4. Expenses

	30 June 2013 \$M	30 June 2012 \$M
Life insurance claims and expenses	60.1	53.3
Cost of life insurance contract liabilities ¹	65.0	34.1
Cost of life investment contract liabilities ¹	251.6	296.2
Property related expenses	63.0	65.0
Management fees	56.6	49.4
Commission expenses	50.1	53.8
Amortisation of deferred portfolio and origination costs	2.6	2.8
Fee expenses – SPV	2.7	3.0
Intangibles amortisation expense	2.6	1.3
Employee expenses	108.8	104.2
Employee share-based payments	16.6	22.5
Superannuation	5.0	4.7
Occupancy expense – operating lease	4.4	6.9
Depreciation expense	11.1	6.9
Communications	17.2	16.4
IT maintenance	5.2	4.4
Professional fees	15.1	13.1
Other expenses	38.1	32.1
Total expenses	775.8	770.1

¹ Cost of life 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 disclosed in Note 3 Revenue.

5. Finance costs

	30 June 2013 \$M	30 June 2012 \$M
Interest and loan amortisation expenses incurred by:		
– SPV	176.4	317.7
– Property trusts	21.2	21.4
– Other entities	88.0	181.1
Other finance costs	4.8	4.5
Total finance costs	290.4	524.7

Notes to the financial statements

6. Income tax

	30 June 2013 \$M	30 June 2012 \$M
Analysis of income tax (expense)/benefit		
Current income tax (expense)/benefit for the period	(97.4)	64.6
Current income tax benefit prior period adjustment	2.9	10.3
Deferred income tax benefit/(expense)	10.2	(62.7)
Income tax (expense)/benefit	(84.3)	12.2
Income tax benefit on translation of foreign entities	7.8	–
Income tax (expense)/benefit on hedge of net investment in foreign entity	(4.5)	4.5
Income tax benefit from other comprehensive income	3.3	4.5
Reconciliation of income tax (expense)/benefit:		
Profit before income tax	545.6	154.5
Prima facie income tax based on the Australian company tax rate of 30%	(163.7)	(46.3)
Tax effect of amounts not deductible/assessable in calculating taxable income:		
Non-assessable and non-deductible items ¹	57.3	63.5
Rate differential	(3.4)	0.1
Utilisation of unrecognised capital loss on a share option expiry	19.0	–
Other items	6.5	(5.1)
Income tax (expense)/benefit	(84.3)	12.2

¹ The 30 June 2013 and 30 June 2012 amounts include a reduction in tax expense of \$30 million in respect of the application of the Taxation of Financial Arrangement laws for which an ATO private binding ruling was received in February 2012. This will also result in a circa \$30 million net reduction of the tax expense until the 2014 financial year.

	Statement of financial position		Income statement	
	30 June 2013 \$M	30 June 2012 \$M	30 June 2013 \$M	30 June 2012 \$M
Analysis of deferred tax				
Deferred tax assets				
Accruals and provisions	30.5	33.3	(2.8)	3.1
Employee entitlements	2.6	2.3	0.3	0.2
Losses	53.0	143.1	17.1	(14.8)
Other	7.5	6.7	1.5	(3.2)
	93.6	185.4		
Deferred tax liabilities				
Deferred acquisition and origination costs	(2.3)	(3.1)	0.8	0.7
Fixed asset temporary differences	1.2	0.1	1.1	0.8
Unrealised foreign exchange movements	21.0	(1.7)	22.7	(1.0)
Unrealised gains on investments	(191.5)	(170.5)	(13.4)	(35.1)
Other	(57.9)	(42.8)	(17.1)	(13.4)
	(229.5)	(218.0)		
Net deferred tax liability	(135.9)	(32.6)		
Deferred income tax benefit/(expense)			10.2	(62.7)

Unused capital losses – unused gross capital losses have reduced from \$99.7 million at 30 June 2012 to \$36.3 million at 30 June 2013 due to current year capital gains that arose during the year. No deferred tax asset has been recognised in respect of these capital losses.

Unused revenue loss – all revenue losses of the Challenger tax consolidated group have been recognised as a deferred tax asset. A deferred tax asset in relation to \$20.7 million of revenue losses (net) has not been recognised in respect of non-tax consolidated group entities as it is unlikely sufficient assessable gains will be derived by these entities to utilise these losses.

7. Dividends paid and proposed

	30 June 2013 \$M	30 June 2012 \$M
Dividends declared and paid during the year		
Final 30 June 2012 unfranked dividend: 10.5 cents (2011: 9.5 cents unfranked)	55.7	45.8
Interim 30 June 2013 unfranked dividend: 9.5 cents (2012: 7.5 cents unfranked)	49.9	40.0
	105.6	85.8

Dividend proposed (not recognised as a liability at 30 June)

Final 30 June 2013 unfranked dividend: 10.5 cents (2012: 10.5 cents unfranked)

54.8 55.5

There is no dividend reinvestment plan in operation for dividends.

8. Earnings per share

The following reflects the income and share data used in the basic and diluted earnings per share computations:

	30 June 2013 Cents	30 June 2012 Cents
Basic earnings per share	79.2	28.8
Diluted earnings per share	78.3	27.8
Profit used in the calculation of earnings per share	\$M	\$M
Profit attributable to equity holders	416.8	148.5
Number of shares	Number	Number
Weighted average ordinary shares for basic earnings per share	526,125,863	516,419,219
Effect of dilution	6,078,816	16,876,774
Weighted average ordinary shares for diluted earnings per share	532,204,679	533,295,993

In determining the weighted average number of ordinary shares used in the calculation of earnings per share, a reduction is made for the average number of treasury shares held. The weighted average number of treasury shares for the period was 12,695,614 (2012: 17,503,214). There have been no material transactions involving ordinary shares or potential ordinary shares since the reporting date and before the completion of the financial report.

9. Cash and cash equivalents

	30 June 2013 \$M	30 June 2012 \$M
Cash at bank and on hand	629.6	395.5
Other cash equivalents	213.7	319.0
Deposits at call	187.3	81.0
Total cash and cash equivalents	1,030.6	795.5

Notes to the financial statements

10. Receivables

	30 June 2013 \$M	30 June 2012 \$M
Interest receivable	81.2	69.2
Trade debtors	100.0	14.4
Derivative credit support	120.4	–
Amounts recoverable from managed trusts	6.1	6.7
Dividends and distributions receivable	5.8	9.9
Other debtors	19.9	14.3
Total receivables	333.4	114.5
Current	329.1	114.5
Non-current	4.3	–
	333.4	114.5

11. Financial assets

	30 June 2013 \$M	30 June 2012 \$M
Financial assets at fair value through profit and loss¹		
Debt securities		
Domestic sovereign bonds	391.7	69.0
Floating Rate Notes and Corporate bonds	4,691.4	4,237.0
Residential mortgage and asset-backed securities	2,006.2	1,705.5
Non-SPV mortgage assets	155.2	190.9
	7,244.5	6,202.4
Equity securities		
Shares in listed and unlisted corporations	199.6	129.6
Unit trusts, managed funds and other	125.7	98.6
Shares in listed corporations held in relation to endowment warrants ²	–	4.2
	325.3	232.4
Infrastructure investments		
Units in listed and unlisted infrastructure trusts	302.3	446.3
Other infrastructure investments	278.8	281.3
	581.1	727.6
Property securities		
Indirect property investments in listed and unlisted trusts	448.3	172.2
Total financial assets at fair value through profit and loss	8,599.2	7,334.6
Total other financial assets	8,599.2	7,334.6
Current	4,281.2	4,374.1
Non-current	4,318.0	2,960.5
	8,599.2	7,334.6

¹ All financial assets at fair value through profit and loss are designated as such on initial recognition.

² On 30 April 2004, the Group entered into a Deed of Assignment with Westpac Banking Corporation (WBC) whereby all legal and beneficial rights, title and interests in respect of these assets were assigned to WBC. All warrants matured prior to 30 June 2013. See Note 17 for the corresponding reduction in liability.

12. Investment and development property

	30 June 2013 \$M	30 June 2012 \$M
Investment property in use	2,333.6	2,327.4
Investment property under development ¹	18.6	17.8
Investment property held for sale ²	–	141.2
Total investment property	2,352.2	2,486.4
Development property ³	79.2	81.8
Total investment and development property⁴	2,431.4	2,568.2
Held for sale	–	141.2
In use/under development	2,431.4	2,427.0
Reconciliation of carrying amounts		
Investment property in use		
Opening balance	2,327.4	2,444.9
Transfer from investment property under development	–	32.0
Acquisitions ⁵	52.5	–
Sale of properties at cost ⁶	(11.5)	(68.2)
Transfer to investment property held for sale ²	–	(141.2)
Capital expenditure	22.8	31.5
Foreign currency exchange (loss)/gain	(54.7)	27.8
Net revaluation (loss)/gain	(2.9)	0.6
Closing balance	2,333.6	2,327.4
Investment property under development¹		
Opening balance	17.8	27.0
Transfer to investment property at fair value	–	(32.0)
Capital expenditure	2.4	24.3
Net revaluation loss	(1.6)	(1.5)
Closing balance	18.6	17.8
Development property³		
Opening balance	81.8	80.0
Sale of properties at cost	(11.0)	(8.0)
Development expenditure	8.4	9.8
Closing balance	79.2	81.8

¹ Investment properties under development are shown at fair value.

² No investment properties are held for sale as at 30 June 2013. June 2012 balance relates to the sale of Rendezvous Hotel, Victoria which settled in September 2012 and 417 St Kilda Rd, Victoria which settled in December 2012.

³ Development property is held at the lower of cost or net realisable value, being fair value on completion less costs to complete and estimated selling costs.

⁴ All investment and development property is considered to be non-current.

⁵ June 2013 balance relates to CLC's acquisition of a 50% interest in Centro Karratha, Western Australia. Federation Limited (formerly Centro) retains the remaining 50% ownership.

⁶ Challenger Diversified Property Group (CDI) sold Rexel, New South Wales for \$9.9 million; a difference on disposal of \$1.6 million was recognised in FY13 for prior year held for sale assets. Fair value was \$141.2 million for Rendezvous Hotel, Victoria and 417 St Kilda Rd, Victoria. The settlement occurred on September 2012 and December 2012 respectively for a total of \$142.8 million.

Notes to the financial statements

12. Investment and development property (continued)

Analysis of investment property

	Acquisition date	Total cost ¹⁵ \$M	Carrying value 2013 \$M	Cap rate ¹⁶ 2013 %	Last external valuation	Carrying value 2012 \$M	Cap rate ¹⁶ 2012 %
Investment property in use							
Australia							
Century City Walk, VIC ^{1,6}	16-Oct-06 & 30-June-08	28.2	31.7	8.25	30-Jun-13	30.0	8.50
Innaloo Cinema, WA ^{2,5}	17-Dec-01	29.2	43.5	8.00	30-Jun-13	42.5	8.00
Jam Factory, VIC ^{2,5}	4-Jul-00	125.5	128.0	7.50	30-Jun-13	118.9	7.75
Karratha, WA ⁴	28-Jun-13	52.5	52.5	7.75	—	—	—
Kings Langley, NSW ^{2,5}	29-Jul-01	16.7	16.8	8.50	30-Jun-13	15.6	8.75
County Court, VIC ⁷	30-Jun-00	207.4	277.1	7.78	31-Dec-12	276.6	7.25
CSIRO, NSW ⁷	27-Jun-01	150.7	160.0	8.00	30-Jun-13	159.0	8.00
Kraft, Port Melbourne, VIC ^{2,9}	28-Jun-02	28.6	21.8	9.00	30-Jun-13	22.6	9.50
Rexel, North Ryde, NSW ^{1,17}	30-Nov-06 & 30-Jun-08	—	—	—	—	9.9	9.50
ABS Building, ACT ^{2,9}	1-Jan-00	116.8	140.0	8.50	30-Jun-13	146.0	8.25
DIAC Building, ACT ^{2,9}	1-Dec-01	103.2	118.5	8.25	30-Jun-13	115.0	8.00
Discovery House, ACT ^{2,9}	28-Apr-98	85.4	99.0	8.00	31-Dec-12	102.4	7.75
Elders House, SA ^{2,5}	21-Jun-02	48.1	43.9	9.50	31-Dec-12	46.5	9.00
Executive Building, Hobart, TAS ^{2,5}	30-Mar-01	27.0	33.0	8.50	30-Jun-13	34.0	8.75
Makerston, QLD ^{2,9}	14-Dec-00	58.0	73.6	9.00	31-Dec-12	75.2	8.50
31 Queen Street, VIC ^{1,5}	31-Mar-11	92.0	95.5	8.00	30-Jun-13	91.0	8.00
417 St Kilda Rd, Melbourne, VIC ¹⁷	27-Jun-02	—	—	—	—	80.2	8.50
Taylor Institute, Waterloo, NSW ^{2,7}	16-May-01	42.1	42.0	9.25	31-Dec-12	44.8	8.25
The Forum, Cisco, NSW ^{2,9}	5-Jan-01	112.8	111.2	8.25	31-Dec-12	105.1	8.25
The Forum, Verizon, NSW ^{2,9}	5-Jan-01	77.6	69.9	8.75	31-Dec-12	69.7	8.50
6 Foray St, Fairfield, NSW ^{1,7}	23-Oct-06	21.6	14.9	10.50	30-Jun-13	15.2	10.00
Cosgrove Industrial Park, Enfield, NSW ^{1,7}	31-Mar-07	57.2	55.4	8.13	30-Jun-13	54.4	7.75
Spotlight, Laverton North, VIC ^{1,7}	16-Oct-06	16.6	17.0	8.25	31-Dec-12	17.4	8.25
12-30 Toll Drive, Altona North, VIC ^{1,7}	16-Oct-06	13.6	14.0	8.75	30-Jun-13	14.0	8.75
2-10 Toll Drive, Altona North, VIC ^{1,7}	16-Oct-06	6.5	5.8	8.50	31-Dec-12	6.4	8.75
1-9 Toll Drive, Altona North, VIC ^{1,7}	16-Oct-06	3.3	3.9	8.50	30-Jun-13	3.9	8.50
Rendezvous Hotels ¹⁷	8-Dec-05	—	—	—	—	61.0	8.25
Total Australia		1,520.6	1,669.0			1,757.3	
Hungary¹²							
Mangro Kft	12-Apr-07	31.9	9.5	12.00	30-Jun-13	9.5	11.49
Namoc Kft	12-Apr-07	11.7	3.2	12.00	30-Jun-13	3.2	11.49
Rozalia Kft	12-Apr-07	12.7	3.6	12.00	30-Jun-13	3.6	11.49
Rozal Kft	12-Apr-07	7.4	2.1	12.00	30-Jun-13	2.1	11.49
Lazor Kft	12-Apr-07	7.4	2.1	12.00	30-Jun-13	2.1	11.49
Surplus Land	12-Apr-07	1.0	0.4	12.00	30-Jun-13	0.4	11.49
France^{1,8}							
Rue Charles Nicolle, Villeneuve les Beziers	06-Jun-07	14.9	11.7	8.47	30-Jun-13	10.2	8.25
Avenue de Savigny, Aulnay sous Bois	06-Jun-07	17.6	15.1	6.95	30-Jun-13	11.5	6.25
105 Route d'Orleans, Sully sur Loire	06-Jun-07	22.4	11.6	9.75	30-Jun-13	11.1	9.20
140 Rue Marcel Paul, Gennevilliers	06-Jun-07	11.9	10.5	7.25	30-Jun-13	9.0	7.10
ZAC Papillon, Parçay-Meslay	06-Jun-07	9.1	6.9	8.65	30-Jun-13	5.4	8.65

	Acquisition date	Total cost ¹⁵ \$M	Carrying value 2013 \$M	Cap rate ¹⁶ 2013 %	Last external valuation	Carrying value 2012 \$M	Cap rate ¹⁶ 2012 %
Japan							
Carino Chitosedai ^{3,10}	30-Jun-07	117.9	101.3	5.20	31-Dec-12	114.1	5.20
Carino Tokiwadai ^{3,10}	30-Apr-07	76.9	66.6	5.20	30-Jun-13	69.7	5.20
Izumiya Hakubaicho ^{3,10}	30-Apr-07	68.0	60.0	5.30	31-Dec-12	65.2	5.30
Unicus Ina ^{3,10}	30-Apr-07	56.3	49.3	5.30	30-Jun-13	52.1	5.30
Valor Toda ^{3,10}	30-Apr-07	42.2	36.2	5.90	30-Jun-13	40.1	5.90
Life Higashinakano ^{3,10}	30-Apr-07	32.6	29.3	5.10	31-Dec-12	30.3	5.10
Life Asakusa ^{3,10}	30-Apr-07	27.4	25.1	5.10	30-Jun-13	27.4	5.10
Osada Nagasaki ^{3,10}	30-Apr-07	21.1	18.1	6.50	31-Dec-12	20.7	6.50
Yaoko Sakato Chiyoda ^{3,10}	30-Apr-07	18.1	14.4	5.40	31-Dec-12	15.9	5.40
Sunny Noma ^{3,10}	30-Apr-07	16.4	14.4	5.60	30-Jun-13	15.9	5.60
Kansai Super Saigo ^{3,10}	30-Apr-07	13.0	11.4	5.70	30-Jun-13	12.3	5.70
Kojima Nishiarai ^{3,9}	30-Apr-07	10.8	8.7	5.90	31-Dec-12	10.1	5.90
DeoDeo Kure ^{3,10}	31-Aug-07	31.4	26.1	5.80	30-Jun-13	28.9	5.80
Seiyu Miyagino ^{3,10}	30-Sep-07	9.6	8.5	6.00	30-Jun-13	9.1	6.00
Aeon Kushiro ^{3,11}	31-Dec-07	27.8	26.2	5.90	30-Jun-13	29.0	5.90
Valor Ichinomiya ^{3,11}	31-Dec-07	27.9	21.6	5.70	30-Jun-13	24.2	5.70
Life Nagata ^{3,11}	29-Feb-08	25.2	22.5	5.20	30-Jun-13	24.9	5.20
Renaissance Fujimidai ^{3,11}	29-Feb-08	28.3	25.4	5.60	31-Dec-12	28.1	5.60
Valor Takinomizu ^{3,11}	31-Mar-08	26.8	22.8	5.90	31-Dec-12	25.2	5.90
Total overseas		825.7	664.6			711.3	
Investment property in use		2,346.3	2,333.6			2,468.6	
TRE Data Centre ¹³	14-Apr-10	11.8	11.8	–	–	11.0	–
Enfield ^{1,13}	31-Mar-07	7.3	6.8	–	–	6.8	–
Investment property under development		19.1	18.6			17.8	
Maitland ¹⁴	6-Dec-06	79.2	79.2	–	–	81.8	–
Development property held for resale		79.2	79.2			81.8	

Except where noted below all property is owned by CLC or a wholly owned subsidiary.

¹ Property is 100% owned by CDI.

² Property is 60% owned by CDI and 40% owned by CLC.

³ Property is 100% owned by Japanese property trust.

⁴ Property is 50% owned by CLC and 50% by Federation Centres.

⁵ Valued by JLL.

⁶ Valued by Savills.

⁷ Valued by Colliers.

⁸ Valued by Knight Frank.

⁹ Valued by M3 Property.

¹⁰ Valued by TOEI Real Estate.

¹¹ Valued by Japan Valuers.

¹² Valued by CBRE.

¹³ Valued at cost.

¹⁴ Valued at lower of cost or net realisable value.

¹⁵ Total cost represents the original acquisition cost plus additions less full and partial disposals since acquisition date.

¹⁶ The capitalisation rate is derived by dividing the net property income over the carrying value of an investment property.

¹⁷ Property was sold in FY13.

Notes to the financial statements

12. Investment and development property (continued)

Analysis of investment property (continued)

The carrying values for investment properties in use have been determined with reference to independent valuations using market capitalisation and discounted cash flow methods.

Other than where indicated below, the properties are partially debt financed with funding that contains a number of negative undertakings (including an undertaking not to create or allow encumbrances, and an undertaking not to incur financial indebtedness which ranks in priority to existing debt). This debt funding is in place via a note issuance under a security trust structure.

CSIRO and County Court are each financed via separate capital markets bond issuances. Security has been granted over these properties under the bond issuances, which includes a mortgage over the properties. Maitland is partially funded by external debt. Security has been granted over each development in relation to that funding, which includes a mortgage over each property. As at 30 June 2013 the Hungarian properties are not funded by debt and so are not subject to any security or charge.

As at 30 June 2013 the investment property portfolio occupancy rate was 94.7% (CLC, excluding Japan), 95.9% (CDI) and 96.9% (Japan) with a weighted average lease expiry of 6.5 years (CLC, excluding Japan), 4.9 years (CDI) and 11.2 years (Japan).

13. Plant and equipment

	30 June 2013 \$M	30 June 2012 \$M
Office plant and equipment at cost	62.0	60.6
Less accumulated depreciation	(35.5)	(30.2)
	26.5	30.4
Infrastructure plant and equipment at cost	124.1	101.5
Less accumulated depreciation	(13.0)	(7.6)
	111.1	93.9
Total plant and equipment	137.6	124.3

	Office \$M	Infrastructure \$M	Total \$M
Reconciliations			
30 June 2013			
Opening balance	30.4	93.9	124.3
Additions ¹	1.4	14.0	15.4
Disposals	–	(0.4)	(0.4)
Depreciation expense	(5.3)	(5.8)	(11.1)
FX gain	–	9.4	9.4
Closing balance	26.5	111.1	137.6
30 June 2012			
Opening balance	22.3	63.4	85.7
Additions ¹	12.9	31.8	44.7
Depreciation expense	(4.8)	(2.1)	(6.9)
FX gain	–	0.8	0.8
Closing balance	30.4	93.9	124.3

All plant and equipment is non-current.

¹ Includes \$3.3 million of capitalised interest at 6.2% interest rate (30 June 2012: \$3.7 million at 6.2%) on Oikos Infrastructure.

14. Other assets

	30 June 2013 \$M	30 June 2012 \$M
Rental bond deposits	23.8	29.7
Prepayments – deferred portfolio and origination costs	7.5	10.0
Other	13.2	16.2
Other SPV	0.9	0.6
Total other assets	45.4	56.5
Current	15.8	19.0
Non-current	29.6	37.5
	45.4	56.5

15. Goodwill and other intangible assets

	30 June 2013 \$M	30 June 2012 \$M
Goodwill	506.8	505.7
Other intangible assets		
Software at cost	27.1	25.2
Less accumulated amortisation	(24.9)	(23.2)
Total software	2.2	2.0
Operating lease intangible at cost	22.8	22.8
Less accumulated amortisation	(4.9)	(4.0)
Foreign exchange losses	(5.8)	(7.1)
Total operating lease	12.1	11.7
Total other intangible assets	14.3	13.7

	Goodwill		Software		Operating lease	
	30 June 2013 \$M	30 June 2012 \$M	30 June 2013 \$M	30 June 2012 \$M	30 June 2013 \$M	30 June 2012 \$M
Opening balance	505.7	505.4	2.0	1.3	11.7	12.1
Additions	–	–	1.9	1.3	–	–
Foreign exchange gain	1.1	0.3	–	–	1.3	0.3
Amortisation expense	–	–	(1.7)	(0.6)	(0.9)	(0.7)
Closing balance	506.8	505.7	2.2	2.0	12.1	11.7

Notes to the financial statements

16. Impairment testing of goodwill

Goodwill acquired through business combinations is allocated to the Life and Funds Management cash-generating units (CGU) for impairment testing. The recoverable amount of goodwill for each CGU is determined via a value in use calculation that utilises cash flow projections based on financial budgets, approved by senior management, covering an appropriate time horizon. The discount rates, based on the Group's cost of capital, and key assumptions are as follows.

	30 June 2013	30 June 2012	30 June 2013 Discount rate %	30 June 2012 Discount rate %	Cash flow horizon (years)
	\$M	\$M			
CGU					
Life	419.8	418.7	10.5	10.5	5
Funds Management	87.0	87.0	10.5	10.5	5
Total	506.8	505.7			

Budgeted gross margins – is the average gross margins achieved in the year ended immediately before the budgeted year, adjusted for the expected impact of competitive pressure on margins and expected efficiency improvements.

Bond rate – this is taken as the yield on a government bond rate at the beginning of the budgeted year.

Growth rates – are consistent with long-term trends in the industry segments in which the businesses operate.

The derived values for the CGU are in excess of the carrying value of goodwill. Management are of the view that reasonably possible changes in the key assumptions, such as a change in the discount rate of 1% or a change in cash flow of 5%, would not cause the respective recoverable amounts for each CGU to fall short of the carrying amounts as at 30 June 2013. All goodwill is non-current.

17. Payables

	30 June 2013 \$M	30 June 2012 \$M
Trade creditors and accruals	122.2	192.8
Distributions payable	9.9	9.6
Unsettled trades payable	11.9	15.0
Other creditors	46.7	46.6
Payables – SPV	17.1	35.4
Warrant liability ¹	–	4.0
Total payables	207.8	303.4
Current	188.3	267.9
Non-current	19.5	35.5
	207.8	303.4

¹ On 30 April 2004, the Group entered into a Deed of Assignment with Westpac Banking Corporation (WBC) whereby all legal and beneficial rights, title and interests in respect of a portfolio of financial assets were assigned to WBC, see Note 11 for details. The difference between the equity assets and warrant liability equals dividends receivable which are only assigned when paid. All warrants matured prior to 30 June 2013.

18. Interest bearing liabilities

	30 June 2013		30 June 2012	
	Outstanding \$M	Facility \$M	Outstanding \$M	Facility \$M
Bank loans				
Recourse – Corporate	–	250.0	–	250.0
Non-recourse – Controlled property trusts ¹	771.6	827.2	827.3	912.6
Non-recourse – Controlled infrastructure trusts	206.1	206.1	206.1	211.0
Non-recourse – Repurchase agreements	448.9	448.9	–	–
Total bank loans	1,426.6	1,732.2	1,033.4	1,373.6
Non-recourse non-bank loans				
Subordinated debt issuance ²	510.1	510.1	450.1	450.1
Loan note finance	88.2	88.2	74.0	74.0
Controlled property trusts	10.8	10.9	10.0	10.2
Total non-bank loans	609.1	609.2	534.1	534.3
Total interest bearing liabilities	2,035.7	2,341.4	1,567.5	1,907.9
Current	472.3		128.0	
Non-current	1,563.4		1,439.5	
	2,035.7		1,567.5	

¹ Redraw loan facilities total \$300.0 million (facility limit). Non-redraw loan facilities total \$527.3 million (facility limit).

² The balance is considered non-current.

Bank loans

Corporate – the facility of \$250.0 million is secured by guarantees in place between members of the Group. A floating interest rate was applied to this facility during the period.

Controlled property trusts – 30 June 2013 balance includes \$346.4 million (30 June 2012: \$395.7 million) of Yen denominated loans in the Japanese property trusts (30 June 2013: ¥32.2 billion, 30 June 2012 ¥32.4 billion). These loans have variable terms and are secured by way of first ranking mortgages over the investment properties. Both loans are due to mature in the financial year ending 2017.

On 14 June 2013 Challenger Diversified Property Group (CDI) refinanced its \$300.0 million multi-option syndicated finance facility with Westpac Banking Corporation Limited (WBC) and Commonwealth Bank of Australia Limited (CBA). The new facility comprises three tranches with limits of \$90 million, \$110 million and \$100 million maturing in October 2015, July 2016 and July 2017 respectively, with a weighted average term of 3.2 years. For Australian denominated loans (2013: AUD 201.0 million, 2012: AUD 198.9 million), interest on the facility is calculated at the bank bill swap rate, plus a margin. For Euro denominated loans (2013: EUR 38.5 million or AUD 54.7 million, 2012: EUR 36.9 million or AUD 45.7 million), interest on the facility is calculated at EURIBOR, plus a margin. Challenger Diversified Property Trust 2 (CDPT2) and Challenger Diversified Property Development Pty Limited (CDPD), entities forming part of the stapled CDI group, are guarantors of the facility.

The loan facility comprises a secured component and an unsecured component. In relation to the unsecured component, CDI has not granted security over its properties but provided a number of negative undertakings, including an undertaking not to create or allow encumbrance over its properties. The secured component relates to the funding of property acquisitions in France. Security was granted by way of mortgages of shares in, and of debts between, entities established to acquire the French properties.

Bank loans in the other unlisted property trusts of \$170.9 million (June 2012: \$187.9 million) are secured solely by fixed and floating first mortgages over investment properties.

Controlled infrastructure trusts – this is an amortising facility with an expiry date of June 2016. This facility has variable terms and is secured by the way of first ranking mortgages over the infrastructure asset.

Repurchase agreements – CLC has entered into repurchase agreements with the RBA and Banking Institutions whereby a debt security (or portfolios of debt securities) are sold for cash whilst simultaneously agreeing to repurchase the debt securities at a fixed price and fixed date in the future. These arrangements are interest bearing with interest factored into the sellback price and paid on repurchase. CLC has active repurchase agreements for \$448.9 million, which were due in July 2013.

Notes to the financial statements

18. Interest bearing liabilities (continued)

Non-bank loans

Subordinated debt issuance – the Group issued subordinated notes into the US private placement market of US\$150 million in December 2006 and A\$400 million in November 2007. The notes were issued under an APRA approved Instrument of Issue and counted as Approved Subordinated Debt for regulatory capital purposes. Under transition relief provided by APRA from the introduction of LAGIC on 1 January 2013 this subordinated debt issuance continues to be fully eligible as tier 2 regulatory capital until each tranche's first call date after 1 January 2013 and then will amortise over four years.

The December 2006 notes are unsecured and were issued in two maturities (US\$125 million at 10 years with a non-call period of five years; and US\$25 million at 20 years with a non-call period of 10 years). A portion of this subordinated debt has a fixed interest rate with the remaining portion being floating. The November 2007 issuance was unsecured and matures at 30 years with a non-call period of 10 years.

The proceeds of both issuances were made available to Statutory Fund No.2 of Challenger Life Company Limited (SF2) and rank in right of payment either pari passu with, or senior to, all other unsecured and subordinated indebtedness of SF2, except for such indebtedness preferred by operation of bankruptcy laws or similar laws of general application. Subordinated debt is measured at fair value through profit and loss and adjusted for movements in interest rates, credit spreads and foreign exchange rates.

Loan note finance – the Group has entered into a restricted recourse £25 million loan that is secured against properties. The fixed rate interest applied has been capitalised and is expected to be repaid together with the principal on maturity in 2015.

Controlled property trusts – non-bank loans in the unlisted property trusts are secured solely by fixed and floating first mortgages over properties.

19. External unit holders' liabilities

	30 June 2013 \$M	30 June 2012 \$M
Current	1,232.9	1,241.2
Non-current	518.5	610.0
Total liabilities to external unit holders	1,751.4	1,851.2

The Group controls a number of guaranteed index return trusts that contain contributed funds in respect of fixed term wholesale mandates. The external unit holders' liabilities represent the balance owing to third parties on these mandates.

20. Provisions

	30 June 2013 \$M	30 June 2012 \$M
Surplus lease provision	8.4	12.9
Employee entitlements	9.1	8.1
Relocation provision	4.1	3.9
Other provisions	5.4	2.5
Total provisions	27.0	27.4

	Surplus lease provision \$M	Employee entitlements \$M	Relocation provision \$M	Other \$M
30 June 2013				
Opening balance	12.9	8.1	3.9	2.5
Arising during the year	0.5	7.4	0.2	3.5
Amounts utilised	(5.0)	(6.4)	–	(0.6)
Closing balance	8.4	9.1	4.1	5.4
30 June 2012				
Opening balance	14.1	6.9	4.4	4.9
Arising during the year	2.8	7.5	–	0.4
Amounts utilised	(4.0)	(6.3)	(0.5)	(2.8)
Closing balance	12.9	8.1	3.9	2.5

Surplus lease provision represents the Group's net rental expense obligation on surplus space in leased buildings in Sydney and London and the obligation on these leases expires in 2016. The make-good provision represents the Group's net obligations on building leases.

Notes to the financial statements

21. Life contract liabilities

	30 June 2013 \$M	30 June 2012 \$M
Life investment contract liabilities – at fair value	6,150.0	5,806.2
Life insurance contract liabilities – at Margin on services valuation	913.5	685.4
Reinsurance contract liabilities – at Margin on services valuation	59.8	61.4
Total life contract liabilities	7,123.3	6,553.0

	Life investment contract liabilities		Life insurance contract liabilities		Reinsurance contract liabilities		Total life contract liabilities	
	30 June 2013 \$M	30 June 2012 \$M	30 June 2013 \$M	30 June 2012 \$M	30 June 2013 \$M	30 June 2012 \$M	30 June 2013 \$M	30 June 2012 \$M
Reconciliation								
Opening balance	5,806.2	4,998.2	685.4	614.8	61.4	16.0	6,553.0	5,629.0
Deposits and premium receipts	1,922.3	1,907.4	257.6	46.8	–	–	2,179.9	1,954.2
Payments and withdrawals	(1,835.1)	(1,616.0)	(60.1)	(53.3)	(3.9)	(2.3)	(1,899.1)	(1,671.6)
Revenue per Note 3	5.0	220.6	(94.5)	(10.3)	2.3	47.7	(87.2)	258.0
Expense per Note 4	251.6	296.2	125.1	87.4	–	–	376.7	383.6
Other movements	–	(0.2)	–	–	–	–	–	(0.2)
Closing balance	6,150.0	5,806.2	913.5	685.4	59.8	61.4	7,123.3	6,553.0

	30 June 2013 \$M	30 June 2012 \$M
Analysis of life insurance contract liability and expenses		
Best estimate liability		
Value of future life insurance contract benefits	873.3	652.8
Value of future expenses	34.8	32.6
Total best estimate liability	908.1	685.4
Value of future profit margins	5.4	–
Gross life insurance contract liability	913.5	685.4
Life insurance contract operating expenses		
Maintenance expenses – commission	0.6	0.4
Maintenance expenses – other	3.8	3.1
Total life insurance contract operating expenses	4.4	3.5
Analysis of life contract profit		
Profit attributable to life insurance contracts	44.4	21.1
Profit attributable to life investment contracts	280.3	95.0
Profit arising from difference between actual and assumed experience	324.7	116.1
Investment earnings on assets in excess of life contract liabilities	188.0	39.2
Life contract profit¹	512.7	155.3

¹ This profit represents that made by the statutory funds of Challenger Life Company Limited only and includes the investment return on assets backing the life contract liabilities.

Methodology applied in the valuation of life contract liabilities

Life investment contracts are policies regulated by the **Life Insurance Act 1995** (the Life Act) that do not meet the definition of an insurance contract (under AASB 4 **Insurance Contracts**) and are measured at fair value through profit and loss. **Life insurance contracts** are policies regulated by the Life Act that meet the definition of an insurance contract and are measured using the Margin on Services (MoS) methodology.

The MoS valuation, calculated in accordance with Prudential Standards, results in the systematic release of planned margins over the life of the policy via a 'profit carrier'. The Group maintains two types of life insurance contract, being individual lifetime annuities and wholesale mortality reinsurance. Annuity payments are used as the profit carrier for individual lifetime annuities and premium receipts are used as the profit carrier for wholesale mortality reinsurance.

Key assumptions applied in the valuation of life contract liabilities

Discount rates – under APRA standards, life insurance contract policy 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. The illiquidity premium is determined by reference to observable market rates including government guaranteed bank debt, credit-risk adjusted corporate bonds and the spread between the Commonwealth government bond curve and the swap curve. Life investment contract policy liabilities are calculated under the fair value through profit and loss provisions of AASB 139. 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 30 June 2012. Discount rates applied at 30 June 2013 were between 3.2% and 4.8% (2012: 3.7%–4.8%).

Maintenance expenses – are based on budgets for the financial year. The expenses are converted to a per-contract unit cost or percentage of account balance, depending on their nature, based on an expense analysis.

Inflation – based on long-term expectations and reviewed 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 is 1.7% for short-term inflation and 2.5% for long-term (2012: 2.2% short-term, 2.5% long-term).

Voluntary discontinuances/surrenders – no surrenders or voluntary discontinuances are assumed.

Mortality – base mortality rates are determined as a multiple of United Kingdom annuitant lives experience from 1999 to 2002 (IML00 and IFL00 tables), adjusted for Challenger's own recent experience. Rates are adjusted for expected future mortality improvements based on observed improvements in Australia. Rates of future mortality improvement applied at 30 June 2013 are between 1.0% and 4.0% (2012: 1.0%–4.0%).

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 income statement 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 income statement in the period in which they occur.

Restrictions on assets

The **Life Insurance Act 1995** requires the Group to hold investments to back life contract liabilities in separate statutory funds. The assets in a statutory fund can only be used to meet the liabilities and expenses of that fund, to acquire investments to further the business of the fund or as distributions when solvency and capital adequacy requirements are met.

Statutory fund information

CLC has three statutory funds. Fund 1 is a non-investment-linked fund and fund 3 is investment-linked. Both of these are closed to new business. Fund 2 contains non-investment-linked contracts, including the Group's term annuity business, lifetime annuity policies and the related reinsurance, plus the wholesale mortality reinsurance. Life contract liabilities for funds 1, 2 and 3 are \$4.9 million, \$7,114.7 million and \$3.7 million respectively (2012: \$5.6 million, \$6,543.9 million, \$3.5 million).

Current/non-current split for total life contracts

There is a fixed settlement date for the majority of life contract liabilities. Approximately \$1,719 million (2012: \$1,066 million) of life contract liabilities have a contractual maturity within 12 months of the reporting date. Based on assumptions applied for the 30 June 2013 valuation of life contract liabilities, \$1,947 million of principal payments on fixed term and lifetime business are expected in the year to 30 June 2014 (2013: \$1,271 million).

Notes to the financial statements

21. Life contract liabilities (continued)

Life insurance risk

The Group is exposed to longevity risk on its life insurance liabilities, being the risk that annuitants may live longer than expectations, and mortality risk on the wholesale mortality reinsurance, being that death rates in the reference portfolios exceed expectations. The Group manages the longevity risk by using reinsurance as well as the regular review of the portfolio to confirm continued survivorship of annuitants receiving income plus regular review of longevity experience to ensure that longevity assumptions remain appropriate. The Group manages the mortality risk by the regular review of the portfolio to ensure that mortality assumptions remain appropriate.

Insurance risk sensitivity analysis

The table below discloses the sensitivity of life insurance contract liabilities, current shareholder period profit after income tax and equity to changes in the key assumptions relating to insurance risk, both gross and net of reinsurance.

	Increase in life insurance contract liabilities				Profit and equity impact			
	Gross		Net		Gross		Net	
	30 June 2013 \$M	30 June 2012 \$M	30 June 2013 \$M	30 June 2012 \$M	30 June 2013 \$M	30 June 2012 \$M	30 June 2013 \$M	30 June 2012 \$M
50% increase in the rate of mortality improvement	61.0	61.0	19.6	10.8	(42.7)	(42.7)	(13.7)	(7.5)
10% increase in maintenance expenses	2.9	2.8	2.9	2.8	(2.0)	(1.9)	(2.0)	(1.9)

Liquidity risk for insurance contracts

The following table summarises the undiscounted maturity profile of the Group's life insurance contracts. The analysis is based on undiscounted estimated cash outflows, including interest and principal payments. The undiscounted maturity profile of life investment contracts is disclosed in Note 27.

	1 year or less \$M	1-3 years \$M	3-5 years \$M	>5 years \$M	Total undiscounted amount \$M
Life insurance contract liabilities					
2013	111.1	167.8	145.7	1,015.5	1,440.1
2012	57.4	111.6	106.4	760.0	1,035.4

Actuarial information

Mr A Bofinger FIAA, as the Appointed Actuary of Challenger Life Company Limited, 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 Insurance Act 1995.

22. Special Purpose Vehicles

Special Purpose Vehicles (SPV) are entities that fund pools of residential mortgage loans via the issuance of residential mortgage-backed securities. All borrowings of these SPV are limited in recourse to the assets of the SPV. The Group is not originating any significant new mortgage assets or securitised liabilities but is managing the run-off of the portfolio.

The Group is deemed to control these entities as a consequence of holding the beneficial interest to the residual income stream but the major risks and rewards, notably credit risk, lie with the mortgage-backed security holder. The assets and liabilities of the SPV have been separately disclosed in the financial report as this presentation is considered to provide a more transparent view of the Group's financial position. Transactions between the SPV and other entities within the Group are eliminated on consolidation. The amounts in respect of the SPV included in the consolidated Group, subject to the footnote on Payables below, are as follows.

	30 June 2013 \$M	30 June 2012 \$M
Cash and cash equivalents	278.7	364.1
Receivables	4,039.4	5,347.7
Derivative assets	5.6	3.8
Other assets	0.9	0.6
Total assets	4,324.6	5,716.2
Payables ¹	493.2	464.2
Derivative liability	1.9	4.7
Interest bearing liabilities	3,825.8	5,248.2
Total liabilities	4,320.9	5,717.1
Net assets	3.7	(0.9)
Cash flow hedge reserve	3.7	(0.9)
Total equity attributable to residual income unit holders	3.7	(0.9)

¹ Payables differ from the SPV Payables per Note 17 by the value of the cumulative eliminations between the SPV and other members of the Group.

SPV receivables is stated net of impairment measured as any shortfall between the carrying amount of the loan and the present value of expected future cash flows, discounted at the loan's original effective interest rate and adjusted for lenders mortgage insurance coverage. A reconciliation of the provision is as follows:

	30 June 2013 \$M	30 June 2012 \$M
Opening balance	57.6	54.5
Additional accruals and adjustments to estimates	15.5	12.4
Utilisation of provision against incurred losses	(12.5)	(9.3)
Closing balance	60.6	57.6

Notes to the financial statements

23. Contributed equity

	30 June 2013		30 June 2012	
	No. of shares M	\$M	No. of shares M	\$M
Ordinary shares issued	530.9	1,335.5	544.7	1,385.5
CPP Trust shares treated as treasury shares	(8.7)	(40.2)	(15.7)	(72.4)
CPP deferred share purchase	(6.6)	(23.4)	–	–
Total contributed equity	515.6	1,271.9	529.0	1,313.1
Movement in contributed equity:				
Ordinary shares				
Opening balance	544.7	1,385.5	497.6	1,191.1
New shares issued ¹	–	–	60.0	247.4
Cancelled under share buy-back	(13.8)	(50.0)	(12.9)	(53.0)
Closing balance	530.9	1,335.5	544.7	1,385.5
CPP Trust				
Opening balance	15.7	72.4	19.3	84.9
Shares purchased	–	–	12.9	60.7
Shares transferred from LTIP	–	–	0.9	4.2
Vested shares released to employees	(7.0)	(32.2)	(17.4)	(77.4)
Closing balance	8.7	40.2	15.7	72.4
CPP deferred share purchases				
Opening balance	–	–	–	–
CPP deferred share purchases	6.6	23.4	–	–
Closing balance	6.6	23.4	–	–

¹ Exercise of the CPH Option. Consists of \$60 million received at grant plus \$195 million on exercise less issue costs.

Terms and conditions of contributed equity

Ordinary shares – a holder of an ordinary share is entitled to receive dividends and to one vote on a show of hands and on a poll.

Challenger Performance Plan Trust (CPP Trust) – the CPP Trust is a controlled entity and holds shares in the Company. As a result, the CPP Trust's shareholding in the Company is disclosed as treasury shares and deducted from equity and dividends paid from the Company to the CPP Trust are eliminated on consolidation.

CPP deferred share purchase – the shares to be purchased under this agreement are to be treated as treasury shares from the date of the agreement.

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 Group manages capital risk via Capital Management Plans at both the Group and the prudentially regulated Challenger Life Company Limited (CLC) levels. The objective of these plans is to maintain financial stability of the Group and CLC whilst ensuring the shareholders earn an appropriate risk adjusted return through optimisation of the capital structures. The Capital Management Plans are approved by the respective boards and are reviewed at least annually.

Capital Management Plan – Group

The Group Capital Management Plan aims to maintain an investment grade credit rating and robust capital ratios in order to support its business objectives and maximise shareholder wealth. The Group believes that maintaining an investment grade rating is the most appropriate target from a capital structure perspective and is essential in order to secure access to capital at a reasonable cost.

Standard & Poor's long-term credit ratings for the Group and CLC as at the balance date are BBB+ (Stable) and A (Stable) respectively. There were no changes to either the Group or CLC ratings during the period.

The Group's current dividend payout ratio target is 30–35% of normalised net profit after tax (as defined in Note 4 of the Directors' report). There were no material changes to the Group's Capital Management Plan during the year.

Internal Capital Adequacy Assessment Process (ICAAP) Summary Statement – CLC

CLC is a life insurance company regulated under the Life Act. The Life Act, via Prudential Standards issued by APRA, imposes minimum statutory capital requirements on all life insurance companies. CLC complied with these requirements at all times during the period.

APRA has introduced new Prudential Standards that took effect from 1 January 2013 (the Life and General Insurance Capital or LAGIC standards). Under these new standards a life company must have in place an ICAAP, documented in an ICAAP summary statement. The CLC ICAAP summary statement replaced the CLC Group Capital Management Plan from 1 January 2013.

Final LAGIC standards were issued by APRA in October 2012, with the new standards effective from 1 January 2013. The LAGIC standards increased CLC's regulatory capital requirement by \$322.8 million from 1 January 2013; however, APRA has confirmed that transition arrangements will apply as outlined below. CLC expects to be able to fully meet the LAGIC requirements within the three-year transition period.

LAGIC transition arrangements

Prescribed capital amount

The introduction of the new LAGIC standards increased CLC's regulatory capital requirement at 1 January 2013 by \$322.8 million. However, APRA has confirmed that transition arrangements will apply which results in the increase in prescribed capital occurring over three years.

The initial LAGIC transition balance (\$322.8 million) will amortise such that the increase in prescribed capital will be phased in by \$107.6 million each year with the first increase being on 1 January 2014. The entire transition balance will be amortised by 1 January 2016.

Subordinated debt

CLC has issued subordinated debt with a current fair value of \$510.1 million (June 2012: \$450.1 million). APRA provided CLC with transition relief under which existing subordinated debt tranches will continue to be fully eligible as Tier 2 regulatory capital until each tranche's first call date after 1 January 2013, and will then amortise over four years. As a result, the largest tranche of the existing subordinated debt will be fully eligible as Tier 2 regulatory capital until its call date in November 2017 and will continue to be partially eligible until November 2021.

At 30 June 2013, \$488.8 million (1 January 2013: \$477.3 million) of subordinated debt was included in regulatory capital base.

Tier 1 and Tier 2 regulatory capital

Under APRA's transition arrangements, CLC's statutory funds have three years to transition to the minimum requirement of Tier 1 capital representing 80% of the prescribed capital amount. At a CLC consolidated level, APRA has provided an 18-month transition period to meet the minimum 80% Tier 1 requirement. CLC is currently meeting these requirements at both the statutory fund and consolidated level.

CLC's excess capital under LAGIC

CLC's excess capital above the prescribed capital amount under LAGIC as at 30 June 2013 was \$897.4 million. CLC's excess includes an allowance of \$322.8 million in respect of transition. The table below sets out CLC's capital position based on the new LAGIC standards as at 30 June 2013¹:

	\$M
Common equity tier 1 regulatory capital	1,563.5
Tier 2 regulatory capital – subordinated debt ²	488.8
CLC total regulatory capital based	2,052.3
CLC prescribed capital amount (PCA)	
Prescribed capital amount – excluding transition relief	1,477.7
Transition relief ³	(322.8)
CLC prescribed capital amount	1,154.9
CLC excess over prescribed capital amount	897.4
Capital adequacy multiple	1.8

¹ 30 June 2012 solvency multiple was 1.6. This is under the previous APRA capital regime and is not a direct comparison to capital adequacy.

² Differs from \$510.1 million disclosed in Note 18 due to \$4.5 million of accrued interest and capitalised borrowing costs and (\$25.8 million) of inadmissible Tier 2 regulatory capital.

³ LAGIC transition relief will reduce by one third (\$107.6 million) on 1 January 2014, 1 January 2015, 1 January 2016.

Notes to the financial statements

24. Reserves

	30 June 2013 \$M	30 June 2012 \$M
Share-based payments reserve		
Opening balance	35.6	62.7
Transfer from equity option premium reserve	1.7	–
Share-based payments for the period	16.6	22.5
Releases from share-based payments reserve	(23.9)	(49.6)
Closing balance	30.0	35.6
Cash flow hedge reserve – SPV¹		
Opening balance	(0.9)	(5.4)
Charged to equity	4.5	4.5
Closing balance	3.6	(0.9)
Foreign currency translation reserve¹		
Opening balance	(8.4)	(13.1)
(Loss)/gain on translation of foreign entities ²	(4.3)	15.3
Gain/(loss) on hedge of net investment in foreign entities ²	10.7	(10.6)
Closing balance	(2.0)	(8.4)
Adjusted controlling interests reserve¹		
Opening balance	17.7	11.8
Change in holding in controlled entity	0.5	5.9
Closing balance	18.2	17.7
Equity option premium reserve		
Opening balance	65.0	125.4
Expiry of equity option transferred to retained earnings	(63.3)	–
Transfer to share-based payments reserve	(1.7)	–
Exercise of equity option	–	(60.0)
Option issue costs	–	(0.4)
Closing balance	–	65.0
Total reserves	49.8	109.0

¹ These items may eventually be recycled to the profit and loss section of the income statement.

² Net of tax.

Nature and purpose of reserves

Share-based payments reserve – an expense is recognised over the vesting period of share-based payments granted to employees. This expense is based on the valuation of the equity benefits granted at the grant date. When an instrument is granted, and an expense incurred, there is a corresponding increase in the share-based payments reserve directly in equity. The total of this reserve is net of any gain or loss realised on the disposal of forfeited shares held within the schemes.

Cash flow hedge reserve – comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

Foreign currency translation reserve – used to record foreign exchange differences arising from the translation of the foreign subsidiaries. It also includes the effective portion of fair value changes on foreign exchange derivative contracts designated as hedges of a net investment in a foreign entity.

Adjusted controlling interests reserve – relates to changes arising from movements in the ownership interests in entities already controlled by the Group. The difference between the fair value of the consideration paid/received for the change in holding and the change in the Group's share of the net assets of the entity is recorded in this reserve.

Equity option premium reserve – the options issued to Colony Marlin-Holdings LLC (Colony) on 7 November 2007 expired on 26 November 2012. On expiry the option premium of \$63.3 million was transferred to retained earnings, net of tax.

25. Retained earnings

	30 June 2013 \$M	30 June 2012 \$M
Opening balance	270.1	207.4
Profit attributable to equity holders	416.8	148.5
Expiration of equity option	44.4	–
Dividends paid	(105.6)	(85.8)
Total retained earnings	625.7	270.1

The options issued to Colony Marlin-Holdings LLC (Colony) on 7 November 2007 expired on 26 November 2012. On expiry the option premium of \$63.3 million was transferred to retained earnings, net of tax.

26. Non-controlling interests

	30 June 2013 \$M	30 June 2012 \$M
Representing the following share of equity in the applicable entity:		
Contributed equity	357.6	385.5
Reserves	(22.9)	(6.0)
Opening retained losses ¹	(32.4)	(45.4)
Profit for the year	44.5	18.2
Total non-controlling interests	346.8	352.3

¹ Includes pre-acquisition retained losses.

27. Financial risk management

Governance and risk management framework

The Group's activities expose it to a variety of financial risks, such as market risk (including currency risk, interest rate risk, equity price risk and credit spread risk); credit default risk; and liquidity risk. The management of risks is fundamental to the Group's business and to building shareholder value. The Board is responsible, in conjunction with senior management, for understanding the risks associated with the activities of the Group and putting in place structures and policies to adequately monitor and manage those risks.

The Board has established the Group Risk and Audit Committee (GRAC) as a board sub-committee to assist in the discharge of its responsibilities. In particular, setting risk appetite and ensuring the Company has an effective risk management framework incorporating management, operational and financial controls.

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

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

The Group's principal financial instruments consist of derivatives, cash and cash equivalents, receivables, available-for-sale assets, financial assets at fair value through profit and loss, payables, life investment contract liabilities and other interest bearing financial liabilities.

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial instruments, are disclosed in Note 1.

Market risk

Market risk is the risk that the fair value or future cash flows from a financial instrument will fluctuate because of changes in market factors. Market risk comprises (amongst others): interest rate risk (due to fluctuations in interest rates), price risk (due to fluctuations in the fair value of equities or credit spreads) and currency risk (due to fluctuations in foreign exchange rates).

Notes to the financial statements

27. Financial risk management (continued)

Interest rate risk

Interest rate risk is the risk to the Group's earnings and equity arising from movements in interest rates, including changes in the absolute levels of interest rates, the shape of the yield curve, the margin between the different yield curves and the volatility of the interest rates.

It is the Group's policy to minimise the impact of interest rate movements on debt servicing capacity, Group profitability, business requirements and company valuation. The Group targets hedging of between 30% and 70% of drawn net recourse interest bearing liabilities of the corporate segment. The amount of drawn net recourse corporate interest bearing liabilities, and their duration, is determined with reference to the annual budget and the most current forecasts. The Group's strategy is to have no interest rate hedges with duration greater than five years and targets average hedge duration of three years.

Challenger Life Company Limited's (CLC's) Market Risk Policy is approved by the CLC Board and sets out the relevant risk limits for interest rate exposure. It is CLC's policy to minimise the impact of interest rate movements on its projected future cash flows. The management of the risks associated with life investment and life insurance contracts, including interest rate risk, are subject to the prudential requirements of the Life Act. This includes satisfying solvency requirements, which in turn include consideration of how the interest rate sensitivity of assets and liabilities are matched.

Challenger Diversified Property Group (CDI) is also exposed to interest rate risk arising from liabilities bearing variable interest rates. Interest rate swaps are taken out to effectively hedge interest rates on a minimum of 60% of expected borrowings over the next 2 to 10 years.

For the Special Purpose Vehicles (SPV) the impact of a rising/falling BBSW benchmark over the Reserve Bank of Australia's target cash rate results in an increase/decrease in the cost of funding and therefore on the profit of the trusts. This interest rate risk is mitigated by actively adjusting the interest rate charged to borrowers if a sustained adverse differential to the benchmark is evidenced. SPV are also exposed to the risks arising from borrowers fixing the rates on their mortgage. This interest rate risk is managed by using cash flow hedges to swap the fixed rate for a floating rate on an amount equal to the notional value of the mortgages being fixed.

Interest rate sensitivity

The Group's sensitivity to movements in interest rates in relation to the value of financial assets and liabilities is shown in the table below. It is assumed that the change happens at the balance date and that there are concurrent movements in interest rates and parallel moves in the yield curve. All material underlying exposures and related hedges are included in the analysis; this includes underlying exposures and related hedges for investment properties with leases, where the future income stream is duration hedged for interest rate movements.

		Profit/ (loss) 30 June 2013 \$M	Change in equity 30 June 2013 \$M	Profit/ (loss) 30 June 2012 \$M	Change in equity 30 June 2012 \$M
	Change in variable				
Non-SPV ¹	+100bps	7.2	7.2	7.8	7.8
	-100bps	(7.2)	(7.2)	(7.9)	(7.9)
SPV	+100bps	(3.6)	(3.6)	(4.8)	(4.8)
	-100bps	3.6	3.6	4.8	4.8
Total	+100bps	3.6	3.6	3.0	3.0
	-100bps	(3.6)	(3.6)	(3.1)	(3.1)

¹ The financial impact includes the consolidated post-tax result of Challenger Diversified Properties Group (CDI) +100bp \$1.7 million (2012: \$1.8 million) and -100bp \$(1.7 million) (2012: \$(1.9 million)).

The impact on profit and equity is post-tax at a rate of 30%. The risks faced and methods used in the sensitivity analysis are the same as those applied in the comparative period. As shown above, 100 basis points (1%) movements in interest rates would have only a small net impact on the Group's financial position as upside risks in CLC and the property trusts largely offset downside risk in the SPV, and vice versa.

Price risk

Price risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded on the market. The Group is exposed to equity price risk on its holdings in equity securities and credit spread risk on its debt securities.

It is the Group's policy to hedge the exposure resulting from movements in the value of listed equity portfolio investments. Equity investments regarded as 'operational' or 'strategic' will not be hedged. CLC is required to fair value all equities held to back life contract liabilities. No other entities within the Group have any significant exposure to equity price risk.

Equity price risk sensitivity

The potential impact of movements in the market value of listed and unlisted equities on the Group's income statement and statement of financial position is shown in the below sensitivity analysis. This sensitivity analysis has been performed to assess the direct risk of holding equity instruments; therefore any potential indirect impact on fees from the Group's funds management business has been excluded. It is assumed that the relevant change occurs as at the reporting date.

Asset class	Change in variable	Profit/	Change	Profit/	Change
		(loss)	in equity	(loss)	in equity
		30 June	30 June	30 June	30 June
		2013	2013	2012	2012
		\$M	\$M	\$M	\$M
Property securities	+10%	31.4	31.4	12.0	12.0
	-10%	(31.4)	(31.4)	(12.0)	(12.0)
Infrastructure investment	+10%	21.2	21.2	31.2	31.2
	-10%	(21.2)	(21.2)	(31.2)	(31.2)
Other assets	+10%	16.1	16.1	16.0	16.0
	-10%	(16.1)	(16.1)	(16.0)	(16.0)
Total assets	+10%	68.6	68.6	59.2	59.2
	-10%	(68.6)	(68.6)	(59.2)	(59.2)

The impact on profit and equity is post-tax at a rate of 30%. The risks faced and methods used in the sensitivity analysis are the same as those applied in the comparative period. As shown above a 10% movement in equity prices would have a material impact on the consolidated Group's financial position.

Credit spread risk sensitivity

The Group is exposed to movements in credit spreads above the interbank swap curve through its debt securities. As at 30 June 2013, a fifty basis point increase/decrease in credit spreads would result in a post-tax (at 30%) unrealised loss/gain in the income statement and equity of \$91.9 million (2012: \$75.1 million), the increase on the 2012 number reflects the increase in debt assets.

Currency risk

It is the Group's policy to hedge the exposure of all statement of financial position items to movements in foreign exchange rates other than instruments considered to be Tier 2 capital under regulatory standards. Currency exposure arises primarily as a result of investments in the Eurozone, Japan, the United Kingdom and the United States so currency risk therefore arises from fluctuations in the value of the Euro, British Pound, US Dollar and Japanese Yen against the Australian Dollar. In order to protect against exchange rate movements, the Group has entered into foreign currency derivatives.

In addition, the Group has exposure to foreign exchange risk upon consolidation of its Japanese controlled property trust and mitigates this by designating foreign currency derivatives as hedges of net investments in foreign entities in equity to match its foreign currency translation reserve exposure. The policy is to monitor the hedges closely and rebalance for maturities and underlying changes to the net assets. Effectiveness is monitored on a regular basis to ensure that the hedge remains within 80% to 125% effective and any ineffective portion of the hedge is recognised directly in the income statement.

The SPV entities hedge exposure to foreign currency risk arising from issuing mortgage-backed securities in foreign currency. The currencies impacted are primarily the British Pound, Euro and US Dollar. All derivatives in the SPV are designated as cash flow hedges. These hedges are effective and there is no material impact on the results.

Notes to the financial statements

27. Financial risk management (continued)

Currency risk (continued)

The following table details the Group's net exposure to foreign currency as at the reporting date in Australian dollar equivalent amounts.

	GBP \$M	USD \$M	Euro ² \$M	JPY \$M	Other \$M
30 June 2013					
Financial assets	554.5	1,668.2	829.2	255.8	87.2
Financial liabilities ¹	(196.5)	(303.5)	(108.2)	–	–
Foreign currency contracts and cross currency swaps	(372.5)	(1,367.9)	(770.6)	(254.8)	(87.0)
Net exposure in Australian dollars	(14.5)	(3.2)	(49.6)	1.0	0.2
30 June 2012					
Financial assets	526.0	1,492.0	759.8	265.5	64.3
Financial liabilities ¹	(323.1)	(427.8)	(157.0)	–	–
Foreign currency contracts and cross currency swaps	(197.9)	(1,048.3)	(650.2)	(260.3)	(65.0)
Net exposure in Australian dollars	5.0	15.8	(47.4)	5.2	(0.7)

¹ The majority of the Company's net exposure in USD is in respect of USD denominated subordinated debt that qualifies as eligible Tier 2 capital. Under the Market Risk policy this exposure is not hedged within the Company. The Challenger Group hedges this exposure separately.

² Net Euro exposure is primarily matched by an investment property. Investment properties are not included in this note.

The analysis below shows the impact on the income statement and equity of a movement in foreign currency exchange rates against the Australian dollar on the Group's major currency exposures using the net exposure at the balance date. All underlying exposures and related hedges are included in the analysis. A sensitivity of 10% has been chosen as this is a reasonable measurement given the current level of exchange rates and the volatility observed on an historic basis.

	Movement in variable against A\$	Profit/(loss) 30 June 2013 \$M	Change in equity 30 June 2013 \$M	Profit/(loss) 30 June 2012 \$M	Change in equity 30 June 2012 \$M
British Pound (GBP)	+ 10%	(1.0)	(1.0)	0.2	0.2
	– 10%	1.0	1.0	(0.2)	(0.2)
US Dollar (USD)	+ 10%	(0.2)	(0.2)	1.1	1.1
	– 10%	0.2	0.2	(1.1)	(1.1)
Euro (EUR)	+ 10%	(3.6)	(3.6)	(3.3)	(3.3)
	– 10%	3.6	3.6	3.3	3.3
Japanese Yen (JPY)	+ 10%	–	–	–	(0.4)
	– 10%	–	–	–	0.4
Other	+ 10%	–	–	(0.1)	(0.1)
	– 10%	–	–	0.1	0.1

The impact on profit and equity is post-tax at a rate of 30%. The risks faced and methods used in the sensitivity analysis are the same as those applied in the comparative period. As shown above a 10% movement in exchange rates would have minimal impact on the Group's financial position.

Credit default risk

The Group makes use of external ratings (Standard & Poor's, Fitch, Moody's or another reputable credit rating agency). Where a counterparty or debt obligation is rated by multiple external rating agencies, the Group will use Standard & Poor's ratings where available or otherwise in accordance with the current APRA Prudential Standards.

Each business unit is responsible for managing credit risks that arise with oversight from a centralised credit risk management team.

Credit exposure by credit rating

The Group makes use of external ratings (Standard & Poor's, Fitch, Moody's or another reputable credit rating agency). Where a counterparty or debt obligation is rated by multiple external rating agencies, the Group will use Standard & Poor's ratings where available or otherwise in accordance with the current APRA Prudential Standards. All credit exposures with an external rating are also rated internally and cross referenced to the external rating, if applicable. Internal credit ratings are assigned by appropriately qualified and experienced credit personnel who operate separately from the risk originators.

The following table provides information regarding the maximum credit risk exposure of the Group in respect of the major classes of financial assets by equivalent credit rating. The maximum credit exposure is deemed to be the carrying value of the asset. The analysis classifies the assets according to internal or external credit ratings. Assets rated investment grade are those rated S&P BBB- or above, with non-investment grade therefore being below BBB-.

	Investment grade				Non-investment grade	Other	Total
	AAA \$M	AA \$M	A \$M	BBB \$M	grade \$M	\$M	\$M
30 June 2013							
Cash and cash equivalents	1,030.6	–	–	–	–	–	1,030.6
Cash and cash equivalents – SPV	278.7	–	–	–	–	–	278.7
Receivables	5.7	5.6	20.8	12.2	4.3	284.8	333.4
Receivables – SPV	2,339.2	1,654.3	32.9	–	12.5	0.5	4,039.4
Debt securities	1,857.9	1,138.6	1,530.6	1,346.4	1,207.7	163.3	7,244.5
Derivative assets	–	48.2	264.0	15.8	–	–	328.0
Total	5,512.1	2,846.7	1,848.3	1,374.4	1,224.5	448.6	13,254.6
30 June 2012							
Cash and cash equivalents	795.5	–	–	–	–	–	795.5
Cash and cash equivalents – SPV	364.1	–	–	–	–	–	364.1
Receivables	8.7	6.1	19.8	8.5	3.1	68.3	114.5
Receivables – SPV	3,177.7	2,123.8	32.8	–	12.6	0.8	5,347.7
Debt securities	1,254.0	1,248.6	1,715.5	1,058.4	713.7	212.2	6,202.4
Derivative assets	–	118.7	355.3	28.6	–	–	502.6
Total	5,600.0	3,497.2	2,123.4	1,095.5	729.4	281.3	13,326.8

SPV receivables, or mortgage assets, are funded via securitised residential mortgage-backed securities (RMBS). As a result, the Group is not exposed to significant credit risk on these assets as this is borne by the RMBS holder. The credit risk of the mortgage loans within the SPV is therefore taken as being equivalent to that of the residential mortgage-backed security.

Ageing and impairment of amortised cost financial assets

The below tables give information regarding the carrying value of the Group's financial assets measured at amortised cost. The analysis splits these assets by those that are neither past due nor impaired; those that are past due and not impaired (including an ageing analysis); and those past due and impaired at the statement of financial position date.

Past due but not impaired

	Not past due/not impaired \$M	0-1 months \$M	1-3 months \$M	3-6 months \$M	Greater than 6 months \$M	Past due and impaired \$M	Total \$M
As at 30 June 2013							
Receivables	330.1	3.3	–	–	–	–	333.4
Receivables SPV	3,678.2	201.6	115.3	16.6	–	27.7	4,039.4
Total receivables	4,008.3	204.9	115.3	16.6	0.0	27.7	4,372.8
As at 30 June 2012							
Receivables	109.4	2.0	0.2	0.1	2.8	–	114.5
Receivables – SPV	4,890.6	246.0	94.9	76.5	–	39.7	5,347.7
Total receivables	5,000.0	248.0	95.1	76.6	2.8	39.7	5,462.2

Notes to the financial statements

27. Financial risk management (continued)

Collateral held over assets

In the event of a default against any of the mortgages in the SPV, the Trustee has the legal right to take possession of the secured property and sell it as a recovery action against settlement of the outstanding mortgage balance. At all times of possession, the risks and rewards associated with ownership of the property are held by the Trustee on behalf of the RMBS holder.

Concentration risk

The credit risk framework includes an assessment of the counterparty credit risk in each business unit and at a total Group level. The Group has no significant concentrations of credit risk at the statement of financial position date.

Subordinated debt

CLC has subordinated debt liabilities with nominal value of A\$400 million and US\$150 million that are required to be classified as financial liabilities through profit and loss. The change recognised in the income statement in respect of valuation changes (excluding foreign exchange) for the year ended 30 June 2013 was a loss of \$42.0 million (2012: gain \$34.3 million). The liability is valued with regard to a basket of similar instruments.

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in raising funds to meet cash commitments associated with financial instruments. This may result from either the inability to sell financial assets at their face values; a counterparty failing on repayment of a contractual obligation; or the inability to generate cash inflows as anticipated.

The Group aims to ensure that it has sufficient liquidity to meet its obligations on a short-term and medium-term basis. In setting the level of sufficient liquidity, the Group considers new business activities in addition to current contracted obligations. It considers: minimum cash requirements; collateral and margin call buffers; Australian Financial Services (AFS) Licence requirements; cash flow forecasts; associated reporting requirements; other liquidity risks; and contingency plans.

The basis of the approach to liquidity management is on targeting sufficient liquidity to meet the regulatory guidelines set out in ASIC Policy Statement 166 for holders of an AFS Licence. AFS Licence holders make a reasonable estimate of cash flows over at least the next three months to demonstrate whether surplus capital will exceed either:

- 20% of the greater of cash outflows for the forecast three-month average (equivalent to 18 days' outgoings); or
- cash outflow for the most recent financial year, adjusted to produce a three-month average.

CLC aims to ensure that it has sufficient liquidity to meet its obligations on a short-term, medium-term and long-term basis. The Life Liquidity Management Policy is approved by the CLC Board and sets out liquidity targets and mandated actions depending on actual liquidity levels relative to those targets. Detailed forecast cash positions are reported regularly to the CLC Asset Liability Committee. At the reporting date, all requirements of the CLC Board approved liquidity management policy were satisfied.

Maturity profile of undiscounted liabilities

The table below summarises the maturity profile of the Group's undiscounted financial liabilities. This is based on contractual undiscounted repayment obligations. Totals differ to the amounts on the statement of financial position by the amount of discounting recognised in the statement of financial position values.

	1 year or less \$M	1-3 years \$M	3-5 years \$M	> 5 years \$M	Total \$M
30 June 2013					
Payables	168.4	22.3	–	–	190.7
Payables – SPV	17.1	–	–	–	17.1
Interest bearing liabilities	565.4	558.4	774.0	1,140.3	3,038.1
Interest bearing liabilities – SPV	1,073.2	1,378.3	873.5	1,689.3	5,014.3
External unit holders' liabilities	1,232.9	518.5	–	–	1,751.4
Life investment contract liabilities	2,269.5	2,114.5	1,419.1	982.1	6,785.2
Derivative financial liabilities	155.3	49.1	39.4	68.4	312.2
Total financial liabilities	5,481.8	4,641.1	3,106.0	3,880.1	17,109.0
30 June 2012					
Payables	232.5	35.5	–	–	268.0
Payables – SPV	35.4	–	–	–	35.4
Interest bearing liabilities	196.3	322.5	644.3	1,129.3	2,292.4
Interest bearing liabilities – SPV	1,567.2	1,846.0	1,089.2	2,079.1	6,581.5
External unit holders' liabilities	1,241.2	610.0	–	–	1,851.2
Life investment contract liabilities	1,618.2	2,346.8	1,343.8	1,193.3	6,502.1
Derivative financial liabilities	18.9	19.8	28.8	149.9	217.4
Total financial liabilities	4,909.7	5,180.6	3,106.1	4,551.6	17,748.0

The Group was due to receive future cash inflows from interest rate swaps currently in a fair value liability position.

Fair value determination and classification

Fair value reflects the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction. 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 Australian accounting standards to be designated at fair value through profit and loss wherever possible.

All other financial instruments in the Group, with the exception of the SPV balances carried at amortised cost listed below, are either designated at fair value through profit and loss at initial recognition, or the carrying value materially approximates fair value.

	30 June 2013		30 June 2012	
Difference between amortised cost and fair value	Carrying value \$M	Fair value \$M	Carrying value \$M	Fair value \$M
Receivables – SPV	4,039.4	4,129.8	5,347.7	5,392.1
Interest bearing liabilities – SPV	3,825.8	3,693.1	5,248.2	5,002.7

The fair value of investments that are actively traded in organised financial markets are determined by reference to quoted market bid prices at the close of business on each reporting date. Where no such market exists, valuation models that utilise both internal and external inputs are used to determine fair value. Financial instruments are split into the following categories depending on the level of observable inputs into the models used to determine fair value:

- Level 1** unadjusted quoted prices in active markets.
- Level 2** inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. prices) or indirectly (i.e. derived from prices).
- Level 3** there are inputs for the asset or liability valuation that are not based on observable market data (unobservable inputs).

Notes to the financial statements

27. Financial risk management (continued)

Fair value determination and classification (continued)

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 of cash flows, discount rates, earnings multiples and internal credit ratings. Where different levels of the hierarchy are used in a valuation, the instrument is classified according to the lowest level that is significant to the input. The table below summarises those financial instruments for which a fair value has been determined and the level of observable inputs into the valuation methodology.

	Level 1 \$M	Level 2 \$M	Level 3 \$M	Total \$M
30 June 2013				
Derivative assets	–	328.0	–	328.0
Debt securities	–	5,556.3	1,688.2	7,244.5
Equity securities	115.8	36.3	173.2	325.3
Infrastructure investments	89.7	–	491.4	581.1
Property securities	147.1	–	301.2	448.3
Available-for-sale assets	–	–	–	–
Fair value financial assets	352.6	5,920.6	2,654.0	8,927.2
Derivative liabilities	–	381.4	–	381.4
Interest bearing liabilities	–	147.6	598.3	745.9
Interest bearing liabilities – SPV	–	–	–	–
External unit holders' liabilities	–	1,751.4	–	1,751.4
Investment contract liabilities	–	106.1	6,043.9	6,150.0
Fair value financial liabilities	–	2,386.5	6,642.2	9,028.7
30 June 2012				
Derivative assets	–	502.6	–	502.6
Debt securities	–	4,906.5	1,295.9	6,202.4
Equity securities	22.1	50.4	159.9	232.4
Infrastructure investments	190.4	–	537.2	727.6
Property securities	–	–	172.2	172.2
Available-for-sale assets	–	–	–	–
Fair value financial assets	212.5	5,459.5	2,165.2	7,837.2
Derivative liabilities	–	148.5	–	148.5
Interest bearing liabilities	–	160.8	524.1	684.9
External unit holders' liabilities	–	1,851.2	–	1,851.2
Investment contract liabilities	–	113.8	5,692.4	5,806.2
Fair value financial liabilities	–	2,274.3	6,216.5	8,490.8

The Group derivative financial instruments are 'over the counter' so, whilst they are not exchange traded, there is a market observable price. All of the listed debt and government/semi-government securities have prices determined by a market but are not actively traded. Externally rated unlisted debt is valued by applying market observable credit spreads on similar assets with an equivalent credit rating. Both are therefore Level 2. Internally rated debt is Level 3 as the determination of an equivalent credit rating is a significant non-observable input.

Unlisted equity, infrastructure and property securities are valued using either cash flow forecasts discounted using the applicable yield curve, earning-multiple valuations or, for managed funds, the net assets of the trust per the most recent financial report.

The interest bearing liabilities classified as Level 3 are the subordinated debt notes issued by CLC. These are valued using a benchmark credit spread based on a pool of similar assets and, as a result, are Level 3. External unit holder liabilities are valued at the face value of the amounts payable. 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 unmodified account balance, rather than a discounted cash flow as applied to the rest of the portfolio.

Level 3 reconciliation

The following table shows a reconciliation of the movement in the fair value of financial instruments categorised within Level 3 over the year:

	30 June 2013		30 June 2012	
	Assets \$M	Liabilities \$M	Assets \$M	Liabilities \$M
Opening balance	2,165.2	6,216.5	2,030.4	5,365.7
Total gains and losses	513.3	327.4	(28.9)	442.0
Additions	1,672.6	1,811.7	1,031.1	1,821.1
Disposals	(1,592.8)	(1,715.5)	(822.2)	(1,486.3)
Transfers from Level 1 or 2	(104.3)	2.1	(45.2)	74.0
Closing Level 3 balance	2,654.0	6,642.2	2,165.2	6,216.5
Total gains/(losses) included in the income statement for the year for assets and liabilities still held at the statement of financial position date	214.1	(327.4)	38.0	(442.0)

Level 3 sensitivity

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

	Level 3 value \$M	Positive impact \$M	Negative impact \$M	Reasonable change in non-observable input
30 June 2013				
Debt securities	1,688.2	59.1	(16.0)	Primarily credit spreads
Interest bearing liabilities	(598.3)	(25.4)	23.5	Primarily credit spreads
Net debt	1,089.9	33.7	(7.5)	
Equity, infrastructure, property assets	965.8	43.6	(43.2)	Primarily discount rate on cash flow models
Investment contract liabilities	(6,043.9)	4.6	(4.6)	Primarily expense assumptions
Total Level 3	(3,988.2)	81.9	(55.3)	
30 June 2012				
Debt securities	1,295.9	38.7	(35.9)	Primarily credit spreads
Interest bearing liabilities	(524.1)	(23.8)	21.5	Primarily credit spreads
Net debt	771.8	14.9	(14.4)	
Equity, infrastructure, property assets	869.3	34.4	(34.0)	Primarily discount rate on cash flow models
Investment contract liabilities	(5,692.4)	3.5	–	Primarily expense assumptions
Total Level 3	(4,051.3)	52.8	(48.4)	

Notes to the financial statements

28. Derivative financial instruments

The table below shows the notional value, fair value and duration of the Group's derivative financial instruments:

	30 June 2013			30 June 2012		
	Notional/ Principal value \$M	Net fair value assets \$M	Net fair value liabilities \$M	Notional/ Principal value \$M	Net fair value assets \$M	Net fair value liabilities \$M
Interest rate swaps						
Less than 1 year	3,103.2	12.5	(0.8)	1,269.8	6.9	(0.2)
1–3 years	1,830.3	53.9	(5.7)	1,610.2	61.8	(2.7)
3–5 years	1,522.6	77.5	(8.5)	1,179.2	71.4	(9.9)
Greater than 5 years	2,476.4	104.4	(83.4)	2,774.6	175.0	(82.9)
	8,932.5	248.3	(98.4)	6,833.8	315.1	(95.7)
Interest rate swaps – SPV						
Less than 1 year	76.4	0.5	(0.7)	168.2	0.5	(2.0)
1–3 years	22.3	–	(0.3)	81.7	1.3	(2.0)
3–5 years	1.6	–	(0.1)	2.0	–	(0.2)
Greater than 5 years	–	–	–	0.2	–	–
	100.3	0.5	(1.1)	252.1	1.8	(4.2)
Inflation-linked swaps						
Less than 1 year	250.0	–	(6.3)	400.0	4.5	(0.1)
Greater than 5 years	5.9	0.8	(0.8)	11.6	1.0	(1.0)
	255.9	0.8	(7.1)	411.6	5.5	(1.1)
Futures contracts						
Less than 1 year	997.7	–	(0.1)	392.8	0.4	(0.1)
Forward currency contracts						
Less than 1 year	3,494.2	33.7	(142.9)	2,686.0	54.0	(13.2)
1–3 years	28.7	6.5	(0.1)	75.5	11.0	(0.5)
	3,522.9	40.2	(143.0)	2,761.5	65.0	(13.7)
Cross currency swaps						
Less than 1 year	295.1	7.9	(22.3)	330.7	38.3	(3.1)
1–3 years	593.3	19.3	(42.4)	829.9	61.8	(9.7)
3–5 years	210.4	–	(32.5)	356.8	6.8	(9.6)
Greater than 5 years	274.2	0.1	(33.5)	279.9	5.9	(10.8)
	1,373.0	27.3	(130.7)	1,797.3	112.8	(33.2)
Equity swaps						
Less than 1 year	–	2.2	–	–	–	–
1–3 years	0.5	3.7	–	–	–	–
	0.5	5.9	–	–	–	–
Cross currency swaps – SPV						
Greater than 5 years	1,833.1	5.0	(0.8)	2,441.8	2.0	(0.5)
Total derivative financial instruments		328.0	(381.4)		502.6	(148.5)

Derivatives designated as hedges of net investment in foreign currency operations

As described in Note 1(xvi), the Group hedges its exposure to accounting gains and losses arising from translation of foreign controlled entities from their functional currency into the Group's presentation currency on consolidation. At 30 June 2013, a post-tax loss of \$10.7 million (2012: gain \$10.6 million) was recognised in equity for the hedging of exposure to the net investment in foreign operations arising.

Derivatives designated as cash flow hedges

As described in Note 1(xvi), the Group applies hedge accounting when it can demonstrate that all, or a portion of, the value movements of a derivative financial instrument effectively hedges the known outcome of a future transaction. As described in Note 27, SPV purchase interest rate swaps to hedge the interest rate risk between variable rate loans, which generally reprice with changes in official interest rates, and issued residual mortgage-backed securities (RMBS) that reprice with changes in the 30-day and 90-day BBSW. Cross currency swaps are also purchased to hedge currency movements on foreign denominated RMBS. The SPV applies hedge accounting to both types of transaction, with the fair value change on the effective portion of the derivative being recognised in equity.

At 30 June 2013 a post-tax gain of \$4.5 million (2012: gain \$4.5 million) was recognised in equity for cash flow hedges with no income statement impact of any ineffective portions during either the current or prior period.

29. Commitments

	30 June 2013 \$M	30 June 2012 \$M
Commitments		
Non-cancellable operating leases – Group as lessee	167.9	183.1
Capital expenditure	34.5	41.3
Non-cancellable operating leases – Group as lessor	(1,417.7)	(1,609.9)
Other	22.6	–
Total commitments	(1,192.7)	(1,385.5)
Operating leases – Group as lessee		
Amount due in less than 1 year	21.8	20.5
Amount due later than 1 year but not later than 2 years	23.6	21.8
Amount due later than 2 years but not later than 5 years	34.3	47.6
Amount due in more than 5 years	88.2	93.2
Total operating leases – Group as lessee	167.9	183.1
Capital expenditure commitments		
Amount due in less than 1 year	15.7	19.5
Amount due later than 1 year but not later than 5 years	13.2	14.2
Amount due in more than 5 years	5.6	7.6
Total capital expenditure commitments	34.5	41.3
Operating leases – Group as lessor		
Amount due in less than 1 year	(193.7)	(201.6)
Amount due later than 1 year but not later than 2 years	(181.3)	(191.6)
Amount due later than 2 years but not later than 5 years	(446.5)	(503.9)
Amount due in more than 5 years	(596.2)	(712.8)
Total operating leases – Group as lessor	(1,417.7)	(1,609.9)
Other commitments		
Amount due in less than 1 year	22.6	–
Total other commitments	22.6	–

Notes to the financial statements

29. Commitments (continued)

Operating leases

Group as lessee

The Group has entered into commercial operating leases for the rental of properties where it is not in the best interests of the Group to purchase these properties. These leases have an average life of between one and 10 years with renewal terms included in the contracts. Renewals are at the specific option of the entity that holds the lease.

Surplus lease space under non-cancellable operating leases has been subleased with the revenue arising from the sublease being recognised on a straight line basis. The leases have a remaining life of up to six years with renewal terms included in the contract. Renewals are at the specific option of the entity that holds the lease. A surplus lease provision has been created representing the Group's net rental expense obligation and, as such, does not form part of the commitment listed below. Refer to Note 20 for details.

Group as lessor

Investment properties owned by the Group are leased to third parties under operating leases. Lease terms vary between tenants and some leases include percentage rental payments based on sales volume.

Contracted capital expenditure commitments

These represent amounts payable in relation to capital expenditure commitments contracted for at the reporting date but not recognised as liabilities. They primarily relate to the investment property portfolio.

30. Related parties

Controlled entities

Unless an exception applies under relevant legislation, transactions between commonly controlled entities within the Group (except where otherwise disclosed) are conducted on an arm's length basis under normal commercial terms and conditions.

Other related parties

During the year, there were transactions between the Group and Challenger specialised funds for the provision of investment management, transaction advisory and other professional services. Transactions were also entered into between the Group and associated entities (refer to Note 35) for the provision of distribution and administration services. The Group earned fee income during the year of \$36.5 million (2012: \$24.5 million) from transactions entered into with non-controlled funds and associates. Transactions are conducted on an arm's length basis under normal commercial terms and conditions.

Directors and Key Executives

The Directors and Key Executives of Challenger Limited at any time during the financial year were as follows:

Directors

Peter Polson, Chairman

Graham Cubbin

Steven Gregg (appointed 8 October 2012)

Jonathan Grunzweig

Russell Hooper

Brenda Shanahan

JoAnne Stephenson (appointed 8 October 2012)

Leon Zwier

Executive Director – Managing Director and Chief Executive Officer

Brian Benari (appointed 17 February 2012), previously a Key Executive

Key Executives

Richard Howes, Chief Executive, Life

Paul Rogan, Chief Executive, Distribution, Product and Marketing

Andrew Tobin, Chief Financial Officer

Robert Woods, Chief Executive, Funds Management

Loans to Directors and Key Executives

There were no loans made to Directors and specified Key Executives as at 30 June 2013 (2012: nil).

Director and Key Executive compensation

	Year ended 30 June	Short-term employee benefits \$	Post- employment \$	Share- based payments \$	Other long- term benefits \$	Total \$
Directors	2013	1,296,682	48,884	–	–	1,345,566
	2012	1,035,075	29,234	–	–	1,064,309
Executive Director	2013	2,138,143	16,470	1,992,916	226,638	4,374,167
	2012	1,759,173	15,775	2,036,296	329,364	4,140,608
Key Executives	2013	4,405,203	63,135	4,888,580	666,625	10,023,543
	2012	4,162,982	53,101	4,729,844	661,735	9,607,662
Total	2013	7,840,028	128,489	6,881,496	893,263	15,743,276
	2012	6,957,230	98,110	6,766,140	991,099	14,812,579

Split of statutory compensation components for the CEO and Key Executives

Executive	Year ended 30 June	Fixed	Cash STI	Share-based payments	Other	Total
B Benari	2013	29%	21%	45%	5%	100%
	2012	21%	22%	49%	8%	100%
R Howes	2013	21%	20%	52%	7%	100%
	2012	20%	21%	53%	6%	100%
P Rogan	2013	24%	24%	46%	6%	100%
	2012	25%	23%	44%	8%	100%
A Tobin	2013	38%	26%	31%	5%	100%
	2012	45%	26%	26%	3%	100%
R Woods	2013	20%	13%	59%	8%	100%
	2012	21%	20%	53%	6%	100%

Director and Key Executive shareholdings in Challenger Limited

Details of the Directors' and Key Executives' and their affiliates' shareholdings in Challenger Limited as at 30 June 2013 are set out below. All shareholdings were acquired at arm's length prices.

2013 Number of shares	Held at 1 July 2012	Vesting of long- term incentives	Other changes	Held at 30 June 2013
Directors				
P Polson	112,000	–	10,000	122,000
G Cubbin	177,702	–	–	177,702
S Gregg ¹	–	–	10,000	10,000
J Grunzweig	250	–	–	250
R Hooper	160,000	–	–	160,000
B Shanahan	250,000	–	–	250,000
J Stephenson ¹	–	–	–	–
L Zwier	2,360	–	–	2,360
Executive Director				
B Benari	1,377,664	799,688	(233,333)	1,944,019
Key Executives				
R Howes	1,300,000	763,026	(1,225,000)	838,026
P Rogan	500,000	348,325	(748,325)	100,000
A Tobin	218,767	113,927	(118,333)	214,361
R Woods	1,300,000	744,334	(500,000)	1,544,334
Total	5,398,743	2,769,300	(2,804,991)	5,363,052

¹ S Gregg and J Stephenson were appointed as Directors during the 2013 year. Previously held shares are reported in 'Other changes'.

Notes to the financial statements

30. Related parties (continued)

Director and Key Executive shareholdings in Challenger Limited (continued)

2012 Number of shares	Held at 1 July 2011	Vesting of long- term incentives	Other changes	Held at 30 June 2012
Directors				
P Polson	112,000	–	–	112,000
G Cubbin	177,702	–	–	177,702
J Grunzweig	250	–	–	250
R Hooper	160,000	–	–	160,000
B Shanahan	250,000	–	–	250,000
L Zwier	2,360	–	–	2,360
Executive Director				
B Benari	2,166,306	1,722,451	(2,511,093)	1,377,664
D Stevens ¹	867,555	6,205,599	(7,073,154)	–
Key Executives				
R Howes	1,937,722	1,548,508	(2,186,230)	1,300,000
P Rogan	3,390,206	876,364	(3,766,570)	500,000
A Tobin ²	–	–	218,767	218,767
R Woods	2,037,722	1,535,081	(2,272,803)	1,300,000
Total	11,101,823	11,888,003	(17,591,083)	5,398,743

¹ D Stevens ceased to be a Key Executive during the period so his holding disclosure is removed under 'Other changes'.

² A Tobin became a Key Executive during the year. Any prior holdings are included in 'Other changes'.

Director and Key Executive deferred performance share rights

Details of Directors' and Key Executives' and their affiliates' deferred performance share rights in the Company as at 30 June 2013 are set out below.

2013 Number of deferred performance share rights	Held at 1 July 2012	Granted as remuneration	Vested	Other changes	Held at 30 June 2013
Executive Director					
B Benari	308,517	261,058	216,355	–	353,220
Key Executive					
R Howes	258,689	195,794	179,693	–	274,790
P Rogan	172,923	177,664	114,993	–	235,594
A Tobin	45,077	72,516	30,594	–	86,999
R Woods	234,730	181,290	161,001	–	255,019
Total	1,019,936	888,322	702,636	–	1,205,622

Deferred performance share rights are exercised on vesting and shares are transferred out of the plan to the individual. Vested shares are transferred into the name of the Key Executive but remain subject to trading restrictions.

Terms and conditions of deferred performance share rights allocations for the year ended 30 June 2013

2013	Granted number	Grant date	Allocation price \$	Fair value at grant \$	Start vesting date	Last vesting date
Executive Director						
B Benari	130,529	12/9/2012	3.4475	3.18	12/9/2012	1/9/2013
	130,529	12/9/2012	3.4475	3.02	12/9/2012	1/9/2014
Key Executives						
R Howes	97,897	12/9/2012	3.4475	3.18	12/9/2012	1/9/2013
	97,897	12/9/2012	3.4475	3.02	12/9/2012	1/9/2014
P Rogan	88,832	12/9/2012	3.4475	3.18	12/9/2012	1/9/2013
	88,832	12/9/2012	3.4475	3.02	12/9/2012	1/9/2014
A Tobin	36,258	12/9/2012	3.4475	3.18	12/9/2012	1/9/2013
	36,258	12/9/2012	3.4475	3.02	12/9/2012	1/9/2014
R Woods	90,645	12/9/2012	3.4475	3.18	12/9/2012	1/9/2013
	90,645	12/9/2012	3.4475	3.02	12/9/2012	1/9/2014

Director and Key Executive hurdled performance share rights

Details of Directors' and Key Executives' and their affiliates' hurdled performance share rights for shares in the Company as at 30 June 2013 are set out below.

2013	Held at 1 July 2012	Granted as remuneration	Vested	Other changes	Held at 30 June 2013
Number of hurdled performance share rights					
Executive Director					
B Benari	2,200,000	—	—	—	2,200,000
Key Executive					
R Howes	950,000	850,000	—	—	1,800,000
P Rogan	700,000	700,000	—	—	1,400,000
A Tobin	234,500	400,000	—	—	634,500
R Woods	950,000	850,000	—	—	1,800,000
Total	5,034,500	2,800,000	—	—	7,834,500

Terms and conditions of hurdled performance share rights allocations for the year ended 30 June 2013

2013	Granted number	Grant date	Reference price \$	Fair value at grant \$	Start vesting date	Last vesting date
Executive Director						
B Benari	—	—	—	—	—	—
Key Executives						
R Howes	850,000	12/9/2012	3.4475	1.42	12/9/2012	1/9/2016
P Rogan	700,000	12/9/2012	3.4475	1.42	12/9/2012	1/9/2016
A Tobin	400,000	12/9/2012	3.4475	1.42	12/9/2012	1/9/2016
R Woods	850,000	12/9/2012	3.4475	1.42	12/9/2012	1/9/2016

The hurdled performance share rights above vest in three tranches. For further details of this scheme see Note 31.

Notes to the financial statements

30. Related parties (continued)

Director and Key Executive options

Details of Directors' and Key Executives' and their affiliates' options over shares in the Company as at 30 June 2013 are set out below.

2013 Number of options	Held at 1 July 2012	Granted as remuneration	Exercised	Other changes	Held at 30 June 2013
Executive Director					
B Benari	583,333	–	583,333	–	–
Key Executives					
R Howes	583,333	–	583,333	–	–
P Rogan	233,333	–	233,333	–	–
A Tobin	83,333	–	83,333	–	–
R Woods	583,333	–	583,333	–	–
Total	2,066,665	–	2,066,665	–	–

Terms and conditions of option allocations for the year ended 30 June 2013

There were no option allocations during the year.

31. Employee entitlements

	30 June 2013 \$M	30 June 2012 \$M
Employee entitlements provision (see Note 20)	9.1	8.1

The total number of employees of the Group at balance date was 487 (30 June 2012: 479).

Challenger Performance Plan

The Challenger Performance Plan is a flexible plan that provides for the award of either options or performance rights with awards being satisfied from either the issue of new shares or on-market acquisition. Non-Executive Directors are not eligible to participate in the plan. The key features of the plan are as follows:

Deferred performance share rights

This instrument is a performance right which converts into a fully paid share in the Company at the end of the vesting period. The core purpose of deferred performance share rights is to reward individuals for performance over the past 12 months.

The vesting period is typically two years. Deferred performance share rights are converted to ordinary fully paid shares upon vesting.

Hurdled performance share rights

Hurdled performance share rights were first issued during the year ended 30 June 2011 as a replacement for options. This instrument is a performance share right which converts into a fully paid share in the Company at the end of a vesting period, subject to the achievement of performance conditions based on shareholder returns. The hurdled performance share rights are awarded based on a range of criteria reflecting, in addition to current year performance, the longer term ability for an employee to add significant value to Challenger and for retention purposes. The award of hurdled performance share rights ensures longer term alignment of interests between Challenger and its employees.

The vesting period is typically over four years with three vesting parcels at the end of years 2, 3 and 4. Hurdled performance rights are converted to ordinary fully paid shares upon vesting.

Options and capped performance rights

No new options were issued in the year ended 30 June 2013. All previously issued options vested or expired.

Deferred performance share rights

The following table sets out the details of the deferred performance share rights granted under the Challenger Performance Plan during 2013 and movements on previous issues:

Grant date	Latest date for exercise ¹	Reference price \$	Fair value at grant \$	Out-standing at 1 July 2012	Granted during the year	Vested during the year	Expired during the year	Out-standing at 30 June 2013
15 Sep 10	15 Sep 12	3.720	3.65	1,142,389	–	1,142,389	–	–
12 Sep 11	1 Sep 12	4.747	4.37	1,041,982	–	1,041,982	–	–
12 Sep 11	1 Sep 13	4.747	4.20	1,017,041	–	138,243	35,285	843,513
2 Nov 11	1 Sep 12	4.612	4.25	2,000	–	2,000	–	–
2 Nov 11	1 Sep 13	4.612	4.10	2,000	–	–	–	2,000
12 Sep 12	1 Sep 13	3.448	3.18	–	1,234,364	10,007	41,981	1,182,376
12 Sep 12	1 Sep 14	3.448	3.02	–	1,234,412	10,007	41,985	1,182,420
17 Sep 12	17 Sep 12	3.448	3.42 ²	–	185,641	185,641	–	–
11 Jun 13	01 Sep 13	3.306	3.74	–	15,722	–	–	15,722
11 Jun 13	01 Mar 14	3.573	3.64	–	25,887	–	–	25,887
11 Jun 13	01 Sep 14	3.306	3.55	–	15,722	–	–	15,722
11 Jun 13	01 Sep 14	3.573	3.55	–	18,190	–	–	18,190
11 Jun 13	01 Mar 15	3.573	3.45	–	25,888	–	–	25,888
11 Jun 13	01 Sep 15	3.306	3.36	–	15,723	–	–	15,723
11 Jun 13	01 Sep 15	3.573	3.36	–	18,191	–	–	18,191
Total				3,205,412	2,789,740	2,530,269	119,251	3,345,632

¹ At the date of vesting deferred performance share rights are transferred to the individual and released from the CPP Trust.

² Closing share price on 17 September 2012.

Hurdled performance share rights

The following table sets out details of the hurdled performance share rights granted under the Challenger Performance Plan during 2013 and movements on previous issues.

Grant date	Latest date for exercise ¹	Reference price \$	Fair value at grant \$	Out-standing at 1 July 2012	Granted during the year	Vested during the year	Expired during the year	Out-standing at 30 June 2013
08 Sep 10	15 Sep 14	3.72	2.02	5,291,000	–	–	362,500	4,928,500
14 Dec 10	01 Dec 14	4.17	2.38	216,450	–	–	–	216,450
12 Sep 11	01 Sep 15	4.75	1.93	6,848,000	–	–	475,000	6,373,000
14 Dec 11	01 Sep 15	4.75	1.56	750,000	–	–	–	750,000
16 Mar 12	16 Feb 16	4.36	1.16	1,250,000	–	–	–	1,250,000
12 Sep 12	01 Sep 16	3.45	1.42	–	8,208,000	–	175,000	8,033,000
11 Jun 13	01 Jun 17	3.93	1.33	–	200,000	–	–	200,000
Total				14,355,450	8,408,000	–	1,012,500	21,750,950

¹ At the date of vesting hurdled performance share rights are transferred to the individual and released from the CPP Trust.

Notes to the financial statements

31. Employee entitlements (continued)

Options

The following table sets out the details of the movement in share options during the year. No new grants were made during the year.

Grant date	Latest date for exercise	Reference price \$	Fair value at grant \$	Out-standing at 1 July 2012	Granted during the year	Vested during the year	Expired during the year	Out-standing at 30 June 2013
30 Jun 09	30 Aug 12	2.29	0.68	50,000	–	50,000	–	–
23 Oct 09	30 Sep 12	2.33	1.58	4,406,657	–	4,406,657	–	–
Total				4,456,657	–	4,456,657	–	–

All deferred performance share rights and hurdled performance share rights granted during the year have been externally valued. The hurdled performance rights are valued by a Monte Carlo simulation model using the TSR share price hurdles. A Black Scholes model is used to value the deferred performance share rights. Key inputs into the valuation models are as follows:

Input	12 Sep 12 Rights ¹	11 June13 Rights ¹	12 Sep 12 Hurdled Rights ¹	11 Jun 13 Hurdled Rights ¹
Dividend yield (%)	5.46	5.42	5.46	5.42
Risk-free rate (%)	2.66 – 2.85	2.44 – 2.59	2.48	2.61
Volatility ² (%)	30	30	30	30
Valuation (\$)	3.02 – 3.18	3.36 – 3.74	1.42	1.33

¹ Staggered vesting applies to these grants.

² Forecast volatility rate implied from historic trend.

32. Reconciliation of profit to operating cash flow

	30 June 2013 \$M	30 June 2012 \$M
Profit for the year	461.3	166.7
Non-cash and investing adjustments:		
Net realised gain on disposal of financial assets	(193.2)	(57.5)
Net unrealised gain on revaluation of financial assets	(70.9)	(292.9)
Share of associates' net profit	(13.4)	(8.3)
Amortisation and depreciation	16.3	11.0
Share-based payments	16.6	22.5
Operating cash flow not recognised in revenue		
Dividends from associates	8.8	7.7
Change in operating assets and liabilities, net of disposal/acquisition of controlled entities		
Decrease/(increase) in receivables	74.7	(14.7)
Decrease/(increase) in other assets	11.1	(5.1)
Decrease in payables	(95.6)	(1.9)
Decrease in provisions	(0.4)	(2.9)
Increase in life contract liabilities	570.3	924.0
(Decrease)/increase in external unit holders' liabilities	(99.8)	485.8
Increase/(decrease) in net tax liabilities	103.3	(19.9)
Net cash inflow from operating income	789.1	1,214.5

33. Remuneration of auditor

	30 June 2013 \$000	30 June 2012 \$000
Amounts received or due and receivable by Ernst & Young for:		
Full year audit and half year review of the Group financial report	1,318.1	1,312.8
Other audit services – audit and review of trusts and funds	875.3	868.9
Other services in relation to the Group		
Taxation services	354.8	493.1
Other assurance services	423.7	448.0
	2,971.9	3,122.8

Auditor's remuneration for the Group is paid by Challenger Group Services Limited, an entity within the Group.

34. Controlled entities

Name of entity	Country of domicile	Class of shares/ units	% owned 30 June 2013	% owned 30 June 2012
417 St Kilda Road Trust	Australia	Ordinary	100	100
417 St. Kilda Holding Trust A	Australia	Ordinary	100	100
417 St. Kilda Holding Trust B	Australia	Ordinary	100	100
Allfine Holdings Pty Ltd	Australia	Ordinary	100	100
Allfine Property Trust No. 1	Australia	Ordinary	100	100
Balloon Inflation Linked Bond Trust ¹	Australia	Ordinary	–	–
Belconnen Property Trust	Australia	Ordinary	100	100
Belvino Investments No. 2 Pty Limited ²	Australia	Ordinary	–	100
Bluezen Pty Ltd	Australia	Ordinary	100	100
CDPG Australia Pty Limited	Australia	Ordinary	100	100
Cascade Pty Limited	Australia	Ordinary	100	100
CFSG Holdings No.2 Victoria Pty Limited	Australia	Ordinary	100	100
Challenger Alpha Prop Pty Ltd ²	Australia	Ordinary	–	100
Challenger Australia Listed Property Holding Trust	Australia	Ordinary	100	100
Challenger Axminster Mortgages Trust	Australia	Ordinary	100	100
Challenger CKT Holding Trust	Australia	Ordinary	100	100
Challenger Direct Pty Ltd	Australia	Ordinary	100	100
Challenger Diversified Properties Group	Australia	Ordinary	58	55
Challenger Diversified Property Development Pty Limited	Australia	Ordinary	100	100
Challenger European Property Holding Trust	Australia	Ordinary	100	100
Challenger European Property Trust	Australia	Ordinary	100	100
Challenger Ferndale Trust	Australia	Ordinary	100	100
Challenger Financial Services Group	Australia	Ordinary	100	100
Challenger Financial Services Pty Ltd (formerly Challenger Financial Services Limited)	Australia	Ordinary	100	100
Challenger FM 2 Holdings Pty Ltd	Australia	Ordinary	100	100
Challenger FM Nominees Pty Limited	Australia	Ordinary	100	100
Challenger Funds Management Holdings Pty Limited	Australia	Ordinary	100	100
Challenger German Property Trust	Australia	Ordinary	100	100
Challenger GIF Trust ²	Australia	Ordinary	–	100
Challenger Group Holdings Limited	Australia	Ordinary	100	100
Challenger Group Pty Limited	Australia	Ordinary	100	100
Challenger Group Services (UK) Limited	Australia	Ordinary	100	100
Challenger Group Services Pty Limited	Australia	Ordinary	100	100
Challenger Guernsey Trust	Australia	Ordinary	100	100
Challenger High Yield Fund	Australia	Ordinary	100	100
Challenger Holding (Vagyonkezelő) KFT	Hungary	Ordinary	100	100
Challenger Home Loan Corporation Pty Limited	Australia	Ordinary	100	100

Notes to the financial statements

34. Controlled entities (continued)

Name of entity	Country of domicile	Class of shares/ units	% owned 30 June 2013	% owned 30 June 2012
Challenger Howard Property Trust for 417 St Kilda Road	Australia	Ordinary	100	100
Challenger Infrastructure Unit Holding Trust	Australia	Ordinary	100	100
Challenger Infrastructure Unit Trust	Australia	Ordinary	100	100
Challenger Inventory Finance Servicing Pty Limited	Australia	Ordinary	100	100
Challenger Jersey I3 Limited	Jersey	Ordinary	100	100
Challenger Karratha Trust ³	Australia	Ordinary	100	–
Challenger Kenedix Japan Trust	Australia	Ordinary	100	100
Challenger LBC Terminals Australia Pty Limited ²	Australia	Ordinary	–	100
Challenger Lennox Trust ³	Australia	Ordinary	100	–
Challenger Life Collateral Holding Trust ³	Australia	Ordinary	100	–
Challenger Life Company Holdings Pty Ltd	Australia	Ordinary	100	100
Challenger Life Company Limited	Australia	Ordinary	100	100
Challenger Life Debt Investments (Europe) Limited	UK	Ordinary	100	100
Challenger Life Fund Property Investments Pty Ltd ³	Australia	Ordinary	100	–
Challenger Life Nominees No.2 Pty Ltd	Australia	Ordinary	100	100
Challenger Life Nominees No.3 Pty Limited	Australia	Ordinary	100	100
Challenger Life Nominees Pty Ltd	Australia	Ordinary	100	100
Challenger Life Offshore Investments Limited	Jersey	Ordinary	100	100
Challenger Life Subsidiary Holdings Ltd	Australia	Ordinary	100	100
Challenger Listed Investments Limited	Australia	Ordinary	100	100
Challenger Luxembourg Holding No 1A SARL	Luxembourg	Ordinary	100	100
Challenger Luxembourg Holding No.1B SARL	Luxembourg	Ordinary	100	100
Challenger Luxembourg Holding No.2 SARL	Luxembourg	Ordinary	100	100
Challenger Managed Investments (International) Pty Limited	Australia	Ordinary	100	100
Challenger Management Services (UK) Limited	UK	Ordinary	100	100
Challenger Management Services Limited	Australia	Ordinary	100	100
Challenger Margin Lending Pty Limited	Australia	Ordinary	100	100
Challenger MEIF Holding Trust	Australia	Ordinary	100	100
Challenger MEIF Trust	Australia	Ordinary	100	100
Challenger Millennium NPL Trust	Australia	Ordinary	100	100
Challenger Millennium Series 2007-1E Trust	Australia	Ordinary	100	100
Challenger Millennium Series 2007-2L Trust	Australia	Ordinary	100	100
Challenger Millennium Series 2008-1 Trust	Australia	Ordinary	100	100
Challenger Millennium Series 2008-2 Trust	Australia	Ordinary	100	100
Challenger Millennium Series 2009-1 Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse A Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse B Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse B1 Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse B2R Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse C Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse D Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse F Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse G Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse H Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse J Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse JP Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse Mira Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse N Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse NPF Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse S Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse T Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse U Trust	Australia	Ordinary	100	100
Challenger Millennium Warehouse V Trust	Australia	Ordinary	100	100
Challenger Mortgage Management Pty Limited	Australia	Ordinary	100	100

Name of entity	Country of domicile	Class of shares/ units	% owned 30 June 2013	% Owned 30 June 2012
Challenger Non-Conforming Finance Pty Limited	Australia	Ordinary	100	100
Challenger North of England Gas Holding Trust	Australia	Ordinary	100	100
Challenger NZ Millennium Series 2007-AP Trust	NZ	Ordinary	100	100
Challenger NZ Millennium Warehouse W Trust	NZ	Ordinary	100	100
Challenger Originator Finance Pty Limited	Australia	Ordinary	100	100
Challenger Property Asset Management Pty Limited	Australia	Ordinary	100	100
Challenger Property Income Trust	Australia	Ordinary	100	100
Challenger Property Trust No. 18	Australia	Ordinary	100	100
Challenger Property Trust No. 19	Australia	Ordinary	100	100
Challenger Property Trust No. 25	Australia	Ordinary	100	100
Challenger Property Trust No. 27	Australia	Ordinary	100	100
Challenger Property Trust No. 28	Australia	Ordinary	100	100
Challenger Property Trust No. 29	Australia	Ordinary	100	100
Challenger Property Trust No. 30	Australia	Ordinary	100	100
Challenger Property Trust No. 31	Australia	Ordinary	100	100
Challenger Property Trust No. 32	Australia	Ordinary	100	100
Challenger Property Trust No. 33	Australia	Ordinary	100	100
Challenger Property Trust No. 34	Australia	Ordinary	100	100
Challenger Property Trust No. 35	Australia	Ordinary	100	100
Challenger Property Trust No. 36	Australia	Ordinary	100	100
Challenger REIT AFSL Pty Limited ²	Australia	Ordinary	–	100
Challenger Retirement and Investment Services Limited	Australia	Ordinary	100	100
Challenger Retirement Fund ³	Australia	Ordinary	100	–
Challenger SCR LLP Member Limited	UK	Ordinary	100	100
Challenger Seattle Trust	Australia	Ordinary	100	100
Challenger Securitisation Management Pty Limited	Australia	Ordinary	100	100
Challenger SkyBridge (Capital II) Investment LLP	UK	Ordinary	100	100
Challenger SkyBridge (Fund LP) Jersey Limited	Jersey	Ordinary	100	100
Challenger SkyBridge (Fund SLP) Limited	Jersey	Ordinary	100	100
Challenger SkyBridge (GP Holdings) Investment LLP	UK	Ordinary	100	100
Challenger SkyBridge (Group) Holding Company Pty Ltd	Australia	Ordinary	100	100
Challenger SkyBridge (Hastings) Holding Company Pty Ltd	Australia	Ordinary	100	100
Challenger SkyBridge (Hastings) Investment LLP	UK	Ordinary	100	100
Challenger Special Servicing Pty Limited	Australia	Ordinary	100	100
Challenger Specialised Finance Pty Ltd ³	Australia	Ordinary	100	–
Challenger Strategic Property Partner ²	Australia	Ordinary	100	100
Challenger Structured Credit UK Trust	Australia	Ordinary	100	100
Challenger Titanium Series 2004-1 Trust	Australia	Ordinary	100	100
Challenger Titanium Series 2005-1 Trust	Australia	Ordinary	100	100
Challenger Titanium Warehouse C Trust	Australia	Ordinary	100	100
Challenger Towers Holding Trust	Australia	Ordinary	100	100
Challenger Towers Trust	Australia	Ordinary	100	100
Challenger Treasury Limited	Australia	Ordinary	100	100
Challenger UK Tank Storage Holding Trust	Australia	Ordinary	100	100
Challenger UK Tank Storage Limited	UK	Ordinary	100	100
Challenger UK Terminals Ltd	Jersey	Ordinary	100	100
Challenger USPF II Trust	Australia	Ordinary	100	100
Challenger Welcome Break Limited	Jersey	Ordinary	100	100
Challenger Welcome Break Trust	Australia	Ordinary	100	100
Challenger Wholesale Finance Holdings Pty Ltd	Australia	Ordinary	100	100
Challenger Wind Holdings Pty Limited	Australia	Ordinary	100	100
Challenger Wind Trust	Australia	Ordinary	100	100
Clashfern Investments (UK) Limited	UK	Ordinary	100	100
CLC Commercial Mortgages Trust	Australia	Ordinary	100	100
CLC Leveraged Loan Trust	Australia	Ordinary	100	100
CLC Liquidity Trust	Australia	Ordinary	100	100

Notes to the financial statements

34. Controlled entities (continued)

Name of entity	Country of domicile	Class of shares/ units	% owned 30 June 2013	% owned 30 June 2012
CLS US Holdings, LLC ³	USA	Ordinary	100	–
CMM NIM Trust No.1	Australia	Ordinary	100	100
CMM NIM Trust No.2	Australia	Ordinary	100	100
CMM NIM Trust No.3	Australia	Ordinary	100	100
CMM NIM Trust No.4	Australia	Ordinary	100	100
CMM NIM Trust No.5	Australia	Ordinary	100	100
CMM NIM Trust No.6	Australia	Ordinary	100	100
CMM NIM Trust No.7	Australia	Ordinary	100	100
CMM NIM Trust No.8	Australia	Ordinary	100	100
CMM NIM Trust No.9	Australia	Ordinary	100	100
CMS (UK) Limited	UK	Ordinary	100	100
County Court Property Trust	Australia	Ordinary	100	100
CPHIC Investments Pty Ltd	Australia	Ordinary	100	100
Crown Domestic Sovereign Bond Trust ¹	Australia	Ordinary	–	–
CSPP1 Broadbeach Pty Ltd	Australia	Ordinary	100	100
CSPP1 Investment Company 1 Pty Limited	Australia	Ordinary	100	100
CSPP1 Maitland Pty Ltd	Australia	Ordinary	100	100
CSPP1 Mavis Court Pty Ltd	Australia	Ordinary	100	100
Discovery House Trust	Australia	Ordinary	100	100
EMIF Holdings Pty Ltd	Australia	Ordinary	100	100
Endowment Warrants Limited	Australia	Ordinary	100	100
Epping No.1 Trust	Australia	Ordinary	100	100
Epping No.2 Trust	Australia	Ordinary	100	100
Fidante Partners Alphinity Holdings Pty Limited	Australia	Ordinary	100	100
Fidante Partners Ardea Holdings Pty Limited	Australia	Ordinary	100	100
Fidante Partners Bentham Holdings Pty Ltd	Australia	Ordinary	100	100
Fidante Partners Five Oceans Holdings Pty Limited	Australia	Ordinary	100	100
Fidante Partners Holdings Pty Limited	Australia	Ordinary	100	100
Fidante Partners Kapstream Holdings Pty Limited	Australia	Ordinary	100	100
Fidante Partners Kinetic Holdings Pty Limited	Australia	Ordinary	100	100
Fidante Partners Limited	Australia	Ordinary	100	100
Fidante Partners Merlon Holdings Pty Ltd	Australia	Ordinary	100	100
Fidante Partners Metisq Holdings Pty Limited	Australia	Ordinary	100	100
Fidante Partners Novaport Holdings Pty Limited	Australia	Ordinary	100	100
Fidante Partners Services Limited	Australia	Ordinary	100	100
Fidante Partners Wavestone Holdings Pty Limited	Australia	Ordinary	100	100
Five Oceans Global Equity Fund				
(formerly Five Oceans Global Equity Extension Fund)	Australia	Ordinary	95	95
Five Oceans All Point Equity Fund	Luxembourg	Ordinary	73	–
Five Oceans World Fund	Australia	Ordinary	–	26
Godo Kaisha Kenedix Master Tokumei Kumiai	Japan	Ordinary	100	100
Godo Kaisha Sub Tokumei Kumiai One	Japan	Ordinary	100	100
Godo Kaisha Sub Tokumei Kumiai Two	Japan	Ordinary	100	100
Goodman Fielder North Ryde Property Trust	Australia	Ordinary	100	100
Harris Global Sovereign Bond Trust ³	Australia	Ordinary	–	–
Hayes Park Property Trust	Australia	Ordinary	100	100
Hotels Investment Trust	Australia	Ordinary	100	100
Howard Commercial Lending Limited	Australia	Ordinary	100	100
Inexus Australian Holding Company Pty Limited ²	Australia	Ordinary	100	100
Interstar Millennium Series 1999-1 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2000-1 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2000-2 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2000-3E Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2000-4P Trust	Australia	Ordinary	100	100

Name of entity	Country of domicile	Class of shares/ units	% owned 30 June 2013	% owned 30 June 2012
Interstar Millennium Series 2000-5 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2001-1C Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2001-1E Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2001-2 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2001-3 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2002-1G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2002-2 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-1G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-2 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-3G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-4 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2003-5G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-2G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-3P Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-4E Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2004-5 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2005-1G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2005-2L Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2005-3E Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2006-1 Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2006-2G Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2006-3L Trust	Australia	Ordinary	100	100
Interstar Millennium Series 2006-4H Trust	Australia	Ordinary	100	100
Interstar Millennium Warehouse R Trust	Australia	Ordinary	100	100
Interstar NIM Master Trust	Australia	Ordinary	100	100
Interstar NZ Millennium Series 2004-A Trust	NZ	Ordinary	100	100
Interstar RD25 Master Trust	Australia	Ordinary	100	100
Interstar Titanium 2006-1 Trust	Australia	Ordinary	100	100
Interstar VT30 Master Trust	Australia	Ordinary	100	100
Interstar VT32 Master Trust	Australia	Ordinary	100	100
Interstar Warehouse B Trust	Australia	Ordinary	100	100
Interstar Warehouse R Trust	Australia	Ordinary	100	100
LANV Pty Ltd	Australia	Ordinary	100	100
Maitland Nominee Holdings Pty Limited	Australia	Ordinary	67	67
Maitland Unit Trust	Australia	Ordinary	67	67
Mavis Court Development Co Pty Ltd	Australia	Ordinary	80	80
Mawbury Pty Limited	Australia	Ordinary	100	100
Mercury Term Managed Trust ¹	Australia	Ordinary	–	–
Merlon Australian Long Short Share Fund	Australia	Ordinary	100	100
Oaklands Hill Pty Ltd	Australia	Ordinary	100	100
Quarantine Trust	Australia	Ordinary	67	67
Rendezvous Hotels Flinders Street Trust	Australia	Ordinary	100	100
Riverside Trust No 1	Australia	Ordinary	100	100
Riverside Trust No 2	Australia	Ordinary	100	100
RRETRO Fund Ltd	Cayman Islands	Ordinary	98	80
RRETRO Master Fund Ltd	Cayman Islands	Ordinary	65	51
Sabrand Limited	Cyprus	Ordinary	100	100
Senator House Property Trust	Australia	Ordinary	100	100
Structured Credit Research LLP	UK	Ordinary	48	48
Talavera Herring Unit Trust	Australia	Ordinary	50	50
Talavera Herring Pty Limited	Australia	Ordinary	100	100
The Liberty Group Consortium Pty Ltd	Australia	Ordinary	100	100
TLG Holding Unit Trust	Australia	Ordinary	100	100
TLG Services Pty Limited	Australia	Ordinary	100	100
TLG Unit Trust	Australia	Ordinary	100	100
TLGH Pty Limited	Australia	Ordinary	100	100

Notes to the financial statements

34. Controlled entities (continued)

Name of entity	Country of domicile	Class of shares/units	% owned 30 June 2013	% owned 30 June 2012
TMA C Warehouse C Trust	Australia	Ordinary	100	100
TRE Data Centre Trust	Australia	Ordinary	100	100
TRE Data Centres Canberra Pty Ltd	Australia	Ordinary	100	100
US LLC Holdings Pty Ltd ³	Australia	Ordinary	100	–
Village Property Trust	Australia	Ordinary	100	100
Waterford County Pty Limited	Australia	Ordinary	67	67
Westwind Finance Plc	Ireland	Ordinary	100	100
Wetherill Park Property Trust	Australia	Ordinary	100	100
World Business Centre Heathrow Property Trust	Australia	Ordinary	100	100
Wyetree Asset Management Limited (UK)	UK	Ordinary	50	50

¹ Consolidated due to control rather than % holding.

² Deconsolidated in 2013.

³ Consolidated in 2013.

35. Investment in associates

Name of company	Principal activity	Country of domicile	30 June 2013 %	30 June 2012 %	30 June 2013 \$M	30 June 2012 \$M
Alphinity Investment Management Pty Ltd	Funds Management	Australia	30	30	1.2	0.8
Ardea Investment Management Pty Ltd	Funds Management	Australia	30	30	3.2	2.6
Bentham Asset Management Pty Ltd	Funds Management	Australia	49	49	0.5	0.5
Challenger MBK Fund Management Pte Limited	Funds Management	Singapore	50	50	3.1	3.1
Five Oceans Asset Management Pty Limited	Funds Management	Australia	34	34	5.2	5.2
Greencape Capital Pty Limited	Funds Management	Australia	35	35	14.5	13.8
Homeloans Limited	Mortgage Lending	Australia	–	22	–	20.1
Kapstream Capital Pty Limited	Funds Management	Australia	25	25	5.7	5.0
Kinetic Investment Partners Limited	Funds Management	Australia	20	20	0.4	0.6
Metisq Capital Pty Ltd	Funds Management	Australia	49	49	6.3	7.4
Merlon Capital Partners Pty Ltd	Funds Management	Australia	30	30	1.3	0.8
Novaport Capital Pty Ltd	Funds Management	Australia	49	49	1.2	0.5
Wavestone Capital Pty Limited	Funds Management	Australia	33	30	2.6	2.0
Impairment ¹					(5.2)	(11.2)
					40.0	51.2

¹ In 2013 this impairment relates to the Fidante Partners Boutiques. In 2012 it related to Homeloans Limited.

	30 June 2013 \$M	30 June 2012 \$M
Movements in carrying amount of investment in associates		
Opening balance	51.2	40.9
(Sale of)/purchase of investment in associates in current year	(8.2)	9.7
Share of associates' net profit	13.4	8.3
Impairment	(5.2)	–
Transfer to equity investment	(0.9)	–
Dividend/capital return received	(10.3)	(7.7)
Carrying amount at the end of the financial year	40.0	51.2
Share of the associates' profit or loss:		
Profit before tax	13.4	8.3
Profit for the year	13.4	8.3
Retained profits attributable to associates at the beginning of the financial year	25.4	17.1
Retained profits attributable to associates at the end of the financial year	38.8	25.4
Share of the associates' statement of financial position:		
Assets	28.0	109.8
Liabilities	(13.9)	(91.6)
Net assets	14.1	18.2

Notes to the financial statements

36. Parent entity

The statement of comprehensive income and statement of financial position for the Company for the year ended and as at 30 June are as follows:

	30 June 2013 \$M	30 June 2012 \$M
Statement of comprehensive income		
Revenue	300.1	120.7
Profit before income tax	300.1	120.7
Income tax benefit	18.8	0.8
Profit and total comprehensive income for the year	318.9	121.5
Statement of financial position		
Assets		
Cash and cash equivalents	1.6	1.3
Receivables	795.2	814.8
Current tax asset	0.3	–
Deferred tax assets	43.7	139.5
Investment in controlled entities	1,186.5	1,169.9
Total assets	2,027.3	2,125.5
Liabilities		
Payables	178.0	411.2
Current tax liability	–	1.6
Total liabilities	178.0	412.8
Net assets	1,849.3	1,712.7
Equity		
Contributed equity	1,335.4	1,385.4
Equity option premium reserve	–	65.0
Share-based payment reserve	23.9	27.4
Retained profits	490.0	234.9
Total equity	1,849.3	1,712.7

See Note 38 for details of any contingent liabilities applicable to the parent entity.

37. Subsequent events

At the date of this report, no other matter or circumstance has arisen that has affected, or may significantly affect, Challenger's operations, the results of those operations or the Group's state of affairs in future financial years.

38. 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 real estate properties, warranties to purchasers on several agreements that are still outstanding at 30 June 2013. 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

Challenger Limited has extended the following guarantees and undertakings to entities in 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 Challenger Limited's intention to provide support to those subsidiaries so that they can continue to meet their obligations; and
3. AFS Licence deeds of undertaking as an eligible provider.

Third party guarantees

Bank guarantees have been issued by a third party financial institution 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

Challenger Life Company Limited has made capital commitments to external counterparties for future investment opportunities such as development or investment purchases. As at 30 June 2013 there are potential future commitments totalling \$124.2 million (30 June 2012: \$140.7 million) in relation to these opportunities.

Contingent tax assets and liabilities

From time to time the Group has interactions with the Australian Taxation Office (ATO) in relation to the taxation treatments of various matters. Any potential tax liability resulting from these interactions is only provided for when it is probable that an outflow will occur and reliable estimate of the amount can be made. Tax assets are only recognised on the statement of financial position when agreement over the amount and timing of any inflow or deduction has been reached with the ATO.

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. The information usually required by Australian accounting standards is not disclosed for a number of such contracts on the grounds that it may seriously prejudice the outcome of the claims. At the date of this report, significant uncertainty exists regarding any potential liability under these claims; however, the Directors are of the opinion that no material loss will be incurred.

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, including:
 - (i) giving a true and fair view of the Group's financial position as at 30 June 2013 and of its performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001;
- (b) the financial statements and notes of the Group also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board as disclosed in Note 1(ii) to the financial statements;
- (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 in accordance with section 295A of the Corporations Act 2001 for the financial year ended 30 June 2013.

On behalf of the Board



G A Cubbin
Director
Sydney
16 August 2013



B R Benari
Director
Sydney
16 August 2013

Independent auditor's report



Ernst & Young
680 George Street
Sydney NSW 2000 Australia
GPO Box 2646 Sydney NSW 2001

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Fax: +61 2 9248 5959
ey.com/au

Independent auditor's report to the members of Challenger Limited

Report on the financial report

We have audited the accompanying financial report of Challenger Limited, which comprises the consolidated statement of financial position as at 30 June 2013, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the Corporations Act 2001 and for such internal controls as the directors determine are necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 Presentation of Financial Statements, that the financial statements comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Independence

In conducting our audit we have complied with the independence requirements of the Corporations Act 2001. We have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included in the directors' report.

Independent auditor's report

Independent auditor's report to the members of Challenger Limited (continued)

Opinion

In our opinion:

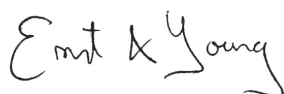
- a. the financial report of Challenger Limited is in accordance with the Corporations Act 2001, including:
 - i. giving a true and fair view of the consolidated entity's financial position as at 30 June 2013 and of its performance for the year ended on that date; and
 - ii. complying with Australian Accounting Standards and the Corporations Regulations 2001; and
- b. the financial report also complies with International Financial Reporting Standards as disclosed in Note 1.

Report on the remuneration report

We have audited the remuneration report included in pages 40 to 60 of the directors' report for the year ended 30 June 2013. The directors of the company are responsible for the preparation and presentation of the remuneration report in accordance with section 300A of the Corporations Act 2001. Our responsibility is to express an opinion on the remuneration report, based on our audit conducted in accordance with Australian Auditing Standards.

Opinion

In our opinion, the remuneration report of Challenger Limited for the year ended 30 June 2013, complies with section 300A of the Corporations Act 2001.



Ernst & Young



D Jewell
Partner

Sydney
16 August 2013

Five-year history

	30 June 2013 \$M	30 June 2012 \$M	30 June 2011 \$M	30 June 2010 \$M	30 June 2009 \$M
Earnings					
Normalised cash operating earnings	452.2	435.7	400.8	338.0	250.8
Net fee income	99.4	83.0	88.4	102.0	114.4
Other income	4.9	8.8	4.8	7.6	4.7
Total net income	556.5	527.5	494.0	447.6	369.9
Personnel expenses	(130.3)	(128.9)	(123.0)	(135.0)	(126.6)
Operating expenses	(61.4)	(60.3)	(56.3)	(46.8)	(59.6)
Total expenses	(191.7)	(189.2)	(180.2)	(181.8)	(186.2)
Discontinued operations	–	–	–	39.1	136.1
Normalised EBIT	364.8	338.3	313.8	304.9	319.8
Interest and borrowing costs	(4.6)	(3.3)	(2.7)	(14.1)	(36.9)
Normalised profit before tax	360.2	335.0	311.1	290.8	282.9
Tax on normalised profit	(51.7)	(38.2)	(63.1)	(58.3)	(64.0)
Normalised profit after tax	308.5	296.8	248.0	232.5	218.9
Investment experience after tax	99.8	(148.3)	(28.7)	51.3	(309.6)
Significant items after tax	8.5	–	42.1	(1.3)	–
Statutory profit for the year	416.8	148.5	261.4	282.5	(90.7)
Normalised cost to income ratio	34.4%	35.9%	36.5%	40.6%	50.3%
Normalised effective tax rate	14.4%	11.4%	20.3%	20.1%	22.6%
Earnings per share (cents)					
Basic earnings per share – normalised profit	58.6	57.5	51.7	45.5	39.2
Basic – statutory profit/(loss)	79.2	28.8	54.5	55.3	(16.2)
Diluted earnings per share – normalised profit	58.0	55.7	48.1	42.7	38.4
Diluted – statutory profit/(loss)	78.3	27.8	50.7	51.9	(15.9)
Capital management					
Normalised return on equity (RoE) – pre-tax	19.6%	21.2%	22.3%	20.7%	19.8%
Normalised return on equity (RoE) – post-tax	16.8%	18.8%	17.7%	16.5%	15.1%
Statutory return on equity (RoE) – post-tax	22.7%	9.4%	18.7%	20.1%	(6.3%)
Statement of financial position					
Total assets	17,784.8	17,778.6	17,836.2	18,375.9	25,237.8
Total liabilities	15,490.6	15,734.1	16,036.8	16,656.2	23,548.4
Net assets (including minority interest) – closing (\$m)	2,294.2	2,044.5	1,799.4	1,719.7	1,689.4
Net assets (excluding minority interest) – closing (\$m)	1,947.4	1,692.2	1,488.3	1,339.6	1,381.9
Net assets (excluding minority interest) – average (\$m) ¹	1,835.7	1,577.2	1,397.8	1,407.7	1,425.3
Net tangible assets (\$m)	1,426.3	1,172.8	969.5	813.0	672.2
Net tangible assets per basic share (\$)	2.77	2.22	2.03	1.72	1.24
Underlying operating cash flow (\$m)	321.5	282.3	276.4	221.7	287.2

¹ Average net assets calculated on a monthly basis.

Five-year history

	30 June 2013 \$M	30 June 2012 \$M	30 June 2011 \$M	30 June 2010 \$M	30 June 2009 \$M
Dividends					
Dividend – Interim unfranked (cps)	9.5	7.5	7.0	6.0	5.0
Dividend – Final unfranked (cps)	10.5	10.5	9.5	8.5	7.5
Total dividend – unfranked (cps)	20.0	18.0	16.5	14.5	12.5
Dividend payout ratio – normalised profit/(loss) (%)	34.1%	31.3%	31.9%	31.9%	31.9%
Dividend payout ratio – statutory profit/(loss) (%)	25.2%	62.5%	30.3%	26.2%	N/A
Sales and net flows					
Retail Life sales (\$m)	2,179.2	1,954.3	1,903.4	933.1	517.8
Institutional Life sales (\$m)	951.8	703.5	59.3	1,252.9	–
Total Life sales	3,131.0	2,657.8	1,962.7	2,186.0	517.8
Life retail net flows (\$m) ²	598.1	582.9	468.1	(1.6)	(433.8)
Life retail annuity book (\$m)	7,123.3	6,553.0	5,629.0	4,745.8	4,573.8
Life retail net book growth ²	9.1%	10.4%	9.9%	–	–
Life institutional net book growth	(2.2%)	35.2%	4.7%	–	–
Funds Management – net flows (\$m)	6,978.6	4,226.0	2,397.0	3,831.0	(2,325.3)
Assets under management (\$m)					
Life	10,787	9,773	8,387	7,578	5,767
Funds Management	41,103	31,017	23,608	20,221	16,041
Crossholdings	(7,120)	(7,361)	(4,086)	(3,851)	(2,164)
	44,770	33,429	27,909	23,948	19,644
Discontinued operations					
Mortgage Management	–	–	–	–	93,295
Crossholdings (discontinued operations)	–	–	–	–	(2,604)
Total assets under management and administration	44,770	33,429	27,909	23,948	110,335
Other					
Headcount – closing FTEs ³	487	479	455	460	837
Weighted average number of basic shares on issue (m)	526.1	516.4	479.4	510.8	558.7
Number of ASX listed shares on issue – closing (m)	530.9	544.7	496.7	499.6	569.3
Share price closing (\$)	4.01	3.25	4.89	3.52	2.24
Market capitalisation at 30 June (\$ million) ⁴	2,128.9	1,770.3	2,428.8	1,758.6	1,275.3

² Retail Annuity net flows and net book growth exclude the High Yield Fund conversion in 2011 (\$444 million).

³ 2010 excludes Mortgage Management employees transferred on completion of the sale of the business on 30 October 2009.

⁴ Calculated as share price multiplied by ordinary share capital.

Investor information

Distribution of shares (as at 27 September 2013)

Range	Number of shareholders	Number of shares	% of issued capital
1 – 1,000	8,740	4,379,470	0.82
1,001 – 5,000	9,529	23,497,181	4.43
5,001 – 10,000	2,214	16,414,127	3.09
10,001 – 100,000	1,531	36,037,494	6.79
100,001 and over	116	450,572,883	84.87
	22,130	530,901,155	100.00

Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum \$500.00 parcel at \$5.56 per unit	90	507	16,493

Substantial shareholders

The number of shares held by substantial shareholders and their associates, based on the latest substantial shareholder notifications:

	Number of shares	% of issued capital
Shareholder		
Caledonia (Private) Investments Pty Ltd and Associates	40,192,256	7.57
National Australia Bank Limited	26,889,208	5.01
LSV Asset Management	28,252,429	5.24
UBS AG	26,907,790	5.07
Paradise Investment Management Pty Ltd	27,050,059	5.02

Twenty largest shareholders as at 27 September 2013

1. HSBC Custody Nominees (Australia) Limited	117,941,271	22.22
2. J P Morgan Nominees Australia Limited	86,359,210	16.27
3. National Nominees Limited	84,422,574	15.90
4. Citicorp Nominees Pty Limited	32,192,843	6.06
5. J P Morgan Nominees Australia Limited <Cash Income A/c>	26,131,809	4.92
6. UBS Nominees Pty Ltd	25,590,595	4.82
7. BNP Paribas Noms Pty Ltd <DRP>	12,588,528	2.37
8. AMP Life Limited	7,992,855	1.51
9. CPU Share Plans Pty Ltd	6,711,485	1.26
10. UBS Wealth Management Australia Nominees Pty Ltd	4,156,920	0.78
11. HSBC Custody Nominees (Australia) Limited <NT – Comnwlth Super Corp A/c>	3,717,491	0.70
12. Argo Investments Limited	2,955,473	0.56
13. QIC Limited	2,003,598	0.38
14. Neweconomy Com AU Nominees Pty Limited <900 Account>	1,992,992	0.38
15. HSBC Custody Nominees (Australia) Limited – GSCO ECA	1,772,767	0.33
16. Citicorp Nominees Pty Limited <Colonial First State Inv A/c>	1,547,556	0.29
17. Mr Dominic John Stevens	1,408,032	0.27
18. Bond Street Custodians Limited <Macquarie Alpha Opport A/c>	1,197,796	0.23
19. Thirty Sixth Vilmar Pty Ltd	1,129,722	0.21
20. Sandhurst Trustees Ltd <DMP Asset Management A/c>	1,073,760	0.20
Total top 20 holders of ordinary fully paid units (total)	422,887,277	79.65
Total remaining holders balance	108,013,878	20.35

Investor information

Voting rights

On a show of hands, every member present at the meeting in person or by proxy shall have one vote and upon a poll each share shall have one vote.

ASX listing

Challenger Limited shares are listed on the ASX under code CGF. Share price details and company information can be accessed via either the Company website www.challenger.com.au or the ASX website www.asx.com.au.

Shareholder queries

For any administrative matters in respect of your Challenger Limited shareholding, please contact the Company's share registrar, Computershare.

Computershare Investor Services Pty Limited
Level 4, 60 Carrington Street, Sydney NSW 2000
Investor queries 1300 850 505
www.computershare.com.au

To assist with all enquiries, please quote your unique Security Reference Number (SRN) and your current address when dealing with Computershare.

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Directory

Principal place of business and registered office in Australia

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Telephone: 02 9994 7000
Facsimile: 02 9994 7777

Directors

Peter Polson (Chairman)
Brian Benari (Managing Director and Chief Executive Officer)
Graham Cubbin
Steven Gregg
Jonathan Grunzweig
Russell Hooper
Brenda Shanahan
JoAnne Stephenson
Leon Zwier

Company secretaries

Michael Vardanega
Andrew Brown

Share register

Computershare Investor Services Pty Limited
Level 4, 60 Carrington Street
Sydney NSW 2000
Telephone: 02 8234 5000
Website: www.computershare.com.au

Auditor

Ernst & Young
680 George Street
Sydney NSW 2000

Website

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Adviser Services

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