Challenger Limited

Annual Report 2014

challenger

Contents

Challenger today

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 from platforms with alignment
- Deliver quality brands, products, service and platforms demonstrating value for money
- Drive a diverse 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[1] largest and one of the fastest growing investment managers

Challenger's Funds Management business comprises Fidante Partners and Challenger Investment Partners.

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.

Challenger Investment Partners originates and manages assets on behalf of the Life business and third-party investors. Challenger Investment Partners invests in fixed income and property assets.

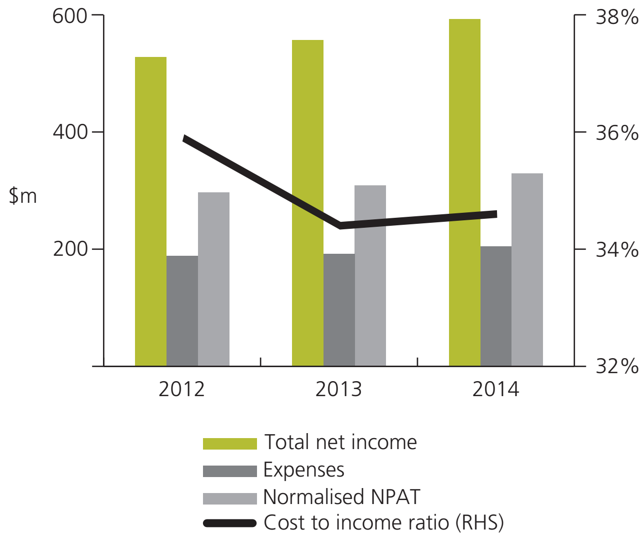
[1] Rainmaker Roundup – March 2014.

Results
at a glance

Strong momentum with growth opportunities

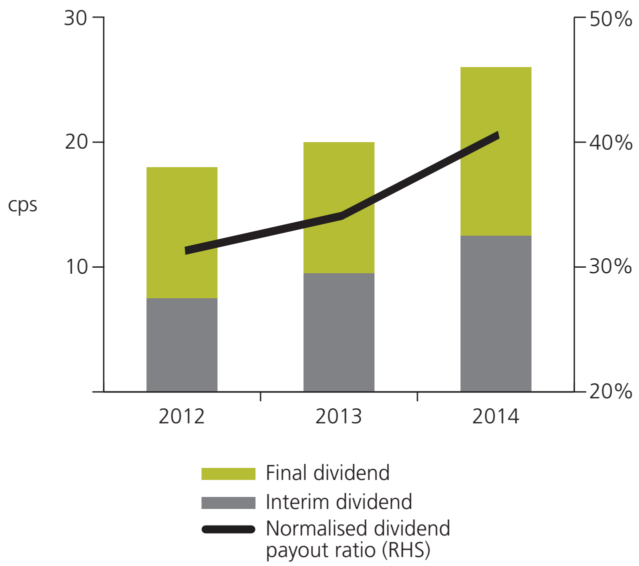
Financial performance

- 2014 normalised net profit after tax[1] (NPAT) increased by 7% to $329 million
- Net income increased by 7% to $593 million. Expenses increased by 7%, and cost to income ratio remained relatively stable
- Statutory NPAT[1] decreased to $341 million, down from $417 million, due to lower investment experience



Sustainable growth in shareholder returns

- 2014 dividends up 30% to 26.0 cents per share and payout ratio increased to 41%
- 2014 final dividend 40% franked
- 2015 dividend payout ratio target range increased to 45% to 50%[2] of normalised profit
- 2015 dividend franking expectations[2]
  – interim 70% franked
  – final 100% franked



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

[2] Dividend payout ratio and franking subject to prevailing market conditions and capital allocation priorities.

Assets Under Management (AUM) continues to grow

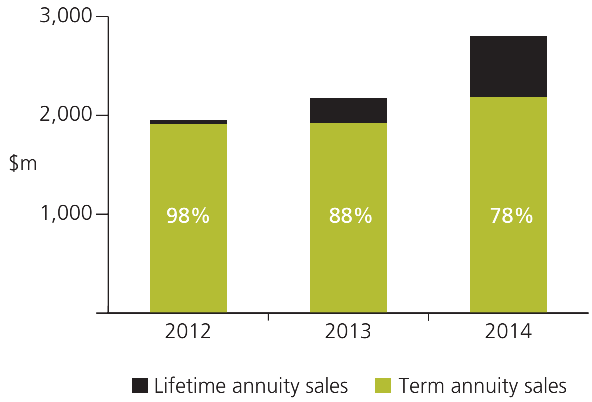
Assets Under Management

- Total AUM up 13% from $44.8 billion to $50.7 billion
- Life's AUM increased by 3% in 2014, driven by earnings and retail annuity sales, offset by retail and institutional maturities
- Funds Management FUM increased by 15% in 2014 as a result of strong Fidante Partners net flows and positive market impacts

Sales growing strongly and driven by demographic changes

Retail annuity sales

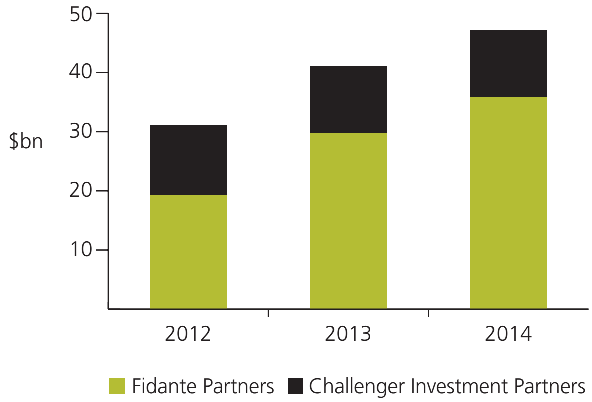
- Record 2014 retail annuity sales of $2.8 billion, up 28%
- Lifetime sales represented 22% of 2014 total retail annuity sales, up from 12% in 2013



Funds Management – Strong Funds Under Management (FUM) and investment performance

Funds Management

- Fidante Partners FUM up 36% in 2014 from $29.8 billion to $35.9 billion
- Fidante FUM driven by strong investment performance and inflows of $2.4 billion in 2014
- Challenger Investment Partners FUM of $11.3 billion



Results at a glance

Key performance measures

	30 June 2014	30 June 2013	30 June 2012
Normalised profit after tax ($m)	328.7	308.5	296.8
Statutory net profit after tax ($m)	340.6	416.8	148.5
Normalised cost to income ratio (%)	34.6	34.4	35.9
Earnings per share			
Basic – normalised profit (cps)	64.0	58.6	57.5
Basic – statutory profit (cps)	66.3	79.2	28.8
Return on equity			
Normalised return on equity (RoE) – post-tax (%)	16.1	16.8	18.8
Statutory return on equity (RoE) – post-tax (%)	16.7	22.7	9.4
Dividends			
Dividend – interim (cps)	12.5	9.5	7.5
Dividend – final (cps)	13.5	10.5	10.5
Dividend – Total (cps)	26.0	20.0	18.0
Normalised dividend payout ratio (%)	40.6	34.1	31.3
Life sales and net flows			
Retail Life sales ($m)	2,798.8	2,179.2	1,954.3
Institutional Life sales ($m)	581.6	951.8	703.5
Total Life sales ($m)	3,380.4	3,131.0	2,657.8
Life retail net flows[1] ($m)	887.1	598.1	582.9
Life retail net book growth[1] (%)	12.5	9.1	10.4
Funds Management net flows			
Fidante Partners ($m)	2,411.7	7,544.7	4,458.0
Challenger Investment Partners ($m)	(264.3)	(566.1)	(232.0)
Total Funds Management net flows ($m)	2,147.4	6,978.6	4,226.0
Total Assets Under Management ($m)	50,725	44,770	33,429
Share price at 30 June ($)	7.44	4.01	3.25
Market capitalisation at 30 June ($m)	3,949.6	2,128.9	1,770.3

[1] Excludes $284 million maturity of the High Yield Fund annuity in the 30 June 2014 period.

Chairman's report

Peter Polson
Chairman

With the growth of Australia's wealth and investment management industries underwritten by compulsory superannuation, it might be easy for some people to imagine that business success comes easily.

But it's also true that these situations usually breed fierce competition, making it critical for independent product providers like Challenger to adapt and innovate. Perhaps, most importantly, companies like ours must sometimes have the courage of conviction to commit to a path not followed by others.

Five years ago, Challenger made the decision to commit to what was regarded by others in the industry as a near-impossible goal – the re-establishment of Australia's longer-tenor and lifetime annuity markets. These markets were decimated in 2004 by the removal of supportive social security rules.

For shareholders, 2014 has been an especially good year, not only because Challenger's normalised profit, earnings per share and dividends continued to rise (the latter by 30%), or that our market capitalisation doubled to $4 billion, but because your company's public advocacy efforts in the retirement income space appear to be making a helpful impact on government, academia and industry.

While Challenger is far from being the only proponent of the view that retirement investing has different objectives and additional risks which require its own specific products and policy settings, our contribution to the retirement income debate has been exceptional for one simple reason.

We were not content to just be 'thought leaders', but were prepared to actively invest, with an aim to also become product and sales leaders. We developed and marketed a lifetime annuity where the high level of sales has proven the intrinsic appeal of the product category.

With Challenger's retail annuity sales reaching a new record of $2.8 billion this year, including a more than doubling of lifetime sales to $613 million, the previously niche guaranteed annuity is becoming mainstream, with or without retirement policy reform.

Behind this phenomenon lies not only our ageing population, but also the widespread realisation that superannuation should be as concerned with sustainable spending in retirement as it is with saving enough beforehand.

The reason for the growth in Challenger's total assets under management of 13% to $50.7 billion lies beyond the Company's achievements in the guaranteed income stream market.

Equally responsible is the continued growth of Funds Management and its Fidante Partners boutique platform, which today comprises 15 managers embracing multiple asset classes.

Another notable feature of the last five years has been a lifting of normalised profit by 50% and earnings per share by 63% using capital generated only from internal cash flow. This was achieved through a global financial crisis which saw other banks and insurers raising fresh capital.

For a company expanding as quickly as ours, there's clearly a limit to this approach. Given the organic growth opportunities which lie ahead, post 30 June your Board has decided to issue $250 million in ordinary shares to institutions, and is undertaking a Share Purchase Plan available to retail investors, which is expected to raise an additional $30 million. We also launched Challenger Capital Notes, a hybrid debt instrument to be listed and traded on the ASX, expected to raise $360 million. This proactive approach to managing our capital base will ensure Challenger's future growth is not constrained. This equity issuance is expected to be earnings per share neutral for 2015 and accretive thereafter.

This capital raising will support retail annuity growth sufficient to drive Challenger Life's cash earnings to new levels, and is expected to further increase our earnings per share and dividends to shareholders. During 2015, these dividends are expected to be franked at 70% for the interim and 100% for final.

If you have any questions about this capital raising or any other matter, you will have the opportunity to ask them at this year's Annual General Meeting, the date of which has been brought forward to 28 October 2014.

This is a good time to be a Challenger shareholder.

I look forward to seeing you at the meeting.

CEO's report

Brian Benari
Chief Executive Officer

By a series of measures, 2014 has been very successful for Challenger and for you, our shareholders.

I am pleased to report that, like the annuities which account for much of our earnings, Challenger as a company has done what it said it would do. We continued to revive the lifetime annuity market, enhancing product features and breaking industry sales records along the way. We pursued the expansion of our funds management footprint, more than doubling our investment capacity through the addition of five new boutiques and new products for existing managers.

At a Group level, our Life and Funds Management divisions have now accumulated $50.7 billion in assets and funds under management, a rise of 13% and which produced $329 million of normalised net profit after tax, an increase of 7%.

Breaking this down further, a 24% increase in Funds Management's average FUM to $44.4 billion produced normalised earnings before interest and tax (EBIT) of $43 million, a rise of 27%. Net flows of $2.1 billion helped lift balance-date FUM to $47.1 billion, up 15% on last year and elevating Challenger to the position of Australia's seventh[1] largest fund manager.

In the annuities business, Life's $11.1 billion balance sheet delivered a 6% rise in cash operating earnings to $481 million. These earnings are largely a function of investment margin, which remained stable at 4.5%, and average assets under management, which grew by 6%. Retail net book growth of 12.5% slightly exceeded the top of our revised guidance range.

This is a very pleasing set of numbers, but what lies behind them is more significant.

An increase in retail annuity book growth means that the rolling off of shorter, fixed term annuities is increasingly being offset by the increase in longer-tenor and lifetime annuity sales. This year, sales of Challenger's lifetime annuities (Liquid Lifetime and Care) reached a striking $613 million for the year, more than double last year's $257 million and higher than any yearly lifetime sales result achieved by the entire Australian annuity industry.

While lifetime product is rapidly increasing as a percentage of overall retail annuity sales, sales of fixed term annuities continued to rise as well, resulting in an overall 28% increase in retail annuity sales to $2.8 billion for the year, a very commendable achievement for our distribution, product and marketing teams.

When added to institutional sales, this retail annuity sales record helped Challenger to achieve a new total annuity product sales record of $3.38 billion.

As mentioned in your Chairman's report, Challenger's Board and management formed the view, post balance date, that the size and immediacy of market growth opportunities warranted the raising of equity capital which is expected to be earnings per share neutral in 2015 and accretive in 2016. The majority of this capital has been earmarked to support the strong growth being achieved in our annuities business.

Most importantly, the new capital will ultimately support further earnings growth over the short, medium and long term, which will translate into higher dividends. When combined with a higher targeted dividend payout ratio range of 45% to 50% and the expected reintroduction of full franking for the FY15 final dividend.

Finally, many of you will be aware that the Government's Financial System Inquiry has been opining positively on the potential of annuities to provide a partial solution to the shortcomings of Australia's retirement system. It may recommend policy measures to encourage the broad uptake of lifetime annuities. In a similar vein, Federal Treasury has also re-opened discussions around the removal of impediments to the provision of new longevity products like deferred lifetime annuities. This could pave the way for innovative new products and more rapid penetration of the private pension market.

Undoubtedly 2014 will be remembered as a year when Challenger moved up a gear, and we are very much looking forward to how the next 12 months, and beyond, unfold.

[1] Rainmaker Roundup – March 2014.

Life

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 six years.

CLC is an APRA regulated entity, with a requirement to hold capital to ensure that, under a range of highly adverse scenarios, CLC can continue to meet its regulatory and customer obligations. CLC is strongly capitalised, with approximately $900 million of capital above APRA's minimum requirement at balance date.

Our business has been growing very strongly, with retail annuity sales increasing by 28% to $2.8 billion in 2014. This growth is supported by favourable macro trends, including more baby boomers (born 1943-1960) retiring each year and retirees becoming more risk averse as they spend longer in retirement. These favourable macroeconomic trends are driving an increase in demand for our retirement income products.

Strong 2014 retail annuity sales, together with the benefit of longer tenor prior period sales, are helping to grow the size of our annuity business, with us achieving 12.5% book growth for the year[1].

Life's investment assets were $11.1 billion at the end of the 2014 year, with investment assets near doubling over the past five years. In order to meet the promises to our customers, we match future annuity cash flow obligations with high quality assets generating dependable cash flows. Investment assets are primarily invested in fixed income (72% of the portfolio) and property (20% of the portfolio).

The fixed income portfolio is a diverse portfolio invested in corporate credit, asset backed securities such as residential mortgage backed securities, and cash equivalent investments.

With the significant increase in lifetime annuity sales (up 139% in 2014), we are increasing our property investments, acquiring $0.4 billion of property (net of debt) during the year. Property is an attractive asset class because contracted rental receipts, which are often indexed to inflation, are a good match for long-term annuity payments.

During the year, we were successful in acquiring the units we did not already own in the listed Challenger Diversified Property Group (CDI). We regard CDI's property portfolio as attractive since it meets our return criteria and generates cash flows well suited to back annuities. Moreover, the properties are well known to us, as we co-owned a number of them with CDI.

Diversifying and extending Life's products and revenue streams is important, and we continually look for natural business adjacencies. Increasing Life's longevity and mortality exposures via wholesale reinsurance transactions is one such adjacency we have pursued in a careful and measured way. Over the year, we successfully executed four wholesale longevity/mortality reinsurance transactions, which delivered approximately $6 million of additional profit for the year.

The Australian retirement incomes market is expected to grow strongly over the next 20 years as Australia's baby boomers move from retirement 'saving' to retirement 'spending'. Over this period, the number of Australians over 65 will increase by 75%. This is our target demographic, and we expect to benefit from the significant increase in potential customers. We are also well positioned to benefit from changes in retiree risk preferences, including the increased focus on longevity risk by retirees.

Annuities address many of the concerns retirees face today, and we are experiencing a significant increase in demand, particularly for longer-dated lifetime annuity products. We are amplifying this demand through market-leading distribution, product innovation and strong retirement income brand recognition.

[1] Excluding maturity of the Challenger High Yield Fund Annuity.

Funds Management

Rob Woods

Chief Executive, Funds Management

Rob Woods

Chief Executive, Funds Management

Challenger's Funds Management business is Australia's seventh[1] largest investment manager and one of the fastest growing. Over five years, Funds under Management (FUM) has grown by over 180%.

Funds Management comprises Fidante Partners, a multi-boutique platform of co-owned, separately branded, active managers, and Challenger Investment Partners, a relative value manager investing on behalf of Life and third parties.

Funds Management has been growing quickly; FUM increased by 15% for the year to $47 billion. The business is highly scalable, with increased FUM translating into higher earnings. Earnings before tax increased by 27%, with net income increasing by 11% and expenses by only 2%. Scale benefits are helping drive an increase in return on equity, which increased six percentage points to 33% pre tax.

The Fidante Partners business model aligns the interests of investors, boutique investment managers and Fidante Partners. The success of the model is resulting in Fidante Partners growing substantially faster than competitors, achieving net inflows of $2.4 billion for the year. Investment performance has also remained strong, with 95% of all mandates and funds exceeding their benchmarks since inception.

Fidante Partners has been successful in attracting new investment manager talent, adding five new managers during the year across Australian equities, international equities, fixed income and infrastructure. In addition to adding new mangers, additional capacity has been added to existing managers. There is approximately $50 billion of available FUM capacity, which should support future business growth.

During the year, we rebranded Aligned Investments to Challenger Investment Partners. The rebrand was designed to provide a fresh and marketable brand as the business grows domestically and offshore and highlights the business' third-party client focus.

Over the past few years, Challenger Investment Partners has been growing new third-party relationships and attracting FUM, whilst closing a series of legacy products. During the year the Howard Mortgage Fund portfolio of loans was sold, with the fund now being wound up.

On 1 July 2014, Challenger Investment Partners' infrastructure business was merged with Access Capital Advisers, creating a $4 billion Fidante Partners infrastructure boutique. Challenger Investment Partners is now a dedicated property and fixed income investment manager, with a strong focus on its third-party fiduciary business.

The Australian funds management market remains an attractive market underpinned by mandated superannuation contributions. Contributions increased to 9.5% of gross salaries on 1 July 2014 and will increase to 12% by 2025. The mandated nature of Australia's superannuation system is expected to significantly grow the size of Australia's superannuation assets from $1.8 trillion today, to over $7 trillion[2] in the next 20 years.

Challenger's Funds Management business is well positioned to benefit from this growth. Our platform has multiple brands and strategies with significant manager capacity. Coupled with Challenger's distribution capability and strong boutique investment manager performance, our Funds Management business is well positioned to continue increasing returns for shareholders.

[1] Rainmaker Roundup – March 2014.

[2] Deloitte – Dynamics of the Australian superannuation system.

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 to achieve this vision.

The Distribution, Product and Marketing team is responsible for:

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

Distribution

Both Life and Funds Management sales continue to benefit from the creation of specialist distribution teams. The Life team is focused on stable, secure retirement income annuity products for retirees. The Funds Management distribution team is focused on products providing superior investment returns across a variety of investment classes.

In 2014, we achieved record retail annuity sales, with sales increasing by 28% to $2.8 billion. Annuity sales are benefiting from Australia's favourable demographic trends, with baby boomers commencing retirement and retirees seeking more stable and dependable retirement incomes.

Challenger's retail annuity sales are increasing, but also the mix of sales is continuing to evolve. Retirees are living longer than ever, and they are demanding retirement income solutions that provide longevity and inflation protection for life. This is helping to propel our lifetime annuity sales, with $613 million of sales this year, up from $257 million last year. Lifetime annuity sales represented 22% of total retail sales, up from only 2% in 2012.

Challenger is seeking to leverage its growth across distribution channels, including the self managed super fund (SMSF) sector. During the year, we acquired Bendzulla Actuarial, the leading provider of SMSF actuarial certificates, which has relationships with approximately 5,500 accounting firms. We are repositioning Bendzulla to be a more broad-based SMSF retirement specialist and are developing a range of new SMSF offerings to help achieve this.

Challenger's Funds Management business continues to gain traction with both retail platforms and institutional investors, attracting over $2 billion of net inflows for the year. Investors are attracted to the Fidante Partners business model, which has strong support from asset consultants due to the alignment between investment managers and investors.

Fidante Partners net inflows continue to benefit from the strong investment performance achieved by our boutique investment managers.

Challenger's distribution capability is highly regarded by financial advisers. Wealth Insights, an independent market researcher, recently ranked Australia's top 40 fund managers, with Challenger ranked number one in overall adviser satisfaction. We also have the number one business development team for the second year running, and our technical services team and client services team were also ranked number two.

Advisers clearly value what Challenger does and how we do it, resulting in advisers recognising Challenger as the leader in retirement incomes.

Product

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

Research shows that retirees are looking to protect themselves against longevity risk, seeking peace of mind in retirement through secure and reliable income products, and want the ability to access their funds during the life of a product. Through our lifetime annuity product innovation, we are addressing these retiree needs.

Our product innovation continues to be externally recognised, with Challenger's Liquid Lifetime Annuity named the 'Best Longevity Fund 2014' at the Chant West/Conexus Financial Super Fund Awards. In determining the winner, Chant West recognised the product's unique features, strong sales result, and our commitment to educating advisers on product features and benefits.

Following strong adviser demand, we have expanded our leading technical services capability. This team's sole focus is supporting advisers and helping them become retirement income and aged care specialists. Our technical services team provides online tools, educational material and support, and presented to over 5,000 advisers during the year.

Marketing

Having a strong and respected brand is critical in order for Challenger to achieve its vision of being recognised as the leader in Australian retirement incomes.

During the year, we launched our new 'retirement on paper' brand campaign. This innovative animation style campaign is designed to further strengthen adviser and consumer brand awareness, whilst also improving the understanding of the benefits annuities can provide as part of the retirement income solution.

The campaign, whilst innovative and designed to cut through, is a call to Google Challenger Annuities, leading consumers to our educational-based website. As a result of the campaign, our online activity has increased significantly, with a more than threefold increase in Challenger's Google search and a 40% increase in Challenger's website traffic.

Challenger's leadership in retirement income education and thought leadership are key drivers in differentiating our brand. Our retirement income research team, led by Jeremy Cooper, continues to play a key role in educating consumers, advisers, media and policy-makers on retirement income issues. During the year, we partnered with Professor Milevsky, a leading global retirement income academic, to produce a series of short videos focusing on important issues such as longevity risk, how much super is needed to fund retirement and retirement income portfolio construction.

The success of the campaign has been externally recognised, winning the 'Advertising Campaign of the Year' at the 2014 Lonsec/Money Management Fund Manager of the Year Awards. The judges applauded our creation of a cut-through campaign, with a memorable message and measurable impact.

The campaign also won the consumer 'Advertising Campaign of the Year' at the Advertising and Sales Excellence Forum and Awards.

Challenger's brand amongst advisers remains very strong. Independent research conducted amongst advisers shows that 89% of advisers recognise Challenger as the Australian leader in retirement incomes. Clients are demanding more information on annuities, with 45% of advisers receiving reverse annuity inquiries from clients.

Challenger's distribution, product and marketing capability remains a core organisational strength. We are committed to ensuring that we remain the leader in retirement incomes, and we will achieve this through diversifying our distribution, continuing our product innovation track record and building a strong and respected brand.

Corporate

Andrew Tobin and Blair Beaton

Chief Financial Officer and Head of Strategy and M&A

Andrew Tobin

Chief Financial Officer

Challenger has experienced another successful year, with strong business momentum translating into another year of earnings growth and higher returns for shareholders.

Normalised profit after tax, Challenger's preferred measure of profitability, as it better reflects the underlying operating performance of the business, increased by 7% to $329 million. Normalised earnings per share increased by even more, up 9% to 64.0 cps, benefiting from higher normalised profits and lower number of shares on issue following the 14 million shares bought back last year.

Challenger is required to value its assets and liabilities supporting the Life business at fair value, despite generally being a hold to maturity investor. This results in positive or negative investment experience and forms part of Challenger's statutory net profit after tax. Investment experience was positive $12 million (post tax) for the year, with fixed income gains from stability in debt markets partially offset by property transaction costs. Statutory net profit after tax for the year was $341 million.

Challenger's business is highly scalable, resulting in Challenger being one of Australia's most efficient financial services companies. Over five years, total revenue has increased by 60% whilst expenses have increased by only 10%, resulting in a market-leading cost to income ratio of 35%.

Life's normalised earnings before income tax increased by 6% to $404 million, with earnings benefiting from AUM growth, a stable margin and our scalable platform. Strong retail annuity sales are helping increase the size of Life's annuity business, which closed the year with $11.1 billion of investment assets.

Challenger Life held $903 million of surplus capital above APRA's minimum regulatory requirements at the end of the year, which included an allowance of $215 million for transition to new capital standards which became effective on 1 January 2013. Life's capital position, as measured by the prescribed capital ratio of 1.7 times APRA's minimum requirement is above the Board's targeted range of 1.4 to 1.6 times.

Challenger's financial strength was also confirmed during the year by Standard & Poor's, which reaffirmed Challenger Life's 'A' rating with a stable outlook.

Funds Management normalised earnings before income tax increased by 27% to $43 million. Earnings benefited from an $11 million increase in fee income, whilst expenses increased by only $2 million. Fee income increased from higher Funds Under Management (FUM) and higher performance fees. FUM increased by 15% for the year to $47.1 billion.

Total dividends declared for the year were 26.0 cents per share, representing an increase of 30% on last year. The increase in dividends is due to both higher normalised profits after tax and a higher dividend payout ratio. The payout ratio increased by seven percentage points for the year to 41% of normalised profit after tax. Divided franking has also recommenced at 40% for the final 2014 dividend.

The Board is focused on increasing shareholder dividends over time, which have doubled over the past five years. The Board has also signalled its intention to increase dividends further in 2015, expecting to increase the payout ratio to a range of 45% to 50% of normalised net profit after tax. Dividend franking is also expected to increase, with the 2015 interim dividend expected to be ~70% franked and the 2015 final dividend ~100% franked. However, the actual dividend payout ratio and franking is subject to prevailing market conditions and capital allocation priorities.

In order to ensure we capture both the structural growth built into the wealth management industry and the new opportunities that may present themselves, we have announced post 30 June 2014 a range of capital initiatives that enable us to support significant growth in the Life business.

In August 2014, we completed a $250 million institutional equity placement, with shareholders subscribing to additional shares at $7.53 per share.

We have also undertaken a Share Purchase Plan expected to raise $30 million, providing retail investors with an opportunity to participate.

In August 2014, we also launched Challenger Capital Notes, which is a debt instrument listed and tradeable on the ASX. Following strong investor demand, the offer is now expected to raise $360 million.

Challenger's business is growing quickly with significant business momentum and enhanced growth opportunities. We remain confident we can continue executing our strategy whilst increasing returns for our shareholders.

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 integral role that 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 the business. This includes setting strategies to achieve our long-term vision of providing Australians with financial security in retirement. To succeed in this long-term vision, a number of medium-term strategies have been set, including:

- increasing the Australian retirement savings pool allocation to secure and lifetime income products;
- being recognised as the leader in retirement income solutions in Australia; and
- being an active investment manager providing superior returns from platforms with alignment.

Each strategy is supported by specific shorter-term steps that are reviewed annually as part of the strategic planning process.

During 2014, the Strategy and M&A team analysed a series of initiatives, with the following undertaken:

- acquiring Bendzulla Actuarial, the leading provider of SMSF actuarial certificates in Australia;
- merging Challenger's infrastructure investment operations with Access Capital Advisers to create Whitehelm Capital, a new $4 billion boutique infrastructure business; and
- selling the Howard Mortgage Fund loan portfolio, enabling a more timely return of capital to unitholders and wind-up of the fund.

The Strategy and M&A team will continue to play a key role in ensuring Challenger remains the Australian leader in retirement incomes and our funds management business continues to grow.

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 undertakes dedicated risk workshops to review the Risk Management Framework and 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 employee engagement surveys showing employees take their compliance obligations seriously.

The Chief Risk Officer is also responsible for oversight of regulatory engagement, including APRA and ASIC. Challenger continues to have a positive and productive relationship with APRA and provides a Board-approved Internal Capital Adequacy Assessment Process Report to APRA each year.

APRA is in the process of developing Level 3 capital standards, which were due to be implemented on 1 January 2015. However, in August 2014 APRA deferred a decision on its final standards and implementation until the Government's response to the recommendations of the Financial System Inquiry has been announced.

The Risk and Compliance team plays an important role in supporting Challenger's growth aspirations. During 2014, this has included adapting the Risk Management Framework to support a number of new initiatives, including the further build-out of Challenger's asset origination capability and execution of a number of Life Risk reinsurance transactions.

Angela Murphy

Executive General Manager, Human Resources

Challenger's culture is core to our success. We continue to invest in attracting and developing a diverse and talented group of people who are engaged in their work and exemplify our principles and culture.

In 2014, we articulated this culture through the development of an employment brand. Employee focus groups confirmed core aspects of working at Challenger that are consistent across the Company.

- We challenge ourselves – we value intellectual inquisitiveness, rigorous analysis and the delivery of results.
- We value each other – we are driven to succeed, and we value and respect each other.
- We offer opportunities – we provide individual development through broad and deep roles and exposure to leaders.
- Employees can make an impact – our vision is bold, and we welcome individual creativity and initiative to achieve it.

Our people strategy is aimed at driving commercial outcomes and enabling sustained success. In addition to our employment brand, key areas of focus in 2014 included:

- Leadership capability and talent development – Challenger has a strong track record of building internal successors and moving leaders and employees across roles. We continue to partner with the Australian Graduate School of Management to deliver leadership programs for our leaders. We also dedicate significant time to reviewing talent across the Company, and designing and implementing plans to further develop the capability and performance of our people.

- 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. In 2014, we significantly increased the percentage of women in senior management and created a Diversity Committee, chaired by the Chief Financial Officer, to ensure ongoing focus on diversity.
- We also seek 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 including Alzheimer's Australia, Barnardos Australia, Bear Cottage, beyondblue, Meals on Wheels and National Seniors Foundation Trust.

Additional details on Challenger's approach and practices relating to people and sustainability are contained in the Sustainability report, which forms part of Challenger's 2014 Annual Report.

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FIGHTDEMENTIA.ORG.AU

Barnardos Australia

proudly supporting bear cottage

Proudly supporting beyondblue

Meals on Wheels

National Seniors Australia

Contents

Corporate governance statement

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 (the Principles) as amended in 2010. The Company will first report against the new third edition of the ASX Corporate Governance Principles and Recommendations released in 2014 in relation to the financial year ending 30 June 2015.

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, evaluation and remuneration of the Chief Executive Officer (CEO) and approval of the appointment of the Chief Financial Officer (CFO), the Chief Risk Officer (CRO), 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.

Non-Executive Directors are issued with formal letters of appointment governing their role and responsibilities. The responsibilities of the Chair 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 and the Remuneration Committee set the performance objectives and review the performance of the CEO's direct reports.

Performance evaluations for the CEO and senior executives have taken place in respect of the 2014 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 of the Company; and
- effectively review and challenge the performance of management.

Name	Position	Independent	Appointed
Peter Polson	Chair	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 Chair is selected by Non-Executive Directors of the Board. The roles of Chair and 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, 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 2014.

The review of the Board's performance is conducted by the Chair 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 provider;
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; or
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 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 Chair, establishes the meeting agendas to ensure adequate coverage of strategic, financial and material risk matters 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.

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 Chair's prior approval is obtained. 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 2013 to 30 June 2014 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	9	8	4	3	6	5	2	2
B Benari	9	9	–	–	–	–	–	–
G Cubbin	9	9	4	4	6	6	2	2
S Gregg	9	9	–	–	6	6	2	2
J Grunzweig	9	9	–	–	–	–	2	2
R Hooper	9	9	–	–	–	–	2	2
B Shanahan	9	9	4	4	6	6	2	2
J Stephenson	9	9	4	4	-	–	2	2
L Zwier	9	7	–	–	–	–	2	1

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:

- Integrity;
- Commercial ownership;
- Working together;
- Compliance; and
- Creative customer solutions.

Code of Conduct

The Board has adopted a Corporate Code of Conduct (the 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 report from page 23.

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 only of 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 19 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 that 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.

During 2014 the position of the independent external auditor was put to tender. A thorough process was conducted to assess the quality of the submissions from three different audit firms and, as a result of a competitive tender process, EY was reaffirmed as the Company's independent external auditor.

External auditors are required to rotate the engagement partner assigned to the Company on a five-year basis. The next engagement partner rotation will take effect from 1 July 2015.

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 that 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 releases of information to the market, the Company publishes half-yearly and annual 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 shareholders, 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 risk 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 the 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 conducted by the Executive Risk Management Committee (ERMC), which is chaired by the CRO. The CRO is independent of the business units and accountable to the CEO and the Board and its committees.

The framework and policies are developed by the CRO, reviewed and approved by the 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, and reports directly to the GRAC.

Assurance

In respect of the financial report for the year ended 30 June 2014, 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, options or performance rights.

It is also Company policy to prohibit Directors, senior executives and staff members from taking out margin loans over Company shares.

Sustainability report

Sustainability commitment

Challenger's vision, to provide Australians with financial security in retirement, is at its core a vision of sustainability. We consider sustainability to be an imperative for our success, and also seek to contribute more broadly to a sustainable future. Our sustainability goals include:

- fostering a diverse culture with strong compliance, ethics and corporate governance;
- contributing to the communities in which we operate; and
- reducing our carbon footprint and minimising our impact on the environment.

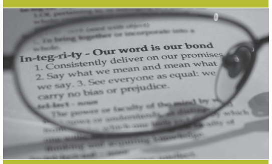
Our employees are critical to our success. We promote a work environment where diversity is embraced, and where people are recruited and promoted on merit and treated with mutual respect and dignity.

We proactively manage our carbon footprint and consider environmental, corporate governance and social issues when making investment decisions. We have committed to developing a Sustainability Policy in 2015 to set clear sustainability objectives and guidelines across the Company.

Challenger Principles

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

Integrity



Being authentic and being accountable for what we say and do

Commercial ownership

Achieving the best for our clients, our business and our people

Working together

True collaboration and embracing diversity

Compliance

Being responsible for what we do and how we do it

Creative customer solutions

Superior customer service and providing innovative solutions to clients

Employee behaviour is assessed against the Challenger Principles and is weighted equally with performance outcomes in determining performance ratings. To receive an annual short-term incentive, employees must achieve a minimum rating against each of the Challenger Principles.

Whistleblower policy

All policies at Challenger include a whistleblower provision and clear instructions on how employees can raise concerns in a confidential and non-threatening manner. We strongly encourage employees to act on any concerns and actively foster a culture where issues can be raised and addressed.

Diversity

We seek to provide a diverse and inclusive workforce and value the capability and experience that a wide variety of employees brings to the organisation. We recognise that an inclusive work environment increases our ability to attract and retain the best talent from the widest pool of candidates, enabling us to maintain a high performing team. We also recognise that successfully harnessing diverse thinking and working styles contributes to innovation and superior long-term sustainable outcomes.

We are further committed to ensuring not only regulatory compliance, but also a deeper commitment to the principles of diversity. Our Diversity Policy emphasises our commitment that employees be treated fairly, equally and with respect when employment and career decisions are made, and sets measurable objectives to ensure that the policy is effective.

Diversity governance

The Challenger Board has oversight of the Company's Diversity Policy, and the leadership team is accountable for promoting and fostering an environment where there is equal access to opportunities and growth. Considerable effort and focus is being given to a range of diversity initiatives. Gender diversity outcomes are monitored in terms of proportional representation of women across the organisation and in management roles by the Board and the leadership team on a monthly basis.

In 2014, a Diversity Committee was established to ensure ongoing focus on, and promotion of, workplace diversity. The committee is accountable for measuring, monitoring and promoting diversity at Challenger, particularly gender diversity, and reporting key outcomes to the Board. The committee is sponsored by the Chair of Challenger Limited and chaired by the CFO.

Diversity progress in 2014

The Board commits to measurable diversity objectives each year. In 2014, these included:

Objective	Initiative/outcome
Build awareness of gender diversity and set it as a key business priority	• Following a successful unconscious bias training pilot in 2013, the training was extended to all Executive Management Team members to raise awareness of unconscious bias and its impact on workplace decisions and outcomes. • Gender diversity was set as one of five key topics at the annual Executive Management Team strategy offsite. A working group prepared and presented the business case for gender diversity and recommended actions to further gender diversity outcomes. • On the recommendation of the Executive Management Team working group, we created a Diversity Committee to provide ongoing focus on diversity across the business.
Increase the representation of women in management positions	• A number of initiatives were undertaken and/or programs continued to identify and promote the development of talented women and increase the gender diversity of the pipeline of potential successors for senior leadership roles including: – a talent and succession exercise undertaken with a specific focus on increasing the female pipeline of potential successors for senior leadership roles, with comprehensive development actions agreed; – developing an advanced understanding of the employment experience of women in Challenger and the potential barriers they face in career advancement. Interviews were conducted with senior women across the organisation, who consistently reported a positive employment experience at Challenger. Strong support was given to the initiatives already in place or underway to continue to improve opportunities and support for female employees. • Women in senior management roles increased from 25% to 30% in 2014.
Ensure equity in pay outcomes	• We seek to pay equitably against market benchmarks across a range of employee segments, including gender. Whilst men and women are positioned similarly on average against market benchmarks for fixed pay, there was historically a gap in competitiveness on a total reward (including incentives) basis. Since 2011, we have worked to close this gap, and in 2014 there was no statistically significant difference in the competitiveness of pay outcomes for men and women.
Support flexible work arrangements and the retention of women following parental leave	• We continue to maintain a 'keep in touch' program for women on parental leave. The program helps employees maintain a connection to the workplace for the duration of their leave. As a result of the program, a number of women accepted invitations to attend key Company briefings and events during their leave period. • Employees returning from parental leave have access to external coaching and support to assist with the transition back to work and balancing family and career.
Increase gender diversity focus in recruiting	• Our recruitment guidelines were updated such that candidate shortlists and interview panels include at least one woman when recruiting roles at or above Executive Management Team level.
Understand the opportunities to attract and retain mature age workers	• We are working with the Federal Government's 'Corporate Champions Program' to develop best practice programs in the recruitment and retention of mature age employees and the implementation of age-friendly work practices.

Board diversity

The Board has a charter on Board renewal as detailed earlier in the corporate governance statement. Women represent 22% of the Challenger Board, compared to 18% in the ASX 200[1].

Gender diversity outcomes

The Challenger Board and leadership team acknowledge that progress on gender diversity requires continued effort over a sustained period. We remain committed to gender diversity and to ensuring that our processes and practices support diversity at all levels of the organisation. One of the initial areas of focus for the Diversity Committee is to determine appropriate gender targets. The following are the actual gender diversity metrics at 30 June 2014 (including employees currently on parental leave) with the prior corresponding period shown:

Role	2013		2014		Net movement	
	By number	By percentage	By number	By percentage	By number	By percentage
Board	2	22%	2	22%	0	0%
Senior management	13	25%	18	30%	5	38%
Management	35	34%	34	34%	(1)	(3%)
Non-management	143	42%	159	41%	16	11%

Engagement, turnover and absenteeism

We measure employee engagement every two years. In 2014, we continued to invest in initiatives in response to the 2013 employee engagement survey, including developing and articulating our employment brand.

Our rolling 12-month voluntary turnover ratio decreased by 6.5% across the year and at 30 June 2014 was more than 10% below the industry benchmark published by the Financial Institutions Remuneration Group in April 2014.

Our average absenteeism rate remained consistent and comparatively low across the year, with total personal leave days (paid and unpaid, including sick and carer's leave) at approximately three days per full-time equivalent employee per annum.

Work health and safety

Our Work Health and Safety Committee meets quarterly and reports via the Executive Risk Management Committee to the Board. The committee includes employee representatives and reviews work health and safety data and recommends any work health and safety initiatives or changes.

During the year, an independent external audit of our work health and safety practices was conducted with no material issues identified. There were four new worker's compensation claims opened across the year.

Employment brand

In 2014, employee focus groups were facilitated by an external consultant to better understand and define the experience of working at Challenger. The focus groups indicated high levels of employee engagement and identified a number of consistently positive and unique aspects of the work culture and employee experience. These attributes were formulated into an employment brand which was launched internally in February 2014.

[1] Australian Institute of Company Directors, 28 May 2014.

Our employment brand communicates the employment experience offered to current and potential employees. The overarching theme of 'Challenge what is possible' is built on four pillars:

We challenge ourselves
We value intellectual inquisitiveness, rigorous analysis and the delivery of results.

We value each other
We are driven to succeed and we value and respect each other.

We offer opportunities
We provide individual development through broad and deep roles and exposure to leaders.

You can make an impact
Our vision is bold and we welcome individual creativity and the initiative to achieve it.

We will monitor employee feedback on an ongoing basis to ensure that our promise to employees is delivered.

Leadership

We continue to invest in the development of leadership capability through the Leadership Foundations Program. The program, which was developed in conjunction with the Australian Graduate School of Management, aims to support individual leadership development, as well as building our leadership succession planning. Feedback on the program has been extremely positive across all three cohorts, with an average participant value score of 88%.

The inaugural Senior Management Forum was also held in 2014 to provide leadership tools and support and to reinforce the importance of the leadership role played by senior managers. The forum provides an opportunity for managers to learn from each other by sharing leadership challenges, experiences and insights.

Supporting family and other personal commitments

We recognise that there are times when a balance is needed between work and external responsibilities. To support our employees with these commitments, we offer 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.

We also support employee wellbeing through an Employee Assistance Program which provides confidential and free counselling support to employees and their immediate family members. The service also provides support and advice to managers in dealing with challenging employee issues.

In 2014, we commenced employee and manager sessions to build awareness of and provide advice on managing stress and mental health issues. These sessions will continue into 2015.

Community giving

We value a sense of community in the workplace and provide financial support for a range of fundraising and social activities which are coordinated by an employee committee (known as Our Community). In 2014, Our Community activities included the JP Morgan Challenge, a trivia night, a cinema night, a World Cup Soccer competition and an end of financial year celebration for employees. Our Community raised funds for charities such as the Australian Red Cross in support of Typhoon Haiyan, the Children's Medical Research Institute Jeans for Genes Day, Alzheimer's Australia, the Barnardos Gifts for Kids Appeal and The Cancer Council's Biggest Morning Tea.

We also seek 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 including Alzheimer's Australia, Barnardos Australia, Bear Cottage, beyondblue, Meals on Wheels and National Seniors Foundation Trust.

We acknowledge that volunteering is a significant way in which employees can contribute to the community and consequently provide all employees with one paid day of leave per year to provide voluntary services to a not-for-profit organisation, or environmental, community or charitable project.

Through the Community Giving Program, employees can make ongoing pre-tax donations directly from their salary to one of our community partners. The contributions are matched by Challenger up to $500 per employee per year. In addition to our community partners, our employees were affected during the year by two worthy causes, Typhoon Haiyan recovery efforts and the Homicide Victims Support Group. Employees contributed generously to both causes, with all donations matched by Challenger.

Our shareholders are also invited to support our community partners by donating some or all of their dividends through the Dividend Donation Program.

FIGHT ALZHEIMER'S SAVE AUSTRALIA FIGHTDEMENTIA.ORG.AU

proudly supporting bear cottage an initiative of the children's hospital at Westmead

Proudly supporting beyondblue

Barnardos Australia

National Seniors Australia

Meals on Wheels

Environment

Property environmental performance

We are committed to reducing our impact on the environment by raising awareness with our employees, utilising 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 minimum rating of 3.5 stars. We also seek to maximise the NABERS energy accreditation of our property assets.

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

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

We continue to be 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.

In 2014, Challenger also voluntarily reported on a range of climate change practices and outcomes to the Carbon Disclosure Project. The Carbon Disclosure Project surveys Australian and New Zealand publicly listed companies on a range of climate change risks, opportunities, strategies and outcomes.

Waste management

Our waste management system, which includes separated, non-recyclable and compostable green waste at workstations, communal kitchens and the on-site commercial café, continues to deliver material reductions in the volume of waste sent to landfill, with a reduction of 11% in 2014.

Our carbon impact

Taking action with climate friendly climatefriendly.com/disclosure

Through continued focus on our environmental impact, we reduced the electricity consumption of our Sydney office by 158MWh or 16% in 2014. We also extended our partnership with Climate Friendly and, in addition to offsetting power usage, further reduced our carbon footprint by offsetting 100% of the carbon emissions generated by taxis, paper and waste disposal. In 2014, Challenger invested in environmental projects with total CO_2 emission reductions of 1,395 tonnes, an increase of 35% over 2013.

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 2014.

1. 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 the Company. Since joining the Company in 2006, he has been extensively involved in the general management of corporate actions, public entity compliance and governance matters for the Company. Prior to joining, 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 the Company in 2003, Mr Brown has been involved in funds management product marketing, compliance and governance. Prior to joining, Mr Brown held senior compliance management positions at MLC.

2. 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 the entire period unless otherwise stated.

Peter L Polson

Independent Chair

Experience and qualifications

Mr Polson holds a Bachelor of Commerce degree from the Witwatersrand University in South Africa and 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 Chair 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 Chair of Customers Limited (appointed as a director on 23 November 2010) and ceased to be Chair and director on 4 July 2012, when the company was acquired by DirectCash Payments Inc.

Brian R Benari

Managing Director and Chief Executive Officer

Experience and qualifications

Mr Benari commenced in the role of Managing Director and Chief Executive Officer on 17 February 2012, having previously been the Company's Group CFO/Group COO for over three years. Joining the Company 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 the acquisition of 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 the Company with many years of finance industry experience, both locally and abroad. 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

Independent Non-Executive Director

Experience and 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 Chair 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

Independent Non-Executive Director

Experience and qualifications

Mr Gregg holds a Bachelor of Commerce from the University of NSW. Mr Gregg has held a number of executive roles 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 both the USA and the UK. Mr Gregg was appointed a Director of the Company on 8 October 2012.

Special responsibilities

Mr Gregg is a member of the Nomination Committee and the Remuneration Committee.

Directorships of other listed companies

Mr Gregg is the Chair of Goodman Fielder Limited and a non-executive director of Tabcorp Holdings Limited. Mr Gregg was a director of Austock Group Limited until May 2012.

Jonathan Grunzweig

Independent Non-Executive Director

Experience and qualifications

Mr 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

Independent Non-Executive Director

Experience and 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.

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

Special responsibilities

Mr Hooper is 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.

Brenda M Shanahan

Independent Non-Executive Director

Experience and 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 stockbroking, 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, the Nomination Committee and the Remuneration Committee.

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

Independent Non-Executive Director

Experience and 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. Ms Stephenson was appointed a Director of the Company on 8 October 2012.

Special responsibilities

Ms Stephenson is Chair of the Group Risk and Audit Committee and a member of the Nomination Committee.

Directorships of other listed companies

Ms Stephenson is a non-executive director of Asaleo Care Limited (appointed 30 May 2014).

Leon Zwier

Independent Non-Executive Director

Experience and 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.

3. Principal activities and changes in the state of affairs

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

Life – the Life segment includes Challenger Life Company Limited (CLC). CLC is Australia's leading provider of annuities and guaranteed retirement income products. 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 the major hubs. Being an independent manufacturer, CLC has distribution representation on all major hubs and platforms.

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

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

4. Review of operations

Strong retail sales of annuities and growing funds under management in financial year 2014 have continued to build on the leading retirement income platform that Challenger has developed over the past number of years.

Key performance indicators for the year include:

- Challenger's statutory profit attributable to equity holders of $340.6 million for the year ended 30 June 2014 was down $76.2 million (18.3%) compared to the prior year, reflecting the substantial fair value gains in the comparative period relating to spread contraction in credit markets. The 2014 result also benefited from a contraction in fixed income credit spreads; however, gains were partially offset by transaction costs associated with recent property acquisitions.
- Normalised net profit after tax increased 6.5% to $328.7 million compared to the prior year.
- Normalised earnings per share increased 5.4 cents (9.2%) to 64.0 cents per share and statutory earnings per share decreased 12.9 cents (16.3%) to 66.3 cents compared to the prior year.
- The normalised cost to income ratio was marginally higher at 34.6%, compared to 34.4% for the prior year, reflecting Challenger's scalable business model.
- A final dividend of 13.5 cents per share was announced, franked at 40.0%, resulting in a total 2014 dividend of 26.0 cents, franked at 21.0%, up from 20.0 cents (unfranked).
- Total Life retail sales of $2.8 billion represented growth of 28.4% and Life retail net book growth of $0.9 billion (12.5%) after adjusting for the High Yield Fund Annuity outflow ($0.3 billion).
- Total Funds Management net inflows were $2.1 billion, down from inflows of $7.0 billion in the prior year.
- Total Assets Under Management increased by $6.0 billion to $50.7 billion.
- Challenger's normalised and statutory return on equity after tax for 2014 was 16.1% and 16.7% respectively.

Normalised profit and investment experience

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 where permitted by other accounting standards. This gives rise to fluctuating valuation movements on assets and liabilities being recognised in the profit and loss in CLC and on consolidation in Challenger Limited. CLC is generally a long-term holder of assets, due to holding assets to match the term of life contract liabilities. As a result, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements.

Investment experience represents the difference between actual investment gains/losses (both realised and unrealised) and expected gains/losses based on CLC's medium to long-term expected returns. Investment experience also includes any economic and actuarial assumption changes arising from changes in market conditions.

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

Challenger's normalised profit after tax was $328.7 million for the year ended 30 June 2014, an increase of $20.2 million (6.5%) on the prior year. Normalised profit after tax increased as a result of higher net income (up $36.8 million) and lower borrowing costs (down $0.5 million), partly offset by higher expenses (up $13.7 million), and higher normalised tax (up $3.4 million).

The net income growth of $36.8 million (6.6%) is attributable to:

- higher Life cash operating earnings (up $29.1 million) as a result of growth in Life investment assets;
- higher Funds Management net fee income (up $10.8 million) due to higher Funds Under Management (FUM); partly offset by:
- lower corporate income (down $3.1 million) due to nil current year distributions from Homeloans Limited following the sale of this investment in 2013.

The management view of operating expenses is $205.4 million for the year ended 30 June 2014, increasing $13.7 million on the prior year. The increase in expenses is due to increased employee numbers to support Challenger's growth and higher long-term incentive amortisation costs. In 2014, Challenger's employee numbers increased by 52 (or 11%) to 539, of which 22 relate to the acquisition of Bendzulla Actuarial Pty Limited (Bendzulla). An additional 30 employees were added across distribution, operations and asset origination.

Challenger's business is highly scalable, resulting in Challenger being one of Australia's most efficient financial services companies. Since 2010, total expenses have increased by only 13%, while income has increased by 33%. The scale and operating leverage in Challenger's business has resulted in the cost to income ratio falling by 6% since 2010. Challenger's medium-term normalised cost to income ratio target is a range of 32-36%. The 2014 normalised cost to income ratio was 34.6%, which is relatively unchanged from 2013 (34.4%) and is well within Challenger's targeted range.

Normalised EBIT for 2014 was $387.9 million, up 6.3% from $364.8 million in 2013. Life normalised EBIT increased by $22.3 million and Funds Management normalised EBIT increased by $9.2 million. The increase in both Life and Funds Management normalised EBIT reflects growth in investment assets and FUM in both businesses. Corporate normalised EBIT fell by $8.4 million, due to higher long-term incentive costs and reduced other income.

Normalised tax for the year was $55.1 million, up $3.4 million (6.6%) from 2013 due to higher normalised profit, with the effective tax rate remaining at 14.4% (including the Taxation of Financial Arrangements (TOFA) adjustments). The TOFA adjustment relates to the effect of a private binding tax ruling received from the Australian Taxation Office (ATO) in February 2012 in relation to the application of TOFA. The TOFA private tax ruling reduced normalised tax by approximately $30.0 million for each of the three financial years 2012 to 2014. Normalised tax in 2015 will not benefit from TOFA. Excluding the TOFA tax deduction, the normalised effective tax rate in 2014 was 22.2%.

2014 investment experience after tax was a profit of $11.9 million for the year compared to $99.8 million for 2013. 2013 benefited from a significant contraction in fixed income credit spreads. Fixed income credit spreads also contracted in 2014; however, gains were partially offset by transaction costs associated with recent property acquisitions.

The following tables provide an overview of Challenger's normalised results and reconciliation to statutory profit:

	30 June 2014 $M	30 June 2013 $M	Change %
Management analysis			
Cash earnings	425.7	416.2	2.3
Normalised capital growth	55.6	36.0	54.4
Normalised cash operating earnings	481.3	452.2	6.4
Net fee income	110.2	99.4	10.9
Other income	1.8	4.9	(63.3)
Net income[1]	593.3	556.5	6.6
Operating expenses[1]	(205.4)	(191.7)	7.1
Normalised EBIT	387.9	364.8	6.3
Interest and borrowing costs	(4.1)	(4.6)	(10.9)
Normalised net profit before tax	383.8	360.2	6.6
Tax on normalised net profit[2]	(55.1)	(51.7)	6.6
Normalised net profit after tax	328.7	308.5	6.5
Investment experience after tax	11.9	99.8	(88.1)
Significant items after tax[3]	–	8.5	N/A
Statutory net profit after tax attributable to equity holders	340.6	416.8	(18.3)
Normalised EBIT by division			
Life	404.2	381.9	5.8
Funds Management	43.3	34.1	27.0
Corporate	(59.6)	(51.2)	16.4
Total	387.9	364.8	6.3

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, property expenses and management fees) are netted off against gross revenues and Special Purpose Vehicle revenues, expenses and finance costs are netted and included in net income. These classifications have been made in the Directors' report, and in Note 2 Segment information, 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 profit for the year.

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 normalised tax of circa $30.0 million for each of the three financial years 2012 to 2014.

3 Primarily relates to the sale of Homeloans Limited in the comparative period.

	30 June 2014 $M	30 June 2013 $M
Investment experience		
Actual capital growth[4]		
Cash and fixed income	41.3	154.1
Infrastructure	31.9	16.3
Property (net of debt)	(8.7)	20.3
Equity and other investments	32.4	16.0
Total actual capital growth	96.9	206.7
Normalised capital growth[5]		
Cash and fixed income	(27.8)	(27.6)
Infrastructure	21.1	20.1
Property (net of debt)	38.7	30.9
Equity and other investments	23.6	12.6
Total normalised capital growth	55.6	36.0
Investment experience		
Cash and fixed income	69.1	181.7
Infrastructure	10.8	(3.8)
Property (net of debt)	(47.4)	(10.6)
Equity and other investments	8.8	3.4
	41.3	170.7
Actuarial assumption changes[6]	(23.1)	(32.6)
Investment experience before tax	18.2	138.1
Tax expense	(6.3)	(38.3)
Investment experience after tax	11.9	99.8

[4] Actual capital growth represents net realised and unrealised capital gains or losses and includes the attribution of interest rate, inflation and foreign exchange derivatives that are used to hedge exposures.

[5] 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 capital growth expectations for each asset class over the investment cycle. The normalised growth rate is 6.0% for equity and other investments, 4.0% for infrastructure, 2.0% for property and (0.35%) for cash and fixed income. The rates have been set with reference to medium to long-term market growth rates and are reviewed to ensure consistency with prevailing market experience.

[6] 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 exposures.

Earnings per share (EPS)

As shown in the table below, basic normalised EPS increased by 5.4 cents (9.2%) to 64.0 cents per share compared to 58.6 cents per share for the prior year. The increase in normalised EPS reflects higher normalised profit after tax and a lower average basic share count in 2014. Basic and diluted statutory EPS experienced decreases compared to the prior year, driven primarily by the lower statutory profit.

For the year ended	30 June 2014 cents	30 June 2013 cents	Change %
Basic – normalised	64.0	58.6	9.2
Diluted – normalised	60.6	58.0	4.5
Basic – statutory	66.3	79.2	(16.3)
Diluted – statutory	62.8	78.3	(19.8)

Life financial results

The Life business includes CLC. CLC is Australia's leading provider of annuities and guaranteed retirement income products. CLC has won the Association of Financial Advisers/Plan for Life Annuity Provider of the Year award for the past six years and has won the Income Stream Innovation Award for the past four years. In addition, CLC won the 2014 Association of Financial Advisers/Plan for Life Retirement Income Innovation Award for its work with the University of NSW in establishing retirement income courses for financial advisers.

CLC is an entity regulated by the Australian Prudential Regulation Authority (APRA), and its financial strength is rated by Standard & Poor's with an 'A' rating and stable outlook.

The Life business also includes Bendzulla, the leading provider in Self-Managed Superannuation Fund (SMSF) actuarial certificates, which was acquired for $25.0 million in February 2014.

CLC is diversifying its capital and earnings base by participating in wholesale reinsurance longevity and mortality reinsurance transactions. The Life team is experienced in managing, pricing and reinsuring longevity risk. Undertaking wholesale longevity and mortality reinsurance transactions is a natural business extension for Life.

The Life segment's normalised EBIT increased by $22.3 million to $404.2 million in 2014, due to higher normalised cash operating earnings (COE) (increased $29.1 million), partly offset by higher expenses (which increased by $6.8 million).

2014 normalised COE increased by 6.4% to $481.3 million. The increase in normalised COE is a result of higher investment assets, with 2014 average investment assets increasing by 6.3%. The 2014 COE margin was 4.5%, which is unchanged from 2013.

Life retail annuity sales for the year were $2.8 billion, representing a 28.4% increase on the prior year. Retail annuity sales in 2014 were a record result for Challenger, with sales continuing to benefit from favourable macroeconomic trends, including an ageing population and retirees taking a more conservative approach to investing in retirement. These favourable macroeconomic trends are being leveraged by Challenger's product innovation and extensive distribution footprint.

Retail annuity sales are benefiting from consistently high reinvestment rates, with around 80% of 2014 maturities (with a residual capital value of 50% or more) reinvested into a new Challenger annuity. Retail annuity net flows (i.e. annuity sales less capital payments) were $0.9 billion[1], up from $0.6 billion in the prior year. Lifetime annuity sales (Liquid Lifetime and Care Annuity) continue to grow strongly and were $613.3 million in 2014, up from $256.9 million in 2013. Lifetime annuity sales represented 21.9% of total 2014 retail annuity sales, up from 11.8% in 2013 and only 2.3% in 2012. Based on the closing 2013 Life retail annuity book, the retail annuity net book growth in 2014 was 12.5%[1], up from 9.1% in the prior year.

Institutional sales represent Challenger's Guaranteed Index Return (GIR) product (disclosed in the External unit holders' liabilities). Sales were $0.6 billion in 2014 and mainly represent the reinvestment of GIR maturities.

Life's closing 2014 investment assets under management (AUM) were $11.1 billion, up 3% ($0.3 billion) on 2013. The increase in investment assets is due to Life cash earnings (net of dividends to Group), retail annuity net flows, partially offset by the maturity of the High Yield Fund annuity and net maturities associated with the institutional GIR product.

Funds Management financial results

Challenger's Funds Management segment is Australia's seventh[2] largest investment manager and one of Australia's fastest growing. Over three years, FUM has doubled, driven by a clear business strategy, which is focused on investor alignment.

Fidante Partners' multi-boutique platform comprises 15 separately branded investment management businesses. The model aligns the interests of investors, boutique investment managers and Fidante Partners. The Fidante Partners model is delivering superior investment performance, with 95% of all funds and mandates outperforming their benchmark since inception. On a one-year basis, 92% of funds and mandates have outperformed their benchmark.

The Fidante Partners platform continues to attract talent, adding five new boutique investment managers to the platform in 2014. The new boutiques include international equities managers River and Mercantile, Tempo Asset Management, fixed income specialist Wyetree Asset Management, Australian equity manager Areté Investment Partners and global infrastructure manager Whitehelm Capital, which was formed on 1 July 2014. In 2014, it was announced that one of the Fidante Partners boutiques, Five Oceans Asset Management, would close.

During 2014, Aligned Investments was rebranded Challenger Investment Partners. Challenger Investment Partners manages a range of assets under the Challenger brand for CLC and third party institutional investors.

Following the formation of Whitehelm Capital, Challenger Investment Partners became a dedicated property and fixed income manager.

[1] Excluding the maturity of the High Yield Fund annuity ($0.3 billion).

[2] Consolidated FUM for Australian fund managers – Rainmaker Roundup March 2014.

Funds Management EBIT increased by $9.2 million (27.0%) to $43.3 million in 2014. The increase in EBIT reflects 10.9% higher net fee income (up $10.8 million), partially offset by higher expenses (up $1.6 million or 2.5%). 2014 Funds Management return on equity (RoE) was 32.8%, up six percentage points for the year. RoE is benefiting from strong FUM growth and capturing the benefits of scale.

Net fee income increased by $10.8 million (10.9%) due to higher Fidante Partners net income (up $17.0 million), partially offset by lower Challenger Investment Partners fee income (down $6.2 million). Fidante Partners net fee income includes distribution fees, administration fees and a share in the equity accounted profits of most boutique investment managers. Fidante Partners net income also includes performance fees earned by the boutiques. Challenger Investment Partners net income decreased due to both lower net performance and transaction fees (down $4.7 million) and lower management fees (down $1.5 million).

Total FUM at 30 June 2014 was $47.1 billion, up 14.6% for the year. Fidante Partners 2014 FUM was $35.9 billion, up $6.1 billion or 20.5% for the year. FUM growth was driven by strong net inflows and positive market movements. Fidante Partners 2014 net inflows were $2.4 billion, with net flows benefiting from the boutique investment managers' strong investment performance and Challenger's extensive distribution capability. Challenger Investment Partners 2014 FUM was $11.2 billion at 30 June 2014, which was down $0.1 billion or 0.9% for the year. The reduction in FUM is a result of the run-off of the Howard Mortgage Fund and reduction in CLC fixed income, partially offset by new institutional mandates in property.

Corporate financial results

The Corporate division comprises central functions such as 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.

Corporate's normalised loss was $63.7 million in 2014, compared to a loss of $55.8 million in 2013. The increase was due to lower net income (down $3.1 million) and higher expenses (up $5.3 million).

Capital management

Challenger's capital position is managed at both the Group and the prudentially regulated 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. Refer to Note 24 Contributed equity in the financial report for further information on the Group's Internal Capital Adequacy Assessment Process (Group ICAAP) and CLC's Internal Capital Adequacy Assessment Process (CLC ICAAP).

Group net assets attributable to equity holders at 30 June 2014 were $2.2 billion, up from $1.9 billion at 30 June 2013. The movement in Group net assets is predominantly due to statutory net profit after tax, partially offset by dividends to shareholders, reserve movements and Challenger Performance Plan (CPP) Trust movements.

At 30 June 2014, there was $141.2 million of available Group cash held outside of CLC (30 June 2013: $177.1 million), and the Group corporate debt facility of $350.0 million remained undrawn (30 June 2013: undrawn facility of $250.0 million), providing additional financial flexibility.

Dividend and share buy-back policy

Challenger has historically targeted a combined dividend and buy-back payout ratio of approximately 50% of normalised profit after tax over the medium term, subject to prevailing market conditions and alternate uses of capital.

The Challenger Board regularly reviews the mix between dividends and share buy-back as part of the Group's capital management plan. In August 2013, the Board increased the targeted dividend payout ratio by five percentage points to a range of 35-40% of normalised net profit after tax. In February 2014, the Board increased the targeted dividend payout ratio again by a further five percentage points (to a range of 40-45%).

No share buy-backs were undertaken during the year.

Refer to Section 5 for further details on the future dividend and share buy-back policy.

CLC regulatory capital base

CLC holds capital in order to ensure that, under a range of adverse scenarios, it can continue to meet its regulatory and contractual obligations to its customers. CLC is regulated by APRA and is required to hold a minimum level of regulatory capital.

CLC's regulatory capital base and prescribed capital amount (PCA) have been calculated based on regulatory capital standards issued by APRA. APRA issued new capital standards in October 2012, the Life and General Insurance Capital (LAGIC) standards, which became effective from 1 January 2013. CLC's regulatory capital disclosures have been prepared based on the LAGIC capital standards.

CLC's excess capital above the PCA at 30 June 2014 was $902.6 million, up $5.2 million for the year. CLC's PCA ratio at 30 June 2014 was 1.66 times and the common equity Tier 1 (CET1) ratio was 1.31 times.

The introduction of the LAGIC standards increased CLC's regulatory capital requirements by $322.8 million on 1 January 2013. APRA has provided a three-year transition period to meet these new requirements. Therefore, CLC's 30 June 2014 excess capital position includes a LAGIC transition balance of $215.2 million (30 June 2013 includes $322.8 million). A further $107.6 million of the remaining LAGIC transition balance will amortise on 1 January 2015 and 1 January 2016.

Subordinated debt

CLC's total regulatory capital base includes $476.8 million of admissible subordinated debt. Subordinated debt tranches issued prior to 1 January 2013 will continue to be fully eligible as Tier 2 regulatory capital under LAGIC until each tranche's first call date after 1 January 2013, and will then amortise over four years. For tranches already past their call date, under LAGIC the first coupon date is considered the first call date.

CLC's subordinated debt includes $129.4 million which had a call date on 7 June 2013. As a result, under APRA's transition arrangements, only $77.6 million (i.e. 60% of the total amount) is eligible as Tier 2 regulatory capital at 30 June 2014.

The largest tranche of CLC's existing subordinated debt is a $371.7 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.

CLC target surplus

CLC maintains a target level of capital representing APRA's PCA plus a target surplus. The target surplus is a level of excess capital that CLC seeks to carry over and above APRA's minimum requirement.

CLC's target surplus is set to ensure that it provides a buffer against adverse market conditions having regard to CLC's credit rating. CLC uses internal capital models to determine its target surplus, which are risk-based and are responsive to changes in CLC's asset allocation and market conditions.

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 to 1.6 times. This range can change over time and is dependent on numerous factors. CLC's PCA ratio is currently higher than this range of 1.4 to 1.6 times, as CLC's capital position contemplates the amortisation of the LAGIC transition balance over the next 18 months.

The PCA ratio at 30 June 2014 was 1.66 times, down from 1.78 times at 30 June 2013, reflecting amortisation of the first transition balance ($107.6 million on 1 January 2014), changes in asset allocation, net AUM growth and retained earnings. Excluding the full LAGIC transition balance ($215.2 million), CLC's PCA ratio at 30 June 2014 was 1.44 times (2013: 1.39 times).

CLC excess regulatory capital and Group cash

In addition to CLC's excess regulatory capital, Challenger maintains cash at a Group level which can be used to meet regulatory requirements. Group cash at 30 June 2014 was $141.2 million, down $35.9 million from 30 June 2013. Challenger has an undrawn Group corporate debt facility of $350.0 million (up from $250.0 million in 2013), which is maintained to provide additional financial flexibility. The facility was undrawn throughout the year.

CLC's excess regulatory capital plus Group cash at 30 June 2014 was $1,043.8 million, down $30.7 million from $1,074.5 million at 30 June 2013. The reduction in the excess capital and Group cash included amortisation of the first tranche ($107.6 million) of the LAGIC transition balance on 1 January 2014.

APRA's Level 3 (conglomerate) proposals

The Group is a Level 3 Head under the APRA conglomerates framework. 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. APRA is currently developing a supervisory framework for Level 3 (conglomerate) groups, which was due to be effective from 1 January 2015. Draft Level 3 standards were issued by APRA in May 2013. However, APRA is yet to confirm the implementation date. In August 2014, APRA deferred a decision on its final standards and implementation until the Government response to the recommendations of the Financial System Inquiry has been announced.

Credit ratings

Challenger Limited and CLC are rated by Standard & Poor's (S&P). In November 2013, S&P affirmed both CLC and Challenger Limited's ratings under S&P's 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, positive earnings and robust capital position.

5. Dividends and share buy-back

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 of $55.0 million (unfranked) was paid on 27 September 2013.

On 17 February 2014, the Directors of the Company declared an interim unfranked dividend on ordinary shares of 12.5 cents per share in respect of the half year ended 31 December 2013, representing a 32% increase on the 2013 interim dividend (31 December 2012: 9.5 cents per share unfranked). The interim dividend of $65.3 million, unfranked, was paid on 28 March 2014.

On 19 August 2014, the Directors of the Company declared a final dividend on ordinary shares in respect of the year ended 30 June 2014 of 13.5 cents per share (franked at 40%). The final dividend is payable on 30 September 2014, and has not been provided for in the 30 June 2014 financial report.

The final dividend brings the total dividend for the 2014 financial year to 26.0 cents per share, 21% franked (2013: 20.0 cents per share unfranked), an increase of 30% on the prior year.

The increase in dividends reflects both higher normalised profit after tax (up 6.5%) and a higher dividend payout ratio. The normalised dividend payout ratio for 2014 was 40.6%, up 6.5% from 2013.

Challenger has recommenced dividend franking for the final 2014 dividend. Dividend franking levels are expected to increase as additional franking credits are generated. Challenger's franking account balance at 30 June 2014 was $24.2 million.

Based on current projections, the interim 2015 dividend is expected to be approximately 70% franked and the final 2015 dividend 100% franked. Dividend franking is, however, subject to market conditions and resultant capital gains or losses that may restrict available credits.

There is no dividend reinvestment plan in operation for the final 2014 dividend.

Dividend and share buy-back policy

Challenger has historically targeted a combined dividend and buy-back payout ratio of approximately 50% of normalised profit after tax over the medium term, subject to prevailing market conditions and alternate uses of capital.

The Challenger Board regularly reviews the mix between dividends and share buy-back as part of the Group's capital management plan. In August 2013, the Board increased the targeted dividend payout ratio, increasing it by five percentage points to a range of 35-40% of normalised net profit after tax. In February 2014, the Board increased the targeted dividend payout ratio again by a further five percentage points (to a range of 40-45%).

Challenger initiated its buy-back program in 2008 and has bought back 150 million shares (approximately $500 million), which has enhanced growth in earnings per share. During 2014, no shares were bought back; instead, capital ($25.0 million) was allocated to the acquisition of Bendzulla.

With the forecast increase in dividend franking levels, the Board has determined that the dividend payout ratio will increase again in 2015, to a range of 45-50% of normalised net profit after tax. The actual dividend payout ratio will depend on prevailing market conditions and capital allocation priorities. As a result, no share buy-backs are anticipated in 2015.

6. Likely developments and expected results

Challenger intends to continue with its current strategy of providing Australians with financial security in retirement. To continue 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 be an active investment manager providing superior returns from aligned platforms.

Life segment outlook

Challenger's Life business has been growing strongly. The growth is supported by favourable macroeconomic trends, including more baby boomers (those born between 1943 and 1960) retiring each year and retirees becoming more risk averse as they spend longer in retirement.

The Australian retirement income market is expected to grow strongly over the next 20 years as baby boomers move from the retirement 'savings' to the retirement 'spending' phase. Over this period, the number of Australians over 65, which is Life's target demographic, is expected to increase by 75%.

Life is well positioned to benefit from changes in retiree risk preferences. Many retirees are risk averse and demanding long-term protection from the risks they face in retirement, including longevity, inflation and market risks. Annuities address these concerns. As a result, Challenger is experiencing an increase in demand for its products, particularly longer-dated lifetime annuities.

Life is leveraging this demand through:

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

Funds Management segment outlook

The Australian funds management market remains an attractive market, underpinned by compulsory superannuation contributions. Contributions increased to 9.5% of gross salaries on 1 July 2014 and are scheduled to increase to 12.0% by 2021. The mandated nature of Australia's superannuation system is expected to significantly grow the size of Australia's superannuation assets, forecast to grow from $1.8 trillion today to over $7.0 trillion[1] over the next 20 years.

Fidante Partners continues to attract new investment manager talent and added five new managers during 2014. The platform has 15 managers across Australian equities, international equities, fixed income and infrastructure. In addition to adding new managers, additional capacity has been added during 2014 to existing managers. This capacity should underwrite future Funds Management growth.

Challenger Investment Partners continues to build out its client base and product offering. Challenger Investment Partners remains focused on growing its third party fiduciary business, and there are significant opportunities to add new mandates from domestic and international institutions, superannuation funds and sovereign wealth funds.

The Funds Management business is well positioned to benefit from Australia's superannuation system. The platform has multiple brands and strategies, and significant manager capacity. Coupled with our distribution capability, strong support of the business by asset consultants, and investment performance track record, Funds Management is well positioned to continue growing strongly.

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.

Guidance for 2015

Retail annuity net book growth

Retail annuity net book growth is targeted to grow by a range of between 12% and 14%. Based on the 2014 Life retail annuity book ($7.8 billion), this equates to growth in 2015 of between circa $0.9 billion and circa $1.1 billion.

Life cash operating earnings

2015 Life COE guidance is a range of $535.0 million to $545.0 million and includes the impact of both the Bendzulla acquisition and the Life Risk reinsurance transactions undertaken, as well as the capital management initiatives approved on 19 August 2014 (refer to Section 7 below).

Based on the mid-point of both retail net book growth and COE guidance, the implied 2015 COE margin is expected to be circa 4.4%.

Normalised cost to income ratio

Challenger's medium-term normalised cost to income ratio target is a range of 32-36%.

Challenger's 2015 cost to income ratio is expected to be around 34%, broadly unchanged from 2014. An increase in total expenses is expected in 2015 due to costs associated with supporting the growth in Challenger's business.

[1] Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2013–2033 – September 2013.

7. Significant events after the balance date

Challenger Life is growing strongly and expects to continue to increase the size of its retail annuity business. In order to support Challenger's growth profile, the following capital management initiatives have been approved by the Challenger Limited Board on 19 August 2014:

- equity placement of Challenger ordinary shares to institutional holders, raising $250 million;
- a Share Purchase Plan (SPP), allowing retail investors to participate and expected to raise $30 million; and
- the intention to launch Challenger Capital Notes (Notes) aiming to raise $250 million[1]. The Notes will be issued by Challenger Limited with the proceeds used for Additional Tier 1 equity issued by Challenger Life Company Limited (CLC).

The equity placement is underwritten, but the SPP and Challenger Capital Notes will not be underwritten.

The majority of the proceeds from the equity placement and the SPP are planned to be injected into CLC as Common Equity Tier 1 capital. The capital initiatives will support new business growth, and Challenger will continue to target RoE of 18% pre-tax.

Following these capital initiatives, CLC's regulatory capital position will be materially strengthened. On a pro forma basis at 30 June 2014, CLC's PCA ratio would increase to 2.1 times[2] including the LAGIC transition balance, or 1.8 times[2] excluding it.

At the date of this report and other than as disclosed above 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, or criminal or dishonest behaviour.

To facilitate the indemnification, 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 therefore 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 2001 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 Commonwealth, State and offshore legislation. The Directors are satisfied that adequate systems are in place for the management of the Company's 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.

[1] Subordinated, unsecured convertible notes issued by Challenger Limited (in Australia) with proceeds used for Additional Tier 1 capital issued by CLC. Targeting $250 million with ability to raise more or less, subject to market conditions.

[2] CLC pro forma PCA ratio assumes an increase in Tier 1 capital ($250 million), Share Purchase Plan ($30 million) and Challenger Capital Notes ($250 million).

10. Remuneration report

Letter from the Chairman

Dear Shareholders,

On behalf of your Board, I am pleased to present Challenger's 2014 Remuneration Report.

Our underlying 2014 business performance remained strong with all key metrics being achieved. Since 2010, Challenger's differentiated business and strategy has delivered 41% growth in earnings per share, which is significantly greater than that achieved by other Australian financial services companies.

In 2014, the market recognised Challenger's growth profile and strong business performance, resulting in Challenger being the best performing ASX 100 company over the year. Coupled with increasing dividends, shareholders enjoyed a total shareholder return of 91% for the year, compared to an average return of 18% for the ASX 100. On a five year basis, Challenger's total shareholder return has been 272%, compared to the ASX 100 average of 74%. This performance recognises the successful execution of our strategy which has delivered and continues to deliver for our shareholders.

As the business has evolved from a transactional model to one generating recurring and growing revenue streams, our remuneration practices have also evolved to reflect this. Your Board takes a proactive approach to setting our remuneration strategy and continually strives to ensure that the right balance is achieved between shareholders and employees. While your Board remains vigilant in this regard, I believe that an equitable balance has been maintained between shareholders and employees as evidenced by the sustained long-term returns we have delivered for you, our shareholders.

Your Board continues to regularly engage with shareholders and external stakeholders when formulating our remuneration strategy. In 2014, we extended our engagement program to include additional institutional shareholders and we continued to meet with retail shareholder representatives and institutional proxy advisory firms. External feedback continues to provide a strong level of support for our remuneration practices.

Notwithstanding this support, your Board will continue to review our remuneration approach. During the year, we assessed the appropriateness of the current absolute Total Shareholder Return (TSR) performance measure and considered adding an additional performance measure. However, your Board determined that while the absolute TSR measure is challenging, particularly in a low interest rate environment, it remains the most appropriate way to incentivise management and align their interests with shareholders.

To further enhance alignment between shareholders and employees, your Board has decided on the following amendments to Challenger's remuneration approach during 2014:

- The use of a funding range for determining the annual Short-Term Incentive (STI) pool has been extended to include Long-Term Incentives (LTI), with a target combined range of 10-15% of Net Profit Before Variable Reward and Tax (NPBVRT) (see page 48).
- A portion of 2014 STI awards for Key Management Personnel to be deferred for three years (see page 57).
- The minimum LTI vesting period was extended from two years to three years (see page 54).
- The minimum shareholding requirements for Key Management Personnel and Non-Executive Directors were updated, with a material increase to the minimum requirement for the Managing Director and CEO and Chair (see page 55).

Your Board is confident that Challenger's remuneration framework and principles remain appropriate and 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 continue to respond quickly to developments as they emerge.

Thank you for taking the time to review the 2014 Remuneration Report.

Yours sincerely

Peter Polson
Chairman

10.1 Performance and remuneration snapshot

Performance outcomes

Since 2010, Challenger has increased both Normalised Net Profit After Tax (NPAT) and Normalised Earnings Per Share (EPS) by 41%, with this sustained strong business performance translating into increased dividends to shareholders by 79% over the period.

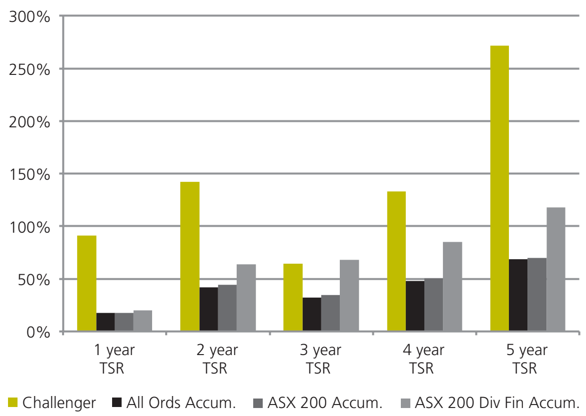
Our performance against key financial metrics and comparison to peer shareholder returns is summarised in the tables and graphs below:

Year ended 30 June	2010	2011	2012	2013	2014
Normalised NPAT ($M)	232.5	248.0	296.8	308.5	328.7
Normalised EPS (cents)	45.5	51.7	57.5	58.6	64.0
Closing share price ($)	3.52	4.89	3.25	4.01	7.44
Dividends per share (cents)	14.5	16.5	18.0	20.0	26.0

Total Shareholder Return (TSR)

Source: IRESS and Bloomberg

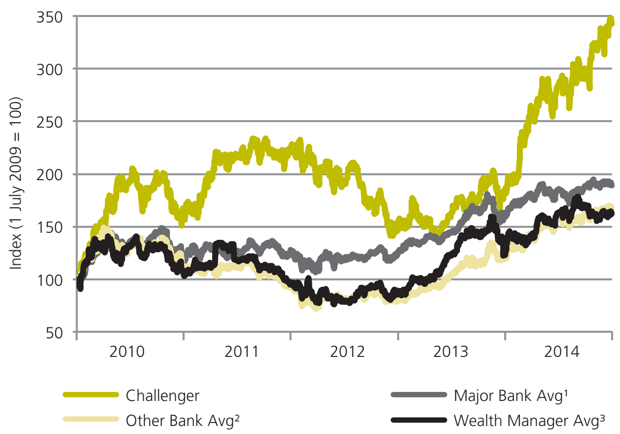
- **Challenger's TSR has increased by 272% since 2010 and outperformed market benchmarks over many timeframes.**



Challenger share price performance versus other Australian financial companies

Source: Bloomberg and company data

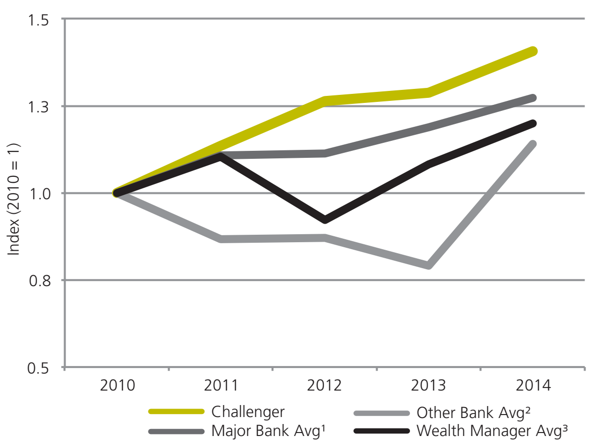
- **Challenger's share price has outperformed many Australian financial companies over the past five years.**



Normalised EPS versus other Australian financial companies

Source: Bloomberg and company data

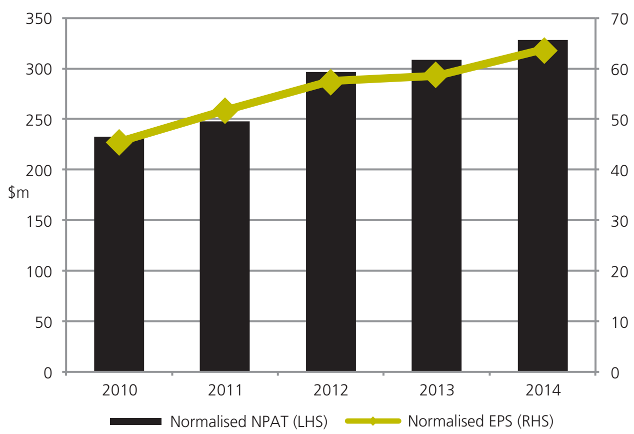
- **Challenger's Normalised EPS has increased by 41% since 2010, outperforming many Australian financial companies.**



Normalised NPAT and Normalised EPS

Source: Company data

- **Normalised NPAT and EPS have increased by 41% since 2010.**

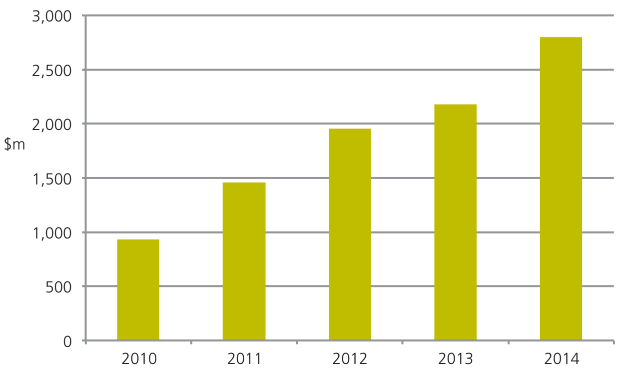


[1] Major Bank Avg – Cash EPS (ANZ, CBA, NAB, WBC)
[2] Other Bank Avg – Cash EPS (BEN, BOQ, MQG, SUN)
[3] Wealth Manager Avg – Normalised EPS (AMP, IOOF, PPT)

Life – Retail annuity sales

Source: Company data

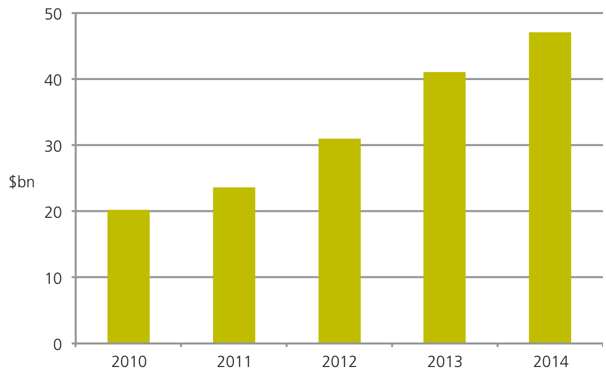
- **Retail annuity sales have increased by 200% since 2010.**



Funds Management – Funds Under Management (FUM)

Source: Company data

- **FM FUM has grown significantly, increasing by 133% since 2010.**



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 shareholder value and takes account of risk.

Changes in remuneration approach in 2014

The Board continues to review Challenger's approach to remuneration both for good governance and to ensure an appropriate level of shareholder alignment. To further enhance alignment between shareholders and employees, your Board has decided on the following amendments to Challenger's remuneration approach during 2014:

Area	Challenger approach	Further details (page)
Total variable remuneration pool	Increased transparency by extending the use of a funding range for determining the annual STI pool to include LTI. Targeted pool of between 10% and 15% of Net Profit Before Variable Reward and Tax (NPBVRT).	48
LTI vesting period	Minimum LTI vesting period extended from two years to three years for awards granted from September 2014.	54
Minimum shareholding requirements	Minimum shareholding requirements for Key Management Personnel and Non-Executive Directors reviewed and updated with material increase in minimum requirement for CEO and Chair.	55
STI deferral	A portion of 2014 STI awards for key employees were deferred for three years to further support shareholder alignment.	57

Remuneration components

Key components of Challenger's remuneration structure for Key Management Personnel (KMP) remain unchanged, with 2014 remuneration outcomes determined using the same remuneration principles as applied in recent years.

Remuneration components comprise fixed and variable remuneration which includes Short-Term Incentive (STI) and Long-Term Incentive (LTI) awards as summarised in the table below:

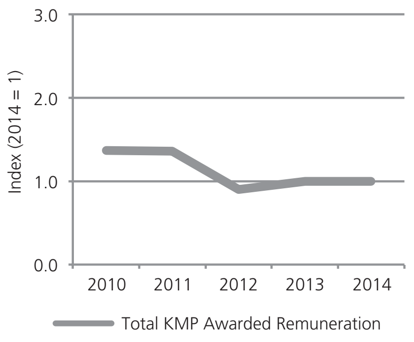
	Component	Overview	Link to strategy
Fixed	Fixed remuneration	Base salary, salary-sacrificed benefits and applicable fringe benefits tax. Employer superannuation contributions.	Positioned at a market competitive level reflecting the size and complexity of role, responsibilities, experience and skills.
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) with vesting in equal tranches over two years. In addition, the Board determined that a portion of 2014 STI awards for all KMP would be deferred for three years. Subject to forfeiture and clawback provisions under the Challenger Performance Plan (CPP). See page 55 for further information.	Clearly links remuneration outcomes with performance and contribution against annual Key Performance Indicators (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 two thirds of the award is eligible to commence vesting on the third anniversary and one third on the fourth anniversary following grant, subject to continued employment and satisfying the absolute TSR performance targets. Any unvested awards will lapse at the end of the fifth anniversary following grant. Subject to forfeiture and clawback provisions under the CPP. See page 55 for further information.	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.

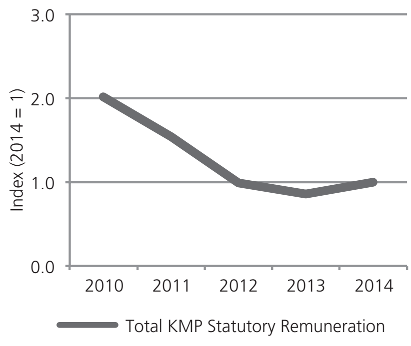
Remuneration outcomes

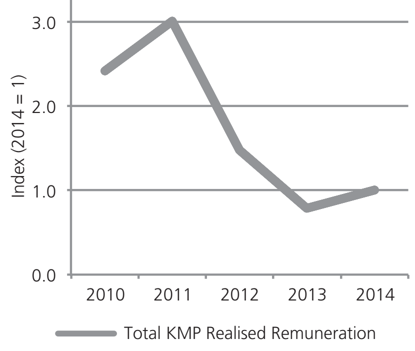
To help provide clarity and transparency on the quantum of KMP remuneration, Challenger discloses three remuneration tables (awarded, statutory and realised) as provided in Section 10.6 2014 remuneration tables. The Board considers awarded remuneration to be the most relevant disclosure. In summary:

	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 value of realised deferred STI and LTI is calculated with reference to the share price at the time of vesting.

The following charts summarise movements in total KMP remuneration from 2010 to 2014. The charts are based on the data contained in the corresponding remuneration tables in Section 10.6 2014 remuneration tables.





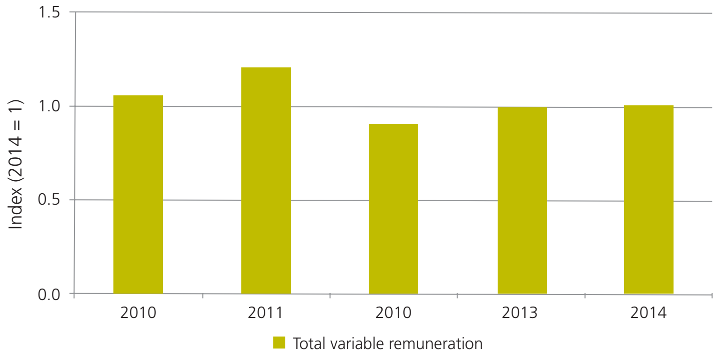


Fixed remuneration

Fixed remuneration increases for KMP have been minimal for a number of years, reflecting our focus on performance-based variable remuneration.

Total variable remuneration

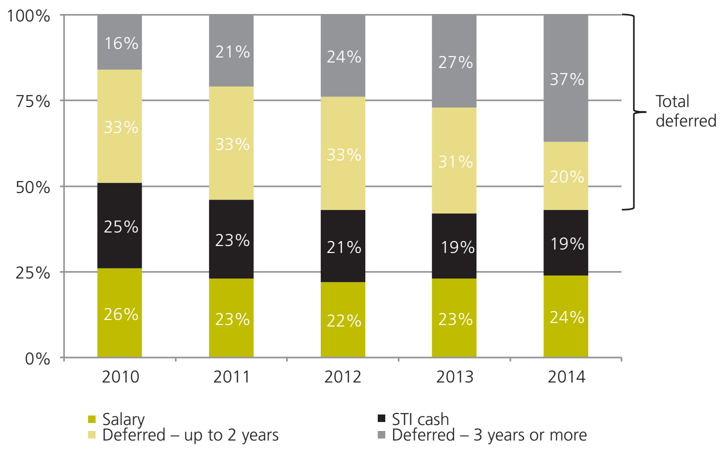
Total variable remuneration (being the awards of STI and LTI) allocated to KMP over the past five years is outlined in the following chart:



The terms and conditions of STI awards and LTI awards (in the form of HPSRs) are consistent with the information contained in Section 10.4 Key Management Personnel remuneration arrangements.

Total remuneration

The mix of remuneration allocated to KMP over the past five years is outlined in the following chart:



For 2014, a greater proportion (37%) of awarded remuneration was deferred for three years or more as a result of increasing the minimum LTI vesting period from two to three years, and deferring a portion of STI for three years.

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 and implementation examples

Market-competitive	Performance-based and equitable	Aligned with shareholders and takes account of risk
• 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.	• 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 across a range of employee segments, including gender.	• 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 Challenger key bodies. Detailed information concerning the scope of the Board and Remuneration Committee's responsibilities and its controlled entities can be found under the corporate governance section of Challenger's website.

Board	• 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 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	• The Board convenes a Remuneration Committee comprising at least three independent directors to assist the Board to discharge its responsibilities. • The Remuneration Committee meets at least five times during the year, with additional meetings scheduled as required. For the year ended 30 June 2014, six meetings were held. • The Remuneration Committee determines and recommends to the Board various principles and policies (including remuneration, recruitment, retention, termination and diversity), Managing Director and CEO and KMP remuneration, incentives, superannuation and life insurance arrangements and the Directors' remuneration framework.
Independent remuneration advisers	• The Board, independent of management, appoints an adviser to the Remuneration Committee. • During 2014, 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-related advice and that such advice is free from undue influence. • For 2014, KPMG made recommendations with respect to KMP remuneration arrangements. Fees paid or payable to KPMG in respect of these activities was $51,810 (inclusive of GST). KPMG further provided internal audit, tax, accounting, actuarial and transaction services and general remuneration factual information in 2014. Fees paid or payable to KPMG in respect of these activities was $619,850 (inclusive of GST). • Mercer was appointed during 2014 to independently test LTI vesting outcomes.

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 2001 and, in respect of CLC and Challenger Retirement and Investment Services Limited, the principles contained in the Australian Prudential Regulation Authority Prudential Governance 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.

During the year, the Risk and Audit Committee provides reports to the Remuneration Committee and Board summarising any breaches of the Risk Management Framework or other compliance policies. The Remuneration Committee and Board consider these reports when finalising remuneration pools and individual allocations.

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 STI and LTI awards.

Variable remuneration governance

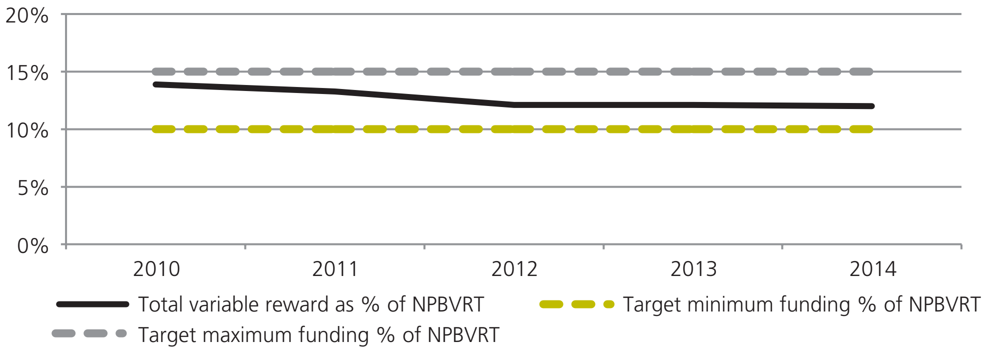
To ensure a consistent and transparent approach to remuneration, in 2014 we extended our current methodology for determining our STI pool to include LTI awards, so that together they constitute total variable remuneration, and a maximum variable remuneration pool (relative to normalised net profit before tax) is set.

In setting the variable remuneration pool, the Board will target a funding range of between 10-15% of Normalised Net Profit Before Variable Reward and Tax (NPBVRT). Combined STI and LTI awards from 2010 through 2014 are shown in the graph below. While working within the targeted range, the Board considers several financial and non-financial factors when determining the size of the pool.

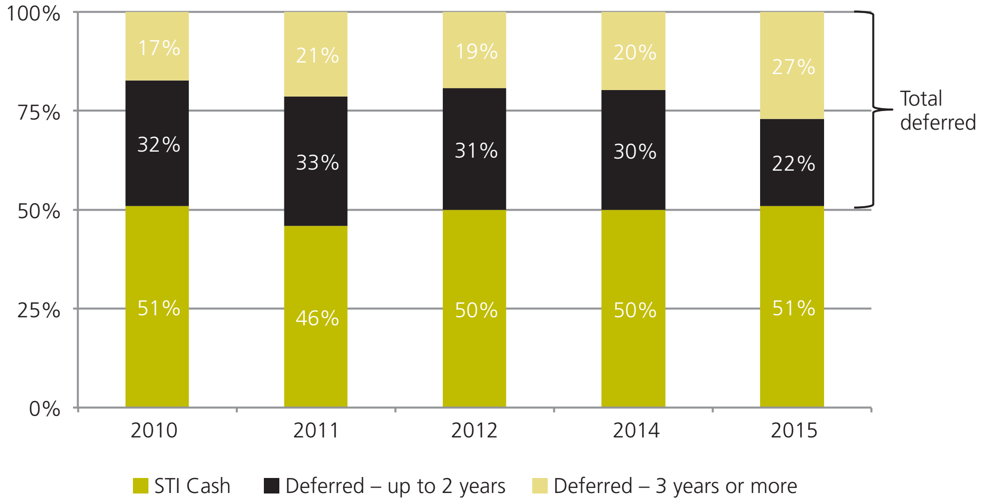
Examples of factors that the Board considers include overall business results, external remuneration levels and movements, capacity to pay, progress on short and long-term strategic objectives, the cost and amount of capital employed, factors beyond management's control, quantum and quality of financial results and management of risk.

For 2014, the Board approved a variable remuneration pool of 12.0% of NPBVRT (12.1% in 2013). The Board considers that the 2014 variable remuneration pool reflects a reasonable and equitable distribution between shareholders and employees and provides a clear line of sight to, and a strong relationship between, performance and remuneration outcomes.

Total variable remuneration pool



The Board retains discretion to determine the proportion of the variable remuneration pool which is allocated to cash and deferred. The graph below details the proportion of cash and deferred allocated since 2010:



For 2014, a greater proportion (27%) of variable remuneration was deferred for three years or more, consistent with the increasing deferral term for KMP. This is as a result of increasing the minimum LTI vesting period from two to three years, and deferring a proportion of STI for three years.

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 2014 are detailed in the table below:

Name	Role	Term as KMP in 2014
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 against the external market, in particular for KMP to roles with comparable financial services, banking, insurance and capital markets skills.

Annually the Board approves the peer groups to be used when benchmarking KMP remuneration. In 2014, the Board approved the following peer groups to be used when benchmarking KMP remuneration, 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 exist 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 to 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 2014, the Board considered remuneration benchmark data for the above peer groups as a key input when determining 2014 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 2014. Remuneration components comprise fixed and variable remuneration, which includes 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.

Variable remuneration

Variable remuneration consists of both annual 'at risk' (STI) and long-term 'at risk' (LTI) remuneration.

Short-Term Incentive

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 performance.

The Board considers that formulaic and targeted incentive arrangements may lead to unintended outcomes. As such, the application of target and maximum STI awards at the individual employee level are not supported at Challenger. STI award limits are provided through strong governance of aggregate STI spend, which is set, in conjunction with LTI, relative to annual normalised profit.

KMP STI awards are determined primarily based on annual contribution and market pay benchmarks. The Board sets objectives for each KMP on the basis of a balanced scorecard, including financial, growth, risk and compliance, customer and stakeholder, and people and sustainability. Annual contribution is assessed based on achievement against these objectives as well as behaviours which support the Challenger Principles.

For 2014, objectives were set and agreed with KMP in July 2013. In July 2014, the Board assessed the performance of each KMP against their balanced scorecard. In August 2014, the Board determined individual STI awards for KMP as outlined in Section 10.6 2014 remuneration tables.

KMP and employees have no contractual right to receive an STI award, and the Board retains discretion to amend or withdraw the STI at any point.

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 2014, 38% of aggregate STI awards for KMP were deferred over two years and 24% over three years. Please refer to Section 10.6 2014 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 nil consideration subject to continued employment at the time of vesting. DPSRs do not provide an entitlement to vote or a right to dividends.

The fair value of DPSRs is used to determine the number of units issued per dollar of STI.

Forfeiture and clawback

Deferred STI awards are subject to forfeiture and clawback provisions under the CPP. Refer to Section 10.5 Other remuneration arrangements for further information.

2014 balanced scorecard outcomes

For 2014, the Board considered the following performance measures and associated targets to be critical indicators of Challenger's performance and drivers of shareholder value. Performance outcomes for these measures are reflected in KMP remuneration outcomes:

Objective	Performance measure	Measurement approach	Actual outcome
Financial	Normalised NPAT	Delivery against budget	$328.7 million – exceeded target.
	Normalised EPS	Delivery against budget	64.0 cents per share – exceeded target.
	Normalised Return on Equity (ROE)	Delivery against hurdle	18.8% – exceeded target.
Growth	Implementation of key growth initiatives	Growth in Life retail annuity sales and net book Continue successful diversification into new product areas Growth in FUM and Funds Management fiduciary capability	Growth in Life retail annuity sales of 28% ($2,799 million in 2014; $2,179 million in 2013). Life retail annuity net book growth of 12.5%. Significant growth in sales from lifetime annuity products ($613 million in 2014; $257 million in 2013). Executed four life risk (longevity and mortality) transactions, generating future profit margins of $105 million. Growth in Funds Management FUM of 15% ($47.1 billion in 2014; $41.1 billion in 2013). Five new managers added to the Fidante platform and circa $40 billion of capacity added to existing managers.

Objective	Performance measure	Measurement approach	Actual outcome
Risk and Compliance	Effective risk management and compliance	Board assessment of compliance with Risk Appetite Statement	Compliance with Board Risk Appetite Statement for 2014 included the following: • Adherence to Internal Capital Adequacy Assessment Process (ICAAP). • 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. Challenger's normalised profit framework assumes a negative 35 basis points (–0.35%), representing an allowance for credit defaults. Credit defaults in 2014 were lower than this assumed rate.
Customer	Increase brand awareness and value	Implementation and success of new brand campaign 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. In 2014, 89% of advisers surveyed recognised Challenger as the leader in retirement income, up from 64% in 2010. Challenger's new consumer brand campaign was launched in September 2013 and has delivered the following results: • Brand awareness increased from 47% to 62%. • Of those who recall the campaign, 56% are now likely to consider annuities, up 27 percentage points. • Brand attribution increased to 56%, up 47 percentage points. • Advertising awareness increased by 11 percentage points. • Product consideration increased by 14 percentage points. The brand campaign was the winner of the 2014 Money Management Advertising Campaign of the Year and Financial Standard MAX Consumer Advertising Campaign of the Year awards. The 2014 Wealth Insights Service Level Report ranked Challenger as follows: • Overall adviser satisfaction – equal first. • Business Development Manager support – first. • Online capability and technical and adviser support – second. Successful pilot of the UNSW Retirement Planning course. Strong educational outcomes with our Technical Services team delivering presentations to over 5,000 advisers, with a further 2,000 advisers watching our technical webinars on AdviserOnline.

Objective	Performance measure	Measurement approach	Actual outcome
People, Community and Sustainability	Employee engagement and diversity Contribution to community and the environment	Increase awareness of culture and employment promise through the development of an employment brand Implementation of diversity initiatives and increased gender equity of senior leadership Impact on community and the environment	Employee focus groups revealed high levels of engagement and a number of positive and unique aspects of working at Challenger. These attributes are reflected in Challenger's employment brand which was successfully launched in February 2014. See page 25 for further details. A Diversity Committee was introduced to provide ongoing focus and promotion of diversity at Challenger. The proportion of women in senior management roles increased from 25% to 30%. Challenger is working with the Federal Government Corporate Champions Program to develop best practice programs in the recruitment and retention of mature age employees and the implementation of age-friendly work practices. Challenger continued to provide support to our community partners through the matching of employee donations, sponsorship of key events and approved volunteering leave. Challenger also supported one-off fundraising initiatives including Typhoon Haiyan and the Homicide Victims Support Group. We continued to partner with Climate Friendly to reduce Challenger's carbon footprint by offsetting 100% of the carbon emissions generated by our power usage, taxis, flights, paper and waste disposal. In 2014, Challenger invested in environmental projects with total CO_2 emission reductions of 1,395 tonnes, an increase of 35% compared to 2013. Additionally, our head office energy consumption decreased by approximately 13% during the year.

Long-Term Incentive

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, individual target and maximum LTI award limits are not supported at Challenger; an aggregate pool is set each year with reference to annual normalised profit and individual LTI awards are determined based on 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. The Board has continued its practice of considering the market value of stock when determining individual awards.

KMP and employees have no contractual right to receive an LTI award, and the Board retains discretion to amend or withdraw the LTI at any point.

LTI instrument

LTI awards are delivered as HPSRs under the CPP. HPSRs represent the right to receive a fully-paid ordinary Challenger share for nil consideration subject to continued employment and satisfying the absolute TSR performance targets. HPSRs do not provide an entitlement to vote. 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 creation of shareholder value; 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.

To reflect current market practice, the level of threshold vesting of LTI awards at an absolute TSR of 8% compounded annually is 50%, as outlined in the following table. 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 50% and 100%
Above 12% p.a.	100%

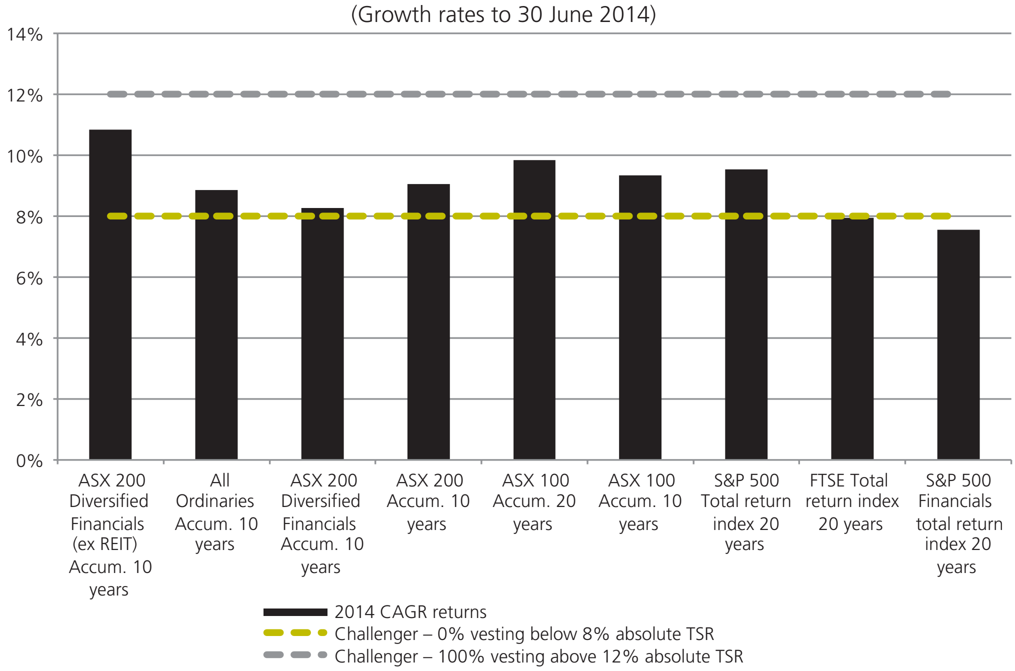
In line with the determination of the number of DPSRs (from deferred STI awards), the calculation of the start and end price for absolute TSR performance testing is calculated using a 90 day volume weighted average price (VWAP) leading up to the final date of the relevant performance period. The use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

The absolute TSR performance targets were set following significant research and consideration, including:

- long-term (10 and 20 year) returns of listed equities;
- long-term (10 and 20 year) 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 a higher TSR performance target 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.

Challenger's LTI performance targets are shown in the chart below relative to a range of indices:

Equity indices TSR – compound annual growth rates (CAGR) over 10 and 20 years
(Growth rates to 30 June 2014)



As an example, a share worth $7.50 today and paying a 25 cents per share dividend reinvested each year would need to produce a total return (i.e. share price appreciation and accumulated reinvested dividends) of $4.30 per share (a 57% return) over four years to achieve a 12% per annum compound return and for LTI awards to vest in full.

During 2014, the Board assessed the appropriateness of the current absolute TSR performance measure and considered adding Return on Net Assets (RONA) as a secondary measure.

However, the Board determined that the absolute TSR performance measure is challenging, particularly in a low interest rate environment and continues to be the most appropriate way to incentivise and measure the creation of shareholder value.

Vesting periods

In 2011, the Board extended the LTI vesting period from three to four years, whereby one third of an LTI award was eligible to commence vesting on the second, third and fourth anniversaries following grant, subject to continued employment and satisfying the absolute TSR performance targets.

Effective 1 July 2014, the Board determined that any new LTI awards will not be eligible to vest until the third anniversary following grant. Subject to continued employment and meeting the absolute TSR performance target, two thirds of an LTI award will be eligible to commence vesting on the third anniversary and the final third on the fourth anniversary following grant. This change has the effect of increasing the vesting period. Challenger's vesting period is now greater than the majority of market participants.

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 the higher absolute TSR performance requirements which reflect another year of compound growth. For awards from 1 July 2014, any unvested awards have the opportunity to vest on the fifth anniversary following grant. Any unvested awards lapse at the end of the fifth anniversary following grant. This approach is applied to ensure that KMP and employees are motivated to deliver strong long-term performance.

Forfeiture and clawback

LTI awards are subject to forfeiture and clawback provisions under the CPP. Refer to Section 10.5 Other remuneration arrangements for further information.

10.5 Other remuneration arrangements

Challenger Performance Plan (CPP) 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 typically acquires physical shares on market or via forward share purchase agreements. 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 seek to match 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.

During the year, the CPP Trust acquired 7.6 million shares at an average share price of $5.68 per share, and entered into forward share purchase agreements for 3.0 million shares at an average price of $5.20 per share. The forward share purchase agreements will be settled in two equal tranches of 1.5 million shares in September 2014 and September 2015. No shares were acquired by the CPP Trust, including the settlement of forward share purchase agreements, during 2013.

At 30 June 2014, 41% and 26% of Challenger's future employee equity obligations are satisfied by shares and forward share purchase agreements currently held by the CPP Trust respectively. Challenger plans to continue to utilise a combination of physical shares and forward share purchase agreements to hedge the CPP Trust equity obligations.

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 maximum 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 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 remuneration recommendations. CPP Trust distributions to KMP are disclosed within the remuneration tables in Section 10.6 2014 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 Disqualification from managing corporations 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 with a means by which to acquire Challenger shares at no cost, and in so doing, participate in the future growth and performance of Challenger. Eligible employees are offered $1,000 worth of fully-paid Challenger ordinary shares on an annual basis, subject to a three year minimum holding period.

As at 30 June 2014, 79% of permanent employees hold unvested Challenger equity.

Employee share ownership levels by way of unvested equity are formally reviewed by the Board on a regular basis. As at 30 June 2014, employee ownership of Challenger by way of unvested equity has increased from 5% in 2013 to 6% in 2014.

Minimum shareholding guidelines

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

In February 2014, the Board reviewed and updated the minimum shareholding guidelines. Reflecting market practice, requirements are now expressed as a multiple of base fees for Non-Executive Directors and fixed remuneration for KMP. The minimum shareholding requirement for the CEO and Chair were materially increased, although it is noted that both continue to have holdings well in excess of these requirements.

Group	Old requirement	Implied value[1]	New requirement	Implied value[2]
Non-Executive Directors (NED)	20,000 shares	$124,000	One times base fees	Chair – $385,000 NED – $165,000
Managing Director and CEO	100,000 shares	$620,000	Two times fixed remuneration	$2,500,000
Other KMP	100,000 shares	$620,000	One times fixed remuneration	$600,000 – $650,000

A five year transitional period in which to acquire the required shareholding continues to apply for Non-Executive Directors and KMP. The Board reviews minimum shareholding guidelines on an annual basis and retains discretion to allow Non-Executive Directors and KMP to vary from this guideline. The shareholdings of Non-Executive Directors and KMP as at 30 June 2014 are set out in Sections 10.7 Other Key Management Personnel remuneration tables and 10.9 Non-Executive Director disclosures.

Employee share trading policy

Employees, including Directors and KMP, must comply with Challenger's employee share trading policy and are required to obtain pre-approval from the Company if they wish to trade in Challenger shares. KMP and employees are prohibited from trading during specified prohibited 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 2014.

10.6 2014 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	• 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	• 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	• 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.

[1] Based on a share price of $6.20 at the time of review.
[2] Based on fees and remuneration at 30 June 2014.

Table 1 – Awarded Remuneration

KMP	Year	Short-term employee benefits: Salary[1] $	Cash STI $	Deferred STI[2] $	Superannuation $	Share-based payments[3] (LTI) $	Other[4] $	Total $
B Benari[5]	2014	1,237,003	900,000	1,400,000	17,775	1,350,000	199,255	5,104,033
	2013	1,238,143	900,000	1,400,000	16,470	1,734,000	226,638	5,515,251
R Howes	2014	633,392	625,000	1,025,000	17,775	725,000	143,939	3,170,106
	2013	634,662	637,500	637,500	16,470	1,071,000	212,729	3,209,861
P Rogan	2014	641,688	575,000	975,000	17,775	675,000	126,380	3,010,843
	2013	639,893	650,000	650,000	16,470	1,020,000	167,467	3,143,830
A Tobin	2014	582,225	400,000	625,000	17,775	475,000	65,198	2,165,198
	2013	583,530	412,500	412,500	16,470	612,000	77,258	2,114,258
R Woods[6]	2014	636,074	600,000	1,000,000	17,775	675,000	128,417	3,057,266
	2013	497,118	350,000	350,000	13,725	1,071,000	209,171	2,491,014

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

[2] The Board determined that 2014 STI awards for all KMP would be subject to a higher deferral requirement vesting over three years.

[3] HPSRs will be formally granted in September 2014 with reference to the fair value at the time of grant.

[4] Values represent distributions from the CPP Trust.

[5] The Board previously determined that Mr Benari's 2013 STI award would be subject to a higher deferral requirement vesting over three years.

[6] Mr Woods was on long service leave during 2013 and relevant remuneration payments were prorated accordingly.

Table 2 – Statutory Remuneration

KMP	Year	Short-term employee benefits: Salary[1] $	Cash STI $	Superannuation $	Share-based payments[2] (LTI) $	Other[3] $	Total $
B Benari	2014	1,237,003	900,000	17,775	2,726,883	199,255	5,080,916
	2013	1,238,143	900,000	16,470	1,992,916	226,638	4,374,167
R Howes	2014	633,392	625,000	17,775	1,973,757	143,939	3,393,863
	2013	634,662	637,500	16,470	1,596,377	212,729	3,097,738
P Rogan	2014	641,688	575,000	17,775	1,780,931	126,380	3,141,774
	2013	639,893	650,000	16,470	1,251,215	167,467	2,725,045
A Tobin	2014	582,225	400,000	17,775	961,392	65,198	2,026,590
	2013	583,530	412,500	16,470	492,892	77,258	1,582,650
R Woods[4]	2014	636,074	600,000	17,775	1,746,331	128,417	3,128,597
	2013	497,118	350,000	13,725	1,548,096	209,171	2,618,110

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

[2] Calculated on the basis outlined in Note 1(xxxiv) Share-based payment transactions 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 LTI 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 payments included in the table may not necessarily have vested during the financial year.

[3] Values represent distributions from the CPP Trust.

[4] Mr Woods was on long service leave during 2013 and relevant remuneration payments were prorated accordingly.

Table 3 – Realised Remuneration[1]

KMP	Year	Short-term employee benefits Salary[2] $	Cash STI $	Superannuation $	Share-based payments Value of prior year's equity-settled shares and rights at issue[3] $	Value due to share price appreciation of prior year's equity-settled shares and rights[4] $	Other[5] $	Total $
B Benari	2014	1,237,003	900,000	17,775	3,008,028	1,211,875	199,255	6,573,936
	2013	1,238,143	900,000	16,470	899,996	545,831	226,638	3,827,078
R Howes	2014	633,392	625,000	17,775	1,016,206	340,395	143,939	2,776,707
	2013	634,662	637,500	16,470	749,997	566,168	212,729	2,817,526
P Rogan	2014	641,688	575,000	17,775	754,890	257,936	126,380	2,373,669
	2013	639,893	650,000	16,470	487,498	192,861	167,467	2,154,189
A Tobin	2014	582,225	400,000	17,775	275,796	106,025	65,198	1,447,019
	2013	583,530	412,500	16,470	128,749	76,873	77,258	1,295,380
R Woods[6]	2014	636,074	600,000	17,775	966,340	325,317	128,417	2,673,923
	2013	497,118	350,000	13,725	674,998	575,245	209,171	2,320,257

[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 date share price.

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

[5] Values represent distributions from the CPP Trust.

[6] Mr Woods was on long service leave during 2013 and relevant remuneration payments were prorated accordingly.

10.7 Other Key Management Personnel remuneration tables

Deferred Performance Share Rights granted to Key Management Personnel during the year ended 30 June 2014

The Board reviews the STI deferral process annually. For DPSRs granted in September 2013, the Board determined 50% of STI awards for KMP excluding the Managing Director and CEO would be deferred over two years, vesting in equal tranches subject to continued employment at the time of vesting. In addition, the Board determined that a portion of the 2013 STI award for the Managing Director and CEO would be subject to a higher deferral requirement of three years.

KMP	Deferral from 2013 $	Allocation price $	Total no. of DPSRs granted	Date of grant	Tranche 1 1 September 2014 Number vesting	Fair value at grant $	Tranche 2 1 September 2015 Number vesting	Fair value at grant $	Tranche 3 1 September 2016 Number vesting	Fair value at grant $
B Benari	1,400,000	$4.0860	342,641	17 Sep 13	110,134	$4.96	110,135	$4.71	122,372	$4.46
R Howes	637,500	$4.0860	156,024	17 Sep 13	78,012	$4.96	78,012	$4.71	N/A	N/A
P Rogan	650,000	$4.0860	159,083	17 Sep 13	79,541	$4.96	79,542	$4.71	N/A	N/A
A Tobin	412,500	$4.0860	100,956	17 Sep 13	50,478	$4.96	50,478	$4.71	N/A	N/A
R Woods	350,000	$4.0860	85,660	17 Sep 13	42,830	$4.96	42,830	$4.71	N/A	N/A

Hurdled Performance Share Rights granted to Key Management Personnel during the year ended 30 June 2014

HPSRs granted in September 2013 represent LTI awards for the 2013 financial year. These awards vest over a four year period subject to continued employment and satisfying the absolute TSR performance targets.

KMP	Grant date	Allocation price $	Total no. of HPSRs granted	Tranche 1 1 September 2015 Number vesting	Tranche 1 1 September 2015 Fair value at grant $	Tranche 2 1 September 2016 Number vesting	Tranche 2 1 September 2016 Fair value at grant $	Tranche 3 1 September 2017 Number vesting	Tranche 3 1 September 2017 Fair value at grant $
B Benari	17 Sep 13	$4.0860	850,000	283,333	$3.79	283,333	$3.23	283,334	$2.69
R Howes	17 Sep 13	$4.0860	525,000	175,000	$3.79	175,000	$3.23	175,000	$2.69
P Rogan	17 Sep 13	$4.0860	500,000	166,666	$3.79	166,666	$3.23	166,668	$2.69
A Tobin	17 Sep 13	$4.0860	300,000	100,000	$3.79	100,000	$3.23	100,000	$2.69
R Woods	17 Sep 13	$4.0860	525,000	175,000	$3.79	175,000	$3.23	175,000	$2.69

Total Key Management Personnel statutory remuneration

Total KMP statutory remuneration is set out below:

KMP	Year	Short-term employee benefits $	Post-employment $	Share-based payments $	Other benefits $	Total $
Total statutory remuneration	2014	6,830,382	88,875	9,189,294	663,189	16,771,740
	2013	6,543,346	79,605	6,881,496	893,263	14,397,710

Split of statutory remuneration components for Key Management Personnel

The splits of KMP statutory remuneration are set out below:

KMP	Year	Fixed remuneration	Cash STI	Share-based payments	Other	Total
B Benari	2014	**25%**	**18%**	**53%**	**4%**	**100%**
	2013	29%	21%	45%	5%	100%
R Howes	2014	**19%**	**19%**	**58%**	**4%**	**100%**
	2013	21%	20%	52%	7%	100%
P Rogan	2014	**21%**	**18%**	**57%**	**4%**	**100%**
	2013	24%	24%	46%	6%	100%
A Tobin	2014	**30%**	**20%**	**47%**	**3%**	**100%**
	2013	38%	26%	31%	5%	100%
R Woods	2014	**21%**	**19%**	**56%**	**4%**	**100%**
	2013	20%	13%	59%	8%	100%

Key Management Personnel shareholdings in Challenger Limited

Details of KMP and their affiliates' shareholdings in Challenger Limited as at 30 June 2014 are set out below:

KMP	Shares held at 1 July 2013	Number of vested DPSRs and HPSRs	Number of shares sold	Shares held at 30 June 2014	Shareholding as multiple of 2014 fixed remuneration[1]
B Benari	1,944,019	721,023	(1,665,042)	1,000,000	6.0
R Howes	838,026	258,559	(916,892)	179,693	2.1
P Rogan	100,000	193,428	(143,428)	150,000	1.7
A Tobin	214,361	72,791	(187,152)	100,000	1.2
R Woods	1,544,334	246,040	(1,490,374)	300,000	3.4
Total	**4,640,740**	**1,491,841**	**(4,402,888)**	**1,729,693**	

[1] Shareholding multiple based on 30 June 2014 closing share price of $7.44.

Details of the KMP and their affiliates' shareholdings in Challenger Limited as at 30 June 2013 are set out below:

KMP	Shares held at 1 July 2012	Number of vested DPSRs and HPSRs	Number of shares sold	Shares held at 30 June 2013	Shareholding as multiple of 2013 fixed remuneration[1]
B Benari	1,377,664	799,688	(233,333)	1,944,019	6.2
R Howes	1,300,000	763,026	(1,225,000)	838,026	5.2
P Rogan	500,000	348,326	(748,326)	100,000	0.6
A Tobin	218,767	113,927	(118,333)	214,361	1.4
R Woods	1,300,000	744,334	(500,000)	1,544,334	9.5
Total	**4,696,431**	**2,769,301**	**(2,824,992)**	**4,640,740**	

[1] Shareholding multiple based on 28 June 2013 closing share price of $4.01.

Key Management Personnel Deferred Performance Share Rights

Details of KMP DPSRs as at 30 June 2014 are set out below:

KMP	Number of DPSRs held at 1 July 2013	Number of DPSRs granted as remuneration	Number of DPSRs vested	Number of DPSRs held at 30 June 2014
B Benari	353,220	342,641	(222,691)	473,170
R Howes	274,790	156,024	(176,893)	253,921
P Rogan	235,594	159,083	(146,762)	247,915
A Tobin	86,999	100,956	(50,741)	137,214
R Woods	255,019	85,660	(164,374)	176,305
Total	**1,205,622**	**844,364**	**(761,461)**	**1,288,525**

Key Management Personnel Hurdled Performance Share Rights

Details of KMP HPSRs as at 30 June 2014 are set out below:

KMP	Number of HPSRs held at 1 July 2013	Number of HPSRs granted as remuneration	Number of HPSRs vested	Number of HPSRs held at 30 June 2014
B Benari	2,200,000	850,000	(498,332)	2,551,668
R Howes	1,800,000	525,000	(81,666)	2,243,334
P Rogan	1,400,000	500,000	(46,666)	1,853,334
A Tobin	634,500	300,000	(22,050)	912,450
R Woods	1,800,000	525,000	(81,666)	2,243,334
Total	**7,834,500**	**2,700,000**	**(730,380)**	**9,804,120**

10.8 Contractual arrangements

Brian Benari – Managing Director and CEO

Mr Benari was appointed Managing Director and CEO effective 17 February 2012. The terms of his appointment and termination arrangements were approved at an 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 CEO) 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 2014 are detailed in the table below:

Name	Term as Non-Executive Director in 2014
Peter Polson (Chair)	Full year
Graham Cubbin	Full year
Steven Gregg	Full year
Jonathan Grunzweig	Full year
Russell Hooper	Full year
Brenda Shanahan	Full year
JoAnne Stephenson	Full year
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 2015.

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 Chair of the Board and sub-committee members to reflect 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 2014:

Board/Committee	Role	Annual fee $
Board[1]	Chair[1,2]	220,000
	Member	165,000
Group Risk and Audit	Chair[2]	22,000
	Member	23,000
Remuneration	Chair[2]	16,000
	Member	18,000

[1] Board fees include Nomination Committee fees.

[2] Chair fees are in addition to Member fees.

The fee framework includes services provided at a subsidiary board level.

Non-Executive Director fees for the year ended 30 June 2014

The following table summarises Non-Executive Director fees for the year ended 30 June 2014:

Non-Executive Director	Year	Director fees $	Superannuation $	Total $
P Polson[1]	2014	408,225	17,775	426,000
	2013	373,530	16,470	390,000
G Cubbin[2]	2014	222,000	–	222,000
	2013	203,000	–	203,000
S Gregg[3]	2014	167,506	15,494	183,000
	2013	100,718	9,065	109,783
J Grunzweig[4]	2014	82,500	–	82,500
	2013	–	–	–
R Hooper[2]	2014	165,000	–	165,000
	2013	210,000	–	210,000
B Shanahan	2014	188,558	17,442	206,000
	2013	158,716	14,284	173,000
J Stephenson[3]	2014	192,225	17,775	210,000
	2013	100,718	9,065	109,783
L Zwier[2]	2014	165,000	–	165,000
	2013	150,000	–	150,000
Total	2014	1,591,014	68,486	1,659,500
	2013	1,296,682	48,884	1,345,566

[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 did not accept fees for his service prior to 1 January 2014.

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.

Non-Executive Director shareholdings in Challenger Limited

Details of the Non-Executive Director and their affiliates' shareholdings in Challenger Limited as at 30 June 2014 are set out below:

Non-Executive Director	Shares held at 1 July 2013	Other changes	Shares held at 30 June 2014
P Polson	122,000	–	122,000
G Cubbin	177,702	(80,000)	97,702
S Gregg	10,000	–	10,000
J Grunzweig	250	–	250
R Hooper	160,000	–	160,000
B Shanahan	250,000	–	250,000
J Stephenson	–	2,000	2,000
L Zwier	2,360	–	2,360
Total	**722,312**	**(78,000)**	**644,312**

Details of the Non-Executive Director and their affiliates' shareholdings in Challenger Limited as at 30 June 2013 are set out below:

Non-Executive Director	Shares held at 1 July 2012	Other changes	Shares held at 30 June 2013
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
Total	**702,312**	**20,000**	**722,312**

[1] Mr Gregg and Ms Stephenson were appointed as directors on 8 October 2012.

10.10 Summary of key terms

To assist shareholders, key terms and abbreviations used in the 2014 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(xxxiv) Share-based payment transactions 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 are determined based on a range of factors 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. Refer to the Review of operations section of the Directors' Report for further information.
Normalised ROE (pre-tax)	Normalised Return on Equity (pre-tax). Normalised Profit Before Tax divided by average Net Assets.
Normalised NPBVRT	Normalised Net Profit Before Variable Reward 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, LTI expense and tax.
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. The value of deferred STI and LTI is calculated with reference to the share price at the time of vesting.

Key term	Description
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.
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. Individual STI awards are allocated on the basis of annual contribution and with reference to market benchmarks. 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:

Building a better working world

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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 2014, 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
19 August 2014

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
19 August 2014

B R Benari
Director
Sydney
19 August 2014

Financial report

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

Income statement

For the year ended 30 June	Note	2014 $M	2013 $M
Revenue	3	1,615.8	1,617.8
Expenses	4	(945.8)	(786.8)
Finance costs	5	(262.3)	(298.8)
Share of profits of associates	38	15.9	13.4
Profit before tax		423.6	545.6
Income tax expense	6	(53.9)	(84.3)
Profit for the year		369.7	461.3
Profit attributable to equity holders		340.6	416.8
Profit attributable to non-controlling interests	27	29.1	44.5
Profit for the year		**369.7**	**461.3**
Earnings per share		Cents	Cents
Basic earnings per share	8	66.3	79.2
Diluted earnings per share	8	62.8	78.3

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

Statement of comprehensive income

For the year ended 30 June	Note	2014 $M	2013 $M
Profit for the year		369.7	461.3
Other comprehensive (expense)/income[1] from:			
– Translation of foreign entities		(16.7)	(8.9)
– Recycled to the profit and loss		(5.4)	–
– Income tax benefit		4.9	4.6
Net translation of foreign entities after tax	25	(17.2)	(4.3)
– Hedge of net investment in foreign entities		17.6	19.4
– Income tax expense		(2.4)	(8.7)
Hedge of net investment in foreign entities after tax	25	15.2	10.7
– Cash flow hedges – SPV[2]	25	(4.0)	4.5
Other comprehensive income net of tax for the year		(6.0)	10.9
Total comprehensive income for the year		363.7	472.2
Comprehensive income attributable to equity holders		334.6	427.7
Comprehensive income attributable to non-controlling interests		29.1	44.5
Total comprehensive income for the year		363.7	472.2

[1] These items may eventually be recycled to the profit and loss section of the income statement.

[2] SPV = Special Purpose Vehicles.

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

Statement of financial position

As at 30 June	Note	2014 $M	2013 $M
Assets			
Cash and cash equivalents	9	391.4	1,030.6
Cash and cash equivalents – SPV	23	216.6	278.7
Receivables	10	148.5	333.4
Mortgage assets – SPV	23	2,978.9	4,039.4
Derivative assets	30	318.0	328.5
Financial assets – fair value through profit and loss	11	10,027.3	8,602.3
Investment property held for sale	12	222.7	–
Investment and development property	12	2,222.1	2,431.4
Finance leases	13	39.4	–
Property, plant and equipment	14	138.1	137.6
Investments in associates	38	39.4	40.0
Other assets	15	35.1	45.4
Goodwill	16	531.0	506.8
Other intangible assets	16	14.8	14.3
Total assets		17,323.3	17,788.4
Liabilities			
Payables	18	443.3	207.8
Derivative liabilities	30	222.5	385.0
Interest bearing financial liabilities	19	2,370.0	2,035.7
Interest bearing financial liabilities – SPV	23	2,931.4	3,825.8
External unit holders' liabilities	20	1,072.4	1,751.4
Provisions	21	26.5	27.0
Current tax liability	6	34.4	2.3
Deferred tax liabilities	6	122.4	135.9
Life contract liabilities	22	7,824.3	7,123.3
Total liabilities		15,047.2	15,494.2
Net assets		2,276.1	2,294.2
Equity			
Contributed equity	24	1,237.5	1,271.9
Reserves	25	69.8	49.8
Retained earnings	26	846.0	625.7
Total equity attributable to equity holders of Challenger Limited		2,153.3	1,947.4
Non-controlling interests	27	122.8	346.8
Total equity		2,276.1	2,294.2

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 2014	Note	Contributed equity $M	Share-based payment reserve $M	Cash flow hedge reserve – SPV $M	Foreign currency translation reserve $M	Adjusted controlling interest reserve $M	Retained earnings $M	Total shareholder equity $M	Non-controlling interests $M	Total equity $M
		Attributable to equity holders of Challenger Limited								
Balance at the beginning of the year		1,271.9	30.0	3.6	(2.0)	18.2	625.7	1,947.4	346.8	2,294.2
Profit for the year	26/27	–	–	–	–	–	340.6	340.6	29.1	369.7
Other comprehensive income for the year		–	–	(4.0)	(2.0)	–	–	(6.0)	–	(6.0)
Total comprehensive income for the year		–	–	(4.0)	(2.0)	–	340.6	334.6	29.1	363.7
Other equity movements										
Shares purchased in the CPP Trust	24	(43.2)	–	–	–	–	–	(43.2)	–	(43.2)
Vested shares released from the CPP Trust	24	17.2	–	–	–	–	–	17.2	–	17.2
CPP deferred share purchases	24	(8.4)	–	–	–	–	–	(8.4)	–	(8.4)
Share-based payment expense less releases	25	–	24.9	–	–	–	–	24.9	–	24.9
Dividends paid	26	–	–	–	–	–	(120.3)	(120.3)	–	(120.3)
Other movements	25	–	–	–	–	1.1	–	1.1	(253.1)	(252.0)
Balance at the end of the year	27	1,237.5	54.9	(0.4)	(4.0)	19.3	846.0	2,153.3	122.8	2,276.1

For the year ended 30 June 2013	Note	Contributed equity $M	Equity option premium reserve $M	Share-based payment reserve $M	Cash flow hedge reserve – SPV $M	Foreign currency translation reserve $M	Adjusted controlling interest reserve $M	Retained earnings $M	Total shareholder equity $M	Non-controlling interests $M	Total equity $M
		Attributable to equity holders of Challenger Limited									
Balance at the beginning of the year		1,313.1	65.0	35.6	(0.9)	(8.4)	17.7	270.1	1,692.2	352.3	2,044.5
Profit for the year	26/27	–	–	–	–	–	–	416.8	416.8	44.5	461.3
Other comprehensive income for the year		–	–	–	4.5	6.4	–	–	10.9	–	10.9
Total comprehensive income for the year		–	–	–	4.5	6.4	–	416.8	427.7	44.5	472.2
Other equity movements											
Shares cancelled under share buy-back	24	(50.0)	–	–	–	–	–	–	(50.0)	–	(50.0)
Vested shares released from the CPP Trust	24	32.2	–	–	–	–	–	–	32.2	–	32.2
CPP deferred share purchases	24	(23.4)	–	–	–	–	–	–	(23.4)	–	(23.4)
Share-based payment expense less releases	25	–	–	(7.3)	–	–	–	–	(7.3)	–	(7.3)
Dividends paid	26	–	–	–	–	–	–	(105.6)	(105.6)	–	(105.6)
Transfer from equity option reserve on expiry of share options, net of tax	25/26	–	(65.0)	1.7	–	–	–	44.4	(18.9)	–	(18.9)
Consolidation of new controlled entities		–	–	–	–	–	–	–	–	9.5	9.5
Other movements	25	–	–	–	–	–	0.5	–	0.5	(59.5)	(59.0)
Balance at the end of the year	27	1,271.9	–	30.0	3.6	(2.0)	18.2	625.7	1,947.4	346.8	2,294.2

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	Note	2014 $M	2013 $M
Operating activities			
Receipts from customers		651.1	735.6
Annuity and premium receipts	22	2,806.2	2,179.9
Annuity and claim payments	22	(2,526.0)	(1,895.2)
Payments to reinsurer	22	(4.0)	(3.9)
Receipts from external unit holders		581.6	951.8
Payments to external unit holders		(1,292.6)	(993.2)
Interest paid to external unit holders		(34.1)	(108.6)
Payments to vendors and employees		(562.3)	(598.5)
Dividends received		61.2	44.2
Interest received		552.8	544.9
Interest paid		(72.3)	(63.1)
Income tax paid		(14.2)	(4.8)
Net cash inflows from operating activities	34	147.4	789.1
Investing activities			
Payments on net purchases of investments		(908.4)	(835.3)
Payments for purchases of controlled entities		(294.6)	–
Net mortgage loan repayments		1,048.0	1,327.9
Net (payments)/proceeds from (purchase)/sale of associate		(0.5)	20.1
Payments for net purchases of property, plant and equipment		(7.4)	(17.3)
Net cash (outflows)/inflows from investing activities		(162.9)	495.4
Financing activities			
Proceeds from borrowings – interest bearing liabilities		571.1	528.3
Repayment of borrowings – interest bearing liabilities		(1,075.7)	(1,500.0)
Payments for Treasury shares, net of option proceeds and share buy-back		(43.2)	(39.7)
Dividends paid		(120.3)	(105.4)
Distributions paid to non-controlling interests		(17.7)	(16.7)
Payments to non-controlling interests for redemption of units		–	(1.3)
Net cash outflows from financing activities		(685.8)	(1,134.8)
Net (decrease)/increase in cash and cash equivalents		(701.3)	149.7
Cash and cash equivalents at the beginning of the year		1,309.3	1,159.6
Cash and cash equivalents at the end of the year		608.0	1,309.3
Cash and cash equivalents	9	391.4	1,030.6
Cash and cash equivalents – SPV	23	216.6	278.7
Cash and cash equivalents at the end of the year		608.0	1,309.3

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

Notes to the financial statements

1. Basis of preparation and summary of significant 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 2014 was authorised for issue in accordance with a resolution of the Directors of the Company on 19 August 2014.

(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 $100,000. 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 as issued by the Australian Accounting Standards Board (AASB) and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

(iii) New and revised accounting standards and interpretations

Except for the matters referred to below, the accounting policies and methods of computation are the same as those adopted in the annual report for the prior comparative period. Where applicable, comparative figures have been updated to reflect any changes in the current period.

Changes in accounting policy or disclosure

AASB 7 Financial Instruments – Disclosures Offsetting Financial Assets and Financial Liabilities

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statement of financial position if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis and realise the assets and settle the liabilities simultaneously. This has resulted in increased disclosure in the 30 June 2014 annual financial report (refer to Note 30 Derivative financial instruments).

AASB 10 Consolidated Financial Statements and AASB 12 Disclosure of Interests in Other Entities

AASB 10 and AASB 12 have been applied in the period. AASB 10 provides further clarity on the concept of control and AASB 12 enhances disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. Application of AASB 10 has not resulted in changes to those entities controlled by the Group and AASB 12 has resulted in increased disclosure in the 30 June 2014 annual financial report.

AASB 13 Fair Value Measurement

This standard establishes a single source of guidance for determining the fair value of assets and liabilities. AASB 13 does not change when an entity is required to use fair value, but rather provides guidance on how to determine fair value when fair value is required or permitted.

AASB 13 also expands the disclosure requirements for all assets or liabilities carried at fair value. This includes information about the assumptions made and the qualitative impact of those assumptions on the fair value determined.

Consequential amendments were also made to other standards via AASB 2011-8 which has resulted in additional disclosures around the fair values of financial instruments.

AASB 119 Employee Benefits

This standard revises the definition of short-term employee benefits (those expected to be wholly settled within 12 months after the reporting date).

The impact on the financial report has been increased disclosure of Long Service Leave accruals at 30 June 2014 (refer to Note 33 Employee entitlements).

AASB 2011-4 Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements

AASB 2011-4 is effective for annual periods beginning on or after 1 July 2013. This amendment to AASB 124 Related Party Disclosures removes individual key management personnel disclosure requirements for disclosing entities, which are not companies currently included in Note 32 Related parties. The information will continue to be disclosed within the Directors' report.

The adoption of other amendments and changes which were effective during the period did not result in any material changes to the financial report.

1. Basis of preparation and summary of significant accounting policies (continued)

(iii) New and revised accounting standards and interpretations (continued)

Changes in accounting policy or disclosure (continued)

AASB 2013-3 Amendments to AASB 136 – Recoverable Amount Disclosures for Non-Financial Assets effective for annual reports beginning on or after 1 January 2014. This amendment includes additional information about the fair value measurement of non-financial assets when the recoverable amount of impaired assets is based on fair value less costs of disposal. The Group has assessed the impact of this amendment as immaterial.

Accounting standards and interpretations issued but not yet effective

AASB 9 Financial Instruments is effective for annual periods beginning on or after 1 January 2017; however, early adoption is permitted in certain circumstances. The standard makes changes to the classification of financial assets for the purpose of determining their measurement basis, as well as to the amounts relating to fair value changes to be taken directly to equity. There are also significant changes to hedge accounting requirements and disclosures.

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 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 Financial Instruments: Presentation to address inconsistencies identified in applying some of the offsetting criteria for 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.

There are a number of amendments to Australian Accounting Standards, in addition to those described above, that are available for early adoption but have not been applied in this annual financial report. The amendments would have resulted in only minor disclosure impacts if they had been early adopted.

(iv) Principles 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 (CLC) are conducted within separate statutory funds as required by the Life Insurance Act 1995 (the Life Act). Both the shareholders' and policyholders' interests in these statutory funds are reported in aggregate in the financial report of the Group (refer Note 1(xxxi) Life contract liabilities).

Controlled entities are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. 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) Goodwill and other intangible assets.

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 date and accounting policies of associate entities are consistent with those of the Company. After application of the equity method, the Group determines whether it is necessary to recognise any impairment loss against the carrying value of the net investment in associates.

The consolidated income statement reflects the share of the results of operations of associates. Where there has been a change recognised directly in the associate's equity, the Group recognises its share of any changes in the statement of changes in equity.

Special Purpose Vehicles

The Group manages and services trusts that hold residential mortgage-backed 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 any changes in presentation made in this financial report.

(vi) Rounding of amounts

Amounts in this financial report are rounded to the nearest $100,000, unless otherwise stated, under the option available to the Company under ASIC Class Order 98/100.

(vii) Segment reporting

Operating segments are identified on the basis of internal reporting to key management personnel 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-backed 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 method, 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.
- Interest revenue on finance leases is recognised on a basis that reflects a constant periodic return on the net investment in the finance lease. Secondary lease income (inertia income) is recognised on a cash basis (as-and-when it is received). Proceeds from the sale of rental assets are recognised upon disposal of the relevant assets.
- 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. Refer Note 1(xxxi) Life contract liabilities 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:

- Rental 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.

1. Basis of preparation and summary of significant accounting policies (continued)

(ix) Expenses (continued)

- Changes in life contract liabilities recognised as an expense consist of the interest expense on the liability and any loss on the initial recognition of new business less the release of expenses over the period. The interest expense on the liability represents the unwind of the discount on the opening liability over the period. Refer Note 1(xxxi) Life contract liabilities for more detail on the recognition and measurement of life contract liabilities.
- Refer Note 1(xxvi) Interest bearing financial liabilities 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.

(x) Finance costs

Finance costs represent interest incurred on interest bearing financial liabilities (primarily the securitised residential mortgage-backed securities (RMBS) issued by the consolidated Special Purpose Vehicles, subordinated debt, 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 applicable 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 applicable 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 (GST inclusive) 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 respective period's taxable income. The tax rates and tax laws used to compute the amounts are those that are enacted or substantively enacted as at 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 and 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 future 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 as 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 or tax consolidated group and the same taxation authority.

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 consolidated 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 or receive tax equivalent amounts 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 in foreign currency are translated into the Company presentation currency, 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 par 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) Derivative financial instruments and hedging.

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 fair value. For the purposes of the statement of cash flows, cash and cash equivalents are stated net of bank overdrafts.

1. Basis of preparation and summary of significant accounting policies (continued)

(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 and to manage its level of exposure to credit risk, 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 both the carrying amount of the hedged item and the derivative are remeasured to fair value through the income statement. The same applies where the hedged item is an unrecognised firm commitment. Any 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 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.

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 recognised in 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) Financial assets

The Group categorises its financial assets into either financial assets – fair value through profit and 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 financial assets are recognised on the date on which the Group commits to purchase or sell the asset. Financial assets are initially recognised at fair value (plus transaction costs for available-for-sale assets). 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.

The fair value of 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 fixed income and 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 when permitted by other Australian Accounting Standards.

(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) Finance leases

Leases are classified at their inception as either operating or finance leases based on the economic substance of the agreement so as to reflect the risks and benefits incidental to ownership. Contracts to lease assets and hire purchase agreements are classified as finance leases for accounting purposes if they transfer substantially all the risks and rewards of ownership of the asset to the customer or an unrelated third party. Assets held under a finance lease are recognised at the beginning of the lease term at an amount equal to the net investment in the lease which comprises the gross investment in the lease discounted at the interest rate implicit in the lease. The collectability of lease receivables is assessed on an ongoing basis and a provision is made for losses based on historical rates of arrears and the current delinquency position of the portfolio. Bad debts are written off as incurred.

1. Basis of preparation and summary of significant accounting policies (continued)

(xx) Property, plant and equipment

Items of property, 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 realise the net cost of each class of these 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 property, plant and equipment is three to five years.

Infrastructure property, plant and equipment

Infrastructure property, plant and equipment are stated at cost and amortised on a straight line basis over their expected 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 property, 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.

(xxi) 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. Refer Note 1(xxiii) Goodwill and other intangible assets. 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. Refer Note 1(xxix) Provisions.

(xxii) 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.

(xxiii) 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. Amortisation is calculated based on the timing of projected cash flows over the estimated useful lives. In the instance of customer list intangibles, this period is four years.

As stated in Note 1(xxi) Operating leases 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 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.

(xxiv) 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.

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 as impairment losses.

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.

(xxv) 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 cost.

(xxvi) Interest bearing financial liabilities

All borrowings and subordinated debt are financial liabilities and are initially recognised at fair value. In the case of borrowings and subordinated debt which are subsequently measured at amortised cost, initial value is calculated net of directly attributable transaction costs. For borrowings and subordinated debt which are subsequently measured at fair value through profit or loss, directly attributable transaction costs are expensed.

Borrowings and subordinated debt, other than those held by CLC's statutory funds or their controlled entities, are subsequently measured at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in the income statement over the period of the contract using the effective interest rate method.

Borrowings of certain controlled investment trusts of CLC's statutory funds are subsequently measured at amortised cost for the purpose of determining the unit price of those trusts. These borrowings are measured at amortised cost in this financial report with a difference between the proceeds (net of transaction costs) and the redemption amount recognised in the income statement over the period of the contract using the effective interest rate method.

All other borrowings of the controlled entities of the statutory funds, or their controlled entities, are subsequently measured at fair value with movements recognised in the income statement.

1. Basis of preparation and summary of significant accounting policies (continued)

(xxvii) Employee benefits (continued)

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 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.

(xxviii) 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.

(xxix) 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 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.

(xxx) Restrictions on assets

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

(xxxi) Life contract liabilities

The operations of the Group include the selling and administration of contracts through CLC. These contracts are governed under 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 premiums received over payments to customers and expenses (the margin) is recognised over the life of the contract in a manner that reflects the pattern of risk accepted from the policyholder (the service) unless future margins are negative, in which case the future losses are recognised. 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 and expenses) are projected into the future. The liability is calculated as the net present value of these projected cash flows using a risk-free discount rate curve.

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 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.

(xxxii) 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.

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(xxxiv) Share-based payment transactions for further details.

(xxxiii) 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 year. 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).

(xxxiv) 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.

1. Basis of preparation and summary of significant accounting policies (continued)

(xxxiv) Share-based payment transactions (continued)

Long-term equity-based incentive plan (continued)

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.

(xxxv) 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 typically purchases shares in the Company on market. Shares acquired are held by the CPP Trust, are disclosed as treasury shares and are 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 the vesting dates of the performance rights issued by the CPP and they require the delivery of Challenger Limited shares to the CPP Trust, 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 these contracts 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.

(xxxvi) 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 model, taking into account the terms and conditions upon which the equity instruments were granted, as discussed in Note 32 Related parties. 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(xxxi) Life contract liabilities. 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 22 Life contract liabilities.

Property valuations

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

Each 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 (or foreign equivalent).

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 external valuation available are valued either by reference to the current market value of another instrument that is substantially the same or a discounted cash flow analysis or other methods consistent with market best practice. Refer Note 28 Financial risk management 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) Goodwill and other intangible assets. These calculations involve an estimation of the recoverable amount of the cash-generating units to which the goodwill is allocated.

2. Segment information

Business segments

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

	Life[2]	
For the year ended 30 June	2014 $M	2013 $M
Net income	481.3	452.2
Operating expenses	(77.1)	(70.3)
Normalised EBIT	404.2	381.9
Interest and borrowing costs	–	–
Normalised net profit/(loss) before tax	404.2	381.9
Tax on normalised profit		
Normalised net profit after tax		
Investment experience after tax		
Significant items after tax		
Profit attributable to equity holders		
As at 30 June		
Segment assets	11,746.5	11,399.7
Segment liabilities	(9,567.4)	(9,534.4)
Net assets attributable to equity holders	2,179.1	1,865.3
Other statutory segment information		
For the year ended 30 June		
Revenue from external customers	715.8	636.5
Interest revenue	738.5	813.6
Interest expense	(257.2)	(294.0)
Intersegment revenue	(25.1)	(24.0)
Depreciation and amortisation	(12.4)	(7.6)

[1] Refer overleaf for definitions of the terms used in the management view of segments.
[2] Includes Bendzulla Actuarial Pty Ltd.
[3] 'Other' includes corporate companies, corporate SPV, non-controlling interests and group eliminations.

Funds Management		Total reporting segments		Corporate and other[3]		Total	
2014 $M	2013 $M	2014 $M	2013 $M	2014 $M	2013 $M	2014 $M	2013 $M
110.2	99.4	591.5	551.6	1.8	4.9	593.3	556.5
(66.9)	(65.3)	(144.0)	(135.6)	(61.4)	(56.1)	(205.4)	(191.7)
43.3	34.1	447.5	416.0	(59.6)	(51.2)	387.9	364.8
–	–	–	–	(4.1)	(4.6)	(4.1)	(4.6)
43.3	34.1	447.5	416.0	(63.7)	(55.8)	383.8	360.2
						(55.1)	(51.7)
						328.7	308.5
						11.9	99.8
						–	8.5
						340.6	**416.8**
153.9	144.4	11,900.4	11,544.1	5,300.1	6,028.0	17,200.5	17,572.1
(20.3)	(14.9)	(9,587.7)	(9,549.3)	(5,459.5)	(6,075.4)	(15,047.2)	(15,624.7)
133.6	129.5	2,312.7	1,994.8	(159.4)	(47.4)	2,153.3	1,947.4
113.8	99.8	829.6	736.3	0.4	0.7	830.0	737.0
–	–	738.5	813.6	47.3	67.2	785.8	880.8
–	–	(257.2)	(294.0)	(5.1)	(4.8)	(262.3)	(298.8)
25.1	24.0	–	–	–	–	–	–
–	(0.2)	(12.4)	(7.8)	(7.6)	(8.5)	(20.0)	(16.3)

2. Segment information (continued)

Definitions

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) and the Bendzulla Actuarial Pty Ltd actuarial certificates business. CLC invests in assets providing long-term income streams for customers. CLC 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 seek capital protection.

Funds Management – earns fees from its Fidante Partners and Challenger Investment Partners (formally Aligned Investments) operations, providing an end-to-end funds management business as well as managing a number of unlisted fund mandates. Funds Management has equity investments in a number of boutique fund managers and, through the Challenger Investment Partners business, offers a range of managed investments across the major asset classes.

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.

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 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 (refer 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 for the Funds Management segment, and other income, being the management view of revenue from Corporate and other.

Normalised cash operating earnings is calculated as cash earnings plus normalised capital growth (refer below). 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 applicable 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 assets being held to match the term of life contract liabilities, the Group takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term volatility. Investment experience is a mechanism employed to 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 investments, 4.0% for Infrastructure, 2.0% for Property and (0.35%) for Cash and fixed income. 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 represent 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.

Major customers

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

Geographical areas

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

	30 June 2014 $M	30 June 2013 $M
Reconciliation of management view of revenue to statutory revenue		
Operating segments	591.5	551.6
Corporate and other	1.8	4.9
Net income (management view of revenue)	593.3	556.5
Expenses and finance costs offset against revenue		
SPV expenses and finance costs offset against SPV income	114.4	179.1
Commission expenses offset against related income	50.2	50.1
Amortisation of deferred portfolio and origination costs offset against mortgage income	1.7	2.6
Change in life contract liabilities and reinsurance contracts recognised in expenses	490.2	376.7
Property related expenses offset against property income	70.2	63.0
Interest and loan amortisation costs	144.4	117.6
Management fees	79.8	56.6
Adjustment for non-controlling interests and other items	53.4	77.5
Difference between management view of investment experience and statutory recognition		
Actual capital growth	96.9	206.7
Normalised capital growth	(55.6)	(36.0)
Actuarial assumption changes	(23.1)	(32.6)
Statutory view of revenue	1,615.8	1,617.8
Reconciliation of management to statutory view of after-tax profit		
Operating segments normalised net profit before tax	447.5	416.0
Corporate and other normalised net loss before tax	(63.7)	(55.8)
Normalised net profit before tax (management view of pre-tax profit)	383.8	360.2
Tax on normalised profit	(55.1)	(51.7)
Normalised net profit after tax	328.7	308.5
Investment experience after tax	11.9	99.8
Profit attributable to non-controlling interests excluded from management view	29.1	44.5
Other	–	8.5
Statutory view of profit after tax	369.7	461.3

3. Revenue

	30 June 2014 $M	30 June 2013 $M
Investment revenue		
Fixed income securities and cash		
Interest revenue	560.9	548.9
Interest revenue – SPV	224.9	331.9
Net realised gain on fixed income securities	151.1	189.2
Net unrealised gain on fixed income securities[1]	89.2	35.5
Investment property and property securities		
Property rental revenue	239.9	228.9
Dividend revenue	25.3	11.2
Net realised gain/(loss) on investment property and property securities	6.5	(1.0)
Net unrealised gain on investment property and property securities	3.8	12.1
Revenue from sale of development properties	17.3	11.5
Equity and infrastructure investments		
Dividend revenue	24.4	18.2
Net realised gain/(loss) on equity investments	38.0	(5.3)
Net unrealised gain on equity investments	0.1	33.8
Net realised gain on infrastructure investments	–	19.2
Net unrealised gain/(loss) on infrastructure investments	47.0	(12.7)
Other		
Net realised loss on foreign exchange translation and hedges	(51.6)	(15.9)
Net unrealised gain on foreign exchange translation and hedges	98.7	57.2
Net realised loss on interest rate derivatives	(19.4)	(6.0)
Net unrealised loss on interest rate derivatives	(38.3)	(50.6)
Net realised gain on equity swap derivatives	0.1	–
Net unrealised gain on equity swap derivatives	0.7	–
Impairment loss on equity accounted associates	–	(5.2)
Realised gain on sale of equity accounted associates	–	12.0
Fee revenue		
Management fee revenue	127.0	105.0
Fee revenue – SPV	1.5	2.4
Other fee revenue	3.3	10.3
Other revenue		
Life insurance contract premiums and related revenue	620.5	257.6
Change in life insurance contract liabilities[2]	(549.7)	(163.1)
Change in life investment contract liabilities[2]	(5.9)	(5.0)
Change in reinsurance contract liabilities	0.5	(2.3)
Total revenue	1,615.8	1,617.8

1 Includes fair value movements in subordinated debt (Note 29 Fair values of financial assets and liabilities).

2 Changes in life insurance and investment 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 2014 $M	30 June 2013 $M
Life insurance contract claims and expenses	109.0	60.1
Cost of life insurance contract liabilities[1]	93.4	65.0
Cost of life investment contract liabilities[1]	285.5	251.6
Reinsurance contracts	2.3	–
Investment property-related expenses[2]	70.2	63.0
Development properties cost of sales	15.6	11.0
Management fee expense	79.8	56.6
Commission expenses	50.2	50.1
Amortisation of deferred portfolio and origination costs	1.7	2.6
Fee expenses – SPV	1.6	2.7
Intangibles amortisation expense	2.2	2.6
Employee expenses	118.4	108.8
Employee share-based payments	25.3	16.6
Superannuation	6.0	5.0
Occupancy expense – operating lease	6.1	4.4
Depreciation expense	16.1	11.1
Communications	16.2	17.2
IT maintenance	5.0	5.2
Professional fees	16.5	15.1
Other expenses	24.7	38.1
Total expenses	945.8	786.8

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.

2 Property-related expenses relate to investment properties that generate rental income.

5. Finance costs

	30 June 2014 $M	30 June 2013 $M
Interest expense – SPV	112.8	176.4
Interest expense – other entities	117.2	88.5
Interest expense – property trusts	27.2	29.1
Other finance costs	5.1	4.8
Total finance costs	262.3	298.8

6. Income tax

	30 June 2014 $M	30 June 2013 $M
Analysis of income tax expense		
Current income tax expense for the year	(89.6)	(97.4)
Current income tax benefit prior year adjustment	1.0	2.9
Deferred income tax benefit	34.7	10.2
Income tax expense	(53.9)	(84.3)
Income tax benefit on translation of foreign entities	4.9	4.6
Income tax expense on hedge of net investment in foreign entities	(2.4)	(8.7)
Income tax benefit from other comprehensive income	2.5	(4.1)
Reconciliation of income tax expense		
Profit before income tax	423.6	545.6
Prima facie income tax based on the Australian company tax rate of 30% (2013: 30%)	(127.1)	(163.7)
Tax effect of amounts not assessable/deductible in calculating taxable income:		
Non-assessable and non-deductible items[1]	52.3	57.3
Rate differential on offshore income	(2.2)	(3.4)
Other items	23.1	25.5
Income tax expense	(53.9)	(84.3)

[1] The 30 June 2014 and 30 June 2013 amounts include a reduction in tax expense of $30.0 million in respect of the application of the Taxation of Financial Arrangements law for which an ATO private binding ruling was received in February 2012. The 2014 financial year is the final period for this tax deduction.

	Statement of financial position		Income statement	
	30 June 2014 $M	30 June 2013 $M	30 June 2014 $M	30 June 2013 $M
Analysis of deferred tax				
Deferred tax assets				
Accruals and provisions	33.6	30.5	3.1	(2.8)
Employee entitlements	3.0	2.6	0.4	0.3
Losses	24.2	53.0	14.3	17.1
Other	20.9	7.5	(4.1)	1.5
	81.7	93.6	13.7	16.1
Deferred tax liabilities				
Deferred acquisition and origination costs	(1.8)	(2.3)	0.5	0.8
Fixed asset temporary differences	–	1.2	(1.2)	1.1
Unrealised foreign exchange movements	(8.7)	21.0	(34.4)	22.7
Unrealised gains on investments	(135.8)	(191.5)	55.7	(13.4)
Other	(57.8)	(57.9)	0.4	(17.1)
	(204.1)	(229.5)	21.0	(5.9)
Net deferred tax liability	(122.4)	(135.9)		
Deferred income tax benefit			34.7	10.2

Unused capital losses – unused gross capital losses have increased from $36.3 million at 30 June 2013 to $141.0 million at 30 June 2014 due mostly to capital losses that arose on termination of SPV trusts during the year. No deferred tax has been recognised in respect of these capital losses.

Unused revenue losses – all revenue losses of the Challenger tax consolidated group have been recognised as a deferred tax asset. A deferred tax asset in relation to $24.4 million (2013: $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 the losses.

7. Dividends paid and proposed

	30 June 2014 $M	30 June 2013 $M
Dividends declared and paid during the year		
Final 30 June 2013 unfranked dividend: 10.5 cents (2012: 10.5 cents unfranked)	55.0	55.7
Interim 30 June 2014 unfranked dividend: 12.5 cents (2013: 9.5 cents unfranked)	65.3	49.9
	120.3	105.6
Dividend proposed (not recognised as a liability at 30 June)		
Final 30 June 2014 40% franked dividend: 13.5 cents (2013: 10.5 cents unfranked)	68.9	54.8
There is no dividend reinvestment plan in operation for dividends.		
Group franking credits account		
Franking account balance at the beginning of the year	8.0	3.6
Franking credits from the payment of income tax during the year	9.3	–
Franking credits from dividends received during the year	6.9	4.4
Franking account balance at the end of the year	24.2	8.0

8. Earnings per share

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

	30 June 2014 Cents	30 June 2013 Cents
Basic earnings per share	66.3	79.2
Diluted earnings per share	62.8	78.3
	$M	$M
Profit attributable to equity holders used in the calculation of earnings per share	340.6	416.8
Number of shares	Number	Number
Weighted average ordinary shares for basic earnings per share	513,778,947	526,125,863
Weighted average effect of dilution	28,221,509	6,078,816
Weighted average ordinary shares for diluted earnings per share	542,000,456	532,204,679

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 17,083,638 (2013: 12,695,614). Refer Note 40 Subsequent events for 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 2014 $M	30 June 2013 $M
Cash at bank and on hand	335.4	756.9
Deposits at call	30.7	60.0
Other cash equivalents	25.3	213.7
Total cash and cash equivalents	391.4	1,030.6

10. Receivables

	30 June 2014 $M	30 June 2013 $M
Interest receivable	70.2	81.2
Trade debtors	33.3	100.0
Amounts recoverable from managed trusts	7.5	6.1
Dividends and distributions receivable	10.0	5.8
Other receivables	27.5	19.9
Derivative credit support	–	120.4
Total receivables	148.5	333.4
Current	146.0	329.1
Non-current	2.5	4.3
	148.5	333.4

11. Financial assets – fair value through profit and loss

	30 June 2014 $M	30 June 2013 $M
Fixed income securities		
Domestic sovereign bonds and semi-government bonds	1,625.8	391.7
Floating rate notes and corporate bonds	4,545.6	4,717.6
Residential mortgage and asset-backed securities	2,199.4	1,980.6
Non-SPV mortgage assets	153.2	155.2
	8,524.0	7,245.1
Equity securities		
Shares in listed and unlisted corporations	73.9	94.5
Unit trusts, managed funds and other	307.9	233.3
	381.8	327.8
Infrastructure investments		
Units in listed and unlisted infrastructure trusts	360.7	302.3
Other infrastructure investments	291.5	278.8
	652.2	581.1
Property securities		
Indirect property investments in listed and unlisted trusts	469.3	448.3
Total financial assets – fair value through profit and loss[1]	10,027.3	8,602.3
Current	2,483.1	4,281.2
Non-current	7,544.2	4,321.1
	10,027.3	8,602.3

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

12. Investment and development property

	30 June 2014 $M	30 June 2013 $M
Investment property held for sale[1]	222.7	–
Investment property in use	2,125.5	2,333.6
Investment property under development[2]	18.8	18.6
Total investment property	2,367.0	2,352.2
Development property[3]	77.8	79.2
Total investment and development property[4]	2,444.8	2,431.4
Reconciliation of carrying amounts		
Investment property in use		
Balance at the beginning of the year	2,333.6	2,327.4
Acquisitions[5]	176.2	52.5
Disposals[6]	(131.1)	(11.5)
Transfer to investment property held for sale	(222.7)	–
Capital expenditure	12.3	22.8
Foreign currency exchange loss	(26.5)	(54.7)
Net revaluation loss	(16.3)	(2.9)
Balance at the end of the year	2,125.5	2,333.6
Investment property under development		
Balance at the beginning of the year	18.6	17.8
Capital expenditure	1.6	2.4
Net revaluation loss	(1.4)	(1.6)
Balance at the end of the year	18.8	18.6
Development property[3]		
Balance at the beginning of the year	79.2	81.8
Sale of properties	(15.6)	(11.0)
Capital expenditure	14.2	8.4
Balance at the end of the year	77.8	79.2

1 Held for sale properties: Taylors Institute $42.6 million, CSIRO $170.0 million, Osada Nagasaki $10.1 million.

2 Investment property under development is shown at fair value.

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 Investment property in use, investment property under development and development property are considered non-current.

5 Investment properties purchased: Lennox $25.2 million, Bunbury Forum $151.0 million.

6 Investment properties sold: Unicus Ina $47.2 million, Sunny Noma $13.8 million, Valor Ichinomiya $20.7 million, Renaissance Fujimidai $24.5 million, Kraft $24.9 million.

12. Investment and development property (continued)

Analysis of investment property

	Acquisition date[2]	Total cost[3] $M	Carrying value 2014 $M	Cap rate[4] 2014 %	Last external valuation	Carrying value 2013 $M	Cap rate[4] 2013 %
Investment property in use							
Australia							
Century City Walk, VIC	16-Oct-06	29.9	34.5	8.00	30-Jun-14	31.7	8.00
Innaloo Cinema, WA	17-Dec-01	32.1	44.4	7.50	30-Jun-14	43.5	8.00
Jam Factory, VIC	04-Jul-00	126.6	126.0	7.25	31-Dec-13	128.0	7.50
Lennox, NSW[1]	27-Jul-13	26.5	26.6	7.50	30-Jun-14	–	7.75
Karratha, WA[1]	28-Jun-13	52.3	53.7	7.75	30-Jun-14	52.5	7.75
Bunbury Forum, WA	03-Oct-13	151.1	145.2	6.75	30-Jun-14	–	–
Kings Langley, NSW	29-Jul-01	15.9	19.2	7.50	30-Jun-14	16.8	8.50
County Court, VIC	30-Jun-00	209.8	281.5	7.50	31-Dec-13	277.1	7.78
CSIRO, NSW	27-Jun-01	150.6	170.0	8.38	30-Jun-14	160.0	8.00
Kraft, Port Melbourne, VIC	28-Jun-02	–	–	–	–	21.8	9.00
ABS Building, ACT	01-Jan-00	119.5	132.5	8.00	30-Jun-14	140.0	8.50
DIAC Building, ACT	01-Dec-01	102.7	120.5	8.25	30-Jun-14	118.5	8.25
Discovery House, ACT	28-Apr-98	87.2	100.0	8.00	31-Dec-13	99.0	8.00
Elders House, SA	21-Jun-02	47.7	37.0	9.00	30-Jun-14	43.9	9.50
Executive Building, Hobart, TAS	30-Mar-01	30.1	32.9	8.50	31-Dec-13	33.0	8.50
Makerston, QLD	14-Dec-00	67.4	72.5	9.00	31-Dec-13	73.6	9.00
31 Queen Street, VIC	31-Mar-11	94.5	97.5	7.75	30-Jun-14	95.5	8.00
Taylors Institute, Waterloo, NSW	16-May-01	42.7	42.6	9.25	31-Dec-13	42.0	9.25
The Forum, Cisco, NSW	05-Jan-01	108.8	110.6	8.25	31-Dec-13	111.2	8.25
The Forum, Verizon, NSW	05-Jan-01	71.7	68.9	8.75	31-Dec-13	69.9	8.75
6 Foray St, Fairfield, NSW	31-Dec-08	18.0	13.1	10.50	31-Dec-13	14.9	10.50
Cosgrove Industrial Park, Enfield, NSW	31-Dec-08	57.8	56.9	7.75	30-Jun-14	55.4	8.13
Spotlight, Laverton North, VIC	31-Dec-08	16.9	18.5	8.00	31-Dec-13	17.0	8.25
12-30 Toll Drive, Altona North, VIC	31-Dec-08	13.9	13.8	8.50	30-Jun-14	14.0	8.75
2-10 Toll Drive, Altona North, VIC	31-Dec-08	6.5	5.9	8.50	31-Dec-13	5.8	8.50
1-9 Toll Drive, Altona North, VIC	31-Dec-08	3.3	3.9	8.25	30-Jun-14	3.9	8.50
Total Australia		1,683.5	1,828.2			1,669.0	
Hungary							
Rozalia park	12-Apr-07	80.4	13.9	10.71	30-Jun-14	20.9	12.00
France							
Rue Charles Nicolle, Villeneuve les Beziers	31-Dec-08	18.3	11.9	8.50	30-Jun-14	11.7	8.47
Avenue de Savigny, Aulnay sous Bois	31-Dec-08	20.3	15.4	6.95	30-Jun-14	15.1	6.95
105 Route d'Orleans, Sully sur Loire	31-Dec-08	27.1	11.6	9.75	30-Jun-14	11.6	9.75
140 Rue Marcel Paul, Gennevilliers	31-Dec-08	14.0	10.7	7.25	30-Jun-14	10.5	7.25
ZAC Papillon, Parcay-Meslay	31-Dec-08	10.1	7.1	8.65	30-Jun-14	6.9	8.65
Japan							
Carino Chitosedai	31-Jan-10	118.3	97.7	5.10	31-Dec-13	101.3	5.20
Carino Tokiwadai	31-Jan-10	77.0	64.5	5.20	30-Jun-14	66.6	5.20
Izumiya Hakubaicho	31-Jan-10	68.4	56.2	5.50	31-Dec-13	60.0	5.30
Unicus Ina	31-Jan-10	–	–	–	–	49.3	5.30
Valor Toda	31-Jan-10	42.5	34.3	6.00	30-Jun-14	36.2	5.90

	Acquisition date[2]	Total cost[3] $M	Carrying value 2014 $M	Cap rate[4] 2014 %	Last external valuation	Carrying value 2013 $M	Cap rate[4] 2013 %
Japan (continued)							
Life Higashinakano	31-Jan-10	32.8	28.4	5.00	31-Dec-13	29.3	5.10
Life Asakusa	31-Jan-10	27.8	24.3	5.20	30-Jun-14	25.1	5.10
Osada Nagasaki	31-Jan-10	21.1	10.1	–	31-Dec-13	18.1	6.50
Yaoko Sakato Chiyoda	31-Jan-10	18.2	13.8	5.50	31-Dec-13	14.4	5.40
Sunny Noma	31-Jan-10	–	–	–	–	14.4	5.60
Kansai Super Saigo	31-Jan-10	13.0	10.9	6.10	30-Jun-14	11.4	5.70
Kojima Nishiarai	31-Jan-10	10.8	8.1	6.00	31-Dec-13	8.7	5.90
DeoDeo Kure	31-Jan-10	31.4	24.8	6.10	30-Jun-14	26.1	5.80
Seiyu Miyagino	31-Jan-10	9.7	8.2	6.10	30-Jun-14	8.5	6.00
Aeon Kushiro	31-Jan-10	26.8	25.1	5.90	30-Jun-14	26.2	5.90
Valor Ichinomiya	31-Jan-10	–	–	–	–	21.6	5.70
Life Nagata	31-Jan-10	27.8	21.5	5.50	30-Jun-14	22.5	5.20
Renaissance Fujimidai	31-Jan-10	–	–	–	–	25.4	5.60
Valor Takinomizu	31-Jan-10	25.2	21.5	5.80	31-Dec-13	22.8	5.90
Total overseas		721.0	520.0			664.6	
Investment property in use		2,404.5	2,348.2			2,333.6	
TRE Data Centre	14-Apr-10	12.0	12.0	–	–	11.8	–
Enfield	31-Dec-08	20.4	6.8	–	30-Jun-14	6.8	–
Investment property under development		32.4	18.8			18.6	
Maitland	6-Dec-06	77.8	77.8	–	–	76.6	–
Development property		**77.8**	**77.8**			**76.6**	

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

1 Property is 50% owned by CLC and 50% by a non-related party.

2 Acquisition date represents the date of CLC's initial acquisition or consolidation of the investment vehicle holding the asset.

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

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

The carrying values for investment properties in use have been determined with reference to independent valuations using market capitalisation and discounted cash flow methods. Valuers are appointed in line with the valuation policy which requires valuers to be authorised, experienced, Australian Property Institute (or international equivalent) compliant, indemnified and without conflict of interest which could affect the valuation. Valuers are required to provide valuation methodology and calculations for fair value including reference to annual net market income, comparable capitalisation rates, and property-specific adjustments. Where the expected net cash flows are discounted to their present value using a market-determined-risk adjusted discount rate, a discounted cash flow analysis is performed. The fair value of investment property does not reflect future capital expenditure that will improve or enhance the property.

Where properties are debt financed other than by secured mortgages, funding contains a number of negative undertakings (including undertakings not to create or allow encumbrances, and undertakings not to incur financial indebtedness which ranks in priority to existing debt).

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 include mortgages 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 2014, the investment property portfolio occupancy rate was 96.4% (Australian and overseas, excluding Japan) and 95.3% (Japan) with a weighted average lease expiry of 4.8 years (Australian and overseas, excluding Japan) and 8.7 years (Japan).

13. Finance leases

	30 June 2014 $M	30 June 2013 $M
Gross finance lease receivable	51.3	–
Due within one year	9.6	–
Due within one to five years	29.5	–
Due later than five years	12.2	–
Less: unearned future finance income on finance lease assets	(11.9)	–
Net finance lease receivables	39.4	–
Present value of net investment in finance lease receivables		
Due within one year	6.2	–
Due within one to five years	22.1	–
Due later than five years	11.1	–
Total	39.4	–

14. Property, plant and equipment

	30 June 2014 $M	30 June 2013 $M
Office property, plant and equipment at cost	58.7	62.0
Less: accumulated depreciation	(35.0)	(35.5)
	23.7	26.5
Infrastructure property, plant and equipment at cost	135.1	124.1
Less: accumulated depreciation	(20.7)	(13.0)
	114.4	111.1
Total property, plant and equipment	138.1	137.6

	Office $M	Infrastructure $M	Total $M
Movement in property, plant and equipment			
30 June 2014			
Balance at the beginning of the year	26.5	111.1	137.6
Additions	3.5	3.3	6.8
Disposals[1]	–	(0.3)	(0.3)
Depreciation expense	(6.3)	(6.5)	(12.8)
Amortisation of capitalised borrowing cost	–	(3.3)	(3.3)
Foreign exchange gains	–	10.1	10.1
Balance at the end of the year	23.7	114.4	138.1
30 June 2013			
Balance at the beginning of the year	30.4	93.9	124.3
Additions	1.4	14.0	15.4
Disposals	–	(0.4)	(0.4)
Depreciation expense	(5.3)	(5.8)	(11.1)
Foreign exchange gains	–	9.4	9.4
Balance at the end of the year	26.5	111.1	137.6

All property, plant and equipment is non-current.

[1] Disposals in 2014 included office property, plant and equipment with a nil carrying value (previously fully depreciated).

15. Other assets

	30 June 2014 $M	30 June 2013 $M
Rental bond deposits	18.6	23.8
Prepayments – deferred portfolio and origination costs	5.9	7.5
Other	10.3	13.2
Other SPV	0.3	0.9
Total other assets	35.1	45.4
Current	11.9	15.8
Non-current	23.2	29.6
	35.1	45.4

16. Goodwill and other intangible assets

	30 June 2014 $M	30 June 2013 $M
Goodwill[1]	531.0	506.8
Other intangible assets		
Software at cost	7.5	27.1
Less: accumulated amortisation	(5.4)	(24.9)
	2.1	2.2
Customer list at cost[1]	0.2	–
Less: accumulated amortisation	–	–
	0.2	–
Operating lease intangible at cost	22.8	22.8
Less: accumulated amortisation	(6.4)	(4.9)
Less: foreign exchange losses	(3.9)	(5.8)
	12.5	12.1
Total other intangible assets	14.8	14.3

	Goodwill[1]		Customer list[1]		Software		Operating lease	
	30 June 2014 $M	30 June 2013 $M	30 June 2014 $M	30 June 2013 $M	30 June 2014 $M	30 June 2013 $M	30 June 2014 $M	30 June 2013 $M
Balance at the beginning of the year	506.8	505.7	–	–	2.2	2.0	12.1	11.7
Additions	24.2	–	0.2	–	0.6	1.9	–	–
Foreign exchange gain	–	1.1	–	–	–	–	1.9	1.3
Amortisation expense	–	–	–	–	(0.7)	(1.7)	(1.5)	(0.9)
Balance at the end of the year	531.0	506.8	0.2	–	2.1	2.2	12.5	12.1

[1] The increase in goodwill and the recognition of the Customer list intangible asset arose on the acquisition of Bendzulla Actuarial Pty Ltd. Refer to Note 36 Acquisitions of subsidiaries and businesses.

17. 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 are based on the Group's cost of capital.

Assumptions used in deriving the weighted average cost of capital are as follows:

Budgeted gross margins – is the average gross margins achieved in the year ended immediately preceding 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 in use for each CGU are in excess of the carrying values of goodwill. Management are of the view that reasonable changes in the key assumptions, such as an increase in the discount rate by 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 2014. All goodwill is non-current.

	30 June 2014 $M	30 June 2013 $M	30 June 2014 Discount rate %	30 June 2013 Discount rate %	Cash flow horizon (years)
CGU					
Life	444.0	419.8	11.0	10.5	5
Funds Management	87.0	87.0	11.0	10.5	5
Total	531.0	506.8			

18. Payables

	30 June 2014 $M	30 June 2013 $M
Trade creditors and accruals	139.2	122.2
Distributions payable	6.8	9.9
Unsettled trades payable	230.8	11.9
Other creditors	32.3	46.7
Payables – SPV	9.7	17.1
Derivative credit support	24.5	–
Total payables	443.3	207.8
Current	428.3	188.3
Non-current	15.0	19.5
	443.3	207.8

19. Interest bearing financial liabilities

	30 June 2014		30 June 2013	
	Facility $M	Outstanding $M	Facility $M	Outstanding $M
Bank loans				
Recourse – Corporate	350.0	–	250.0	–
Non-recourse – Controlled property trusts[1]	809.0	646.0	827.2	771.6
Non-recourse – Controlled infrastructure trusts	206.1	206.1	206.1	206.1
Non-recourse – Repurchase agreements	978.3	978.3	448.9	448.9
Total bank loans	2,343.4	1,830.4	1,732.2	1,426.6
Non-recourse non-bank loans				
Subordinated debt issuance	525.9	525.9	510.1	510.1
Loan note finance	3.2	3.2	88.2	88.2
Controlled property trusts	10.5	10.5	10.9	10.8
Total non-bank loans	539.6	539.6	609.2	609.1
Total interest bearing liabilities	2,883.0	2,370.0	2,341.4	2,035.7
Current		1,043.1		472.3
Non-current		1,326.9		1,563.4
		2,370.0		2,035.7

[1] Total facility limit consists of redraw loan facilities limits totalling $300.0 million and non-redraw loan facilities limits totalling $509.0 million.

Bank loans

Corporate – the facility was renewed on 13 May 2014 with amended terms. The amount was increased to $350.0 million in two equal tranches with three and five year durations which are 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 – the loans have variable terms and are generally secured by way of first-ranking mortgages over the investment properties. The 30 June 2014 balance includes $246.0 million (30 June 2013: $346.4 million) of Yen denominated loans in the Japanese property trusts. Other controlled property trusts loans total $400.0 million (June 2013: $425.2 million). A total of $64.8 million of these liabilities are secured against properties available for sale and so have been classified as current.

Controlled infrastructure trusts – the facility has an expiry date of June 2016 and is secured by way of first-ranking mortgages over the corresponding infrastructure assets.

Repurchase agreements – CLC has entered into repurchase agreements with the Reserve Bank of Australia and other banking institutions whereby fixed income securities (or portfolios of fixed income securities), predominantly Commonwealth Government and Semi-Government bonds, are sold for cash whilst simultaneously agreeing to repurchase the securities at a fixed price and fixed date in the future. These agreements are used for liquidity management purposes and to hedge exposures on the external unit holders' liabilities and are interest bearing, with interest factored into the sellback price and paid on repurchase. All of the 30 June 2014 balance of $978.3 million was current and matured and rolled over into new short-term contracts on 10 July 2014.

19. Interest bearing financial liabilities (continued)

Non-bank loans

Subordinated debt issuance – the Group issued subordinated notes into the US private placement market of $US150.0 million in December 2006 and $400.0 million in November 2007.

The December 2006 notes are unsecured and were issued in two maturities ($US125.0 million at 10 years with a non-call period of five years and $US25.0 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 at a floating rate of interest. 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 CLC (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 the profit and loss and adjusted for movements in interest rates, credit spreads and foreign exchange rates.

The notes were issued under Australian Prudential Regulation Authority (APRA) approved Instruments of Issue and counted as Approved Subordinated Debt for regulatory capital purposes. Under transition relief provided by APRA from the introduction of Life and General Insurance Capital (LAGIC) standards on 1 January 2013, this subordinated debt issuance continued to be fully eligible as Tier 2 regulatory capital until each tranche's first call date (or coupon date, where the tranche was already past its call date) after 1 January 2013, thereafter amortising over four years. At 30 June 2014, there was $476.8 million of subordinated debt admissible as Tier 2 regulatory capital.

Loan note finance – the Group entered into a restricted recourse GBP25.0 million loan in September 2006 that is secured against properties. The loan balance plus all capitalised interest has been marked to fair value at 30 June 2014, consistent with the treatment of the corresponding (offsetting) asset.

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

20. External unit holders' liabilities

	30 June 2014 $M	30 June 2013 $M
Current	1,072.4	1,232.9
Non-current	–	518.5
Total liabilities to external unit holders	1,072.4	1,751.4

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.

21. Provisions

	30 June 2014 $M	30 June 2013 $M
Surplus lease provision[1]	5.3	8.4
Employee entitlements	10.2	9.1
Relocation provision	4.3	4.1
Other provisions	6.7	5.4
Total provisions	26.5	27.0
Current	17.7	16.1
Non-current	8.8	10.9
	26.5	27.0

	Surplus lease provision[1] $M	Employee entitlements $M	Relocation provision $M	Other $M
30 June 2014				
Balance at the beginning of the year	8.4	9.1	4.1	5.4
Arising during the year	0.4	7.7	0.2	4.6
Amounts utilised during the year	(3.5)	(6.6)	–	(3.3)
Balance at the end of the year	5.3	10.2	4.3	6.7
30 June 2013				
Balance at the beginning of the year	12.9	8.1	3.9	2.5
Arising during the year	0.5	7.4	0.2	3.5
Amounts utilised during the year	(5.0)	(6.4)	–	(0.6)
Balance at the end of the year	8.4	9.1	4.1	5.4

1 Surplus lease provision represents the Group's net rental expense obligations on surplus space in leased buildings in Sydney and London. The obligations on these leases expire in 2016. The relocation provision represents the Group's net obligations on building leases.

22. Life contract liabilities

	30 June 2014 $M	30 June 2013 $M
Life investment contract liabilities – at fair value	6,210.1	6,150.0
Life insurance contract liabilities – at Margin on Services value	1,556.6	913.5
Reinsurance contract liabilities – at Margin on Services value	57.6	59.8
Total life contract liabilities	7,824.3	7,123.3

	Life investment contract liabilities		Life insurance contract liabilities		Reinsurance contract liabilities		Total life contract liabilities	
Movement in life contract liabilities	30 June 2014 $M	30 June 2013 $M	30 June 2014 $M	30 June 2013 $M	30 June 2014 $M	30 June 2013 $M	30 June 2014 $M	30 June 2013 $M
Balance at the beginning of the year	6,150.0	5,806.2	913.5	685.4	59.8	61.4	7,123.3	6,553.0
Deposits and premium receipts	2,185.7	1,922.3	620.5	257.6	–	–	2,806.2	2,179.9
Payments and withdrawals	(2,417.0)	(1,835.1)	(109.0)	(60.1)	(4.0)	(3.9)	(2,530.0)	(1,899.1)
Revenue per Note 3	5.9	5.0	(70.8)	(94.5)	(0.5)	2.3	(65.4)	(87.2)
Expense per Note 4	285.5	251.6	202.4	125.1	2.3	–	490.2	376.7
Balance at the end of the year	6,210.1	6,150.0	1,556.6	913.5	57.6	59.8	7,824.3	7,123.3

	30 June 2014 $M	30 June 2013 $M
Analysis of life insurance contract liability and expenses		
Best estimate liability		
Value of future life insurance contract benefits	1,554.1	930.0
Value of future expenses	67.1	43.4
Value of future premiums	(112.2)	(5.4)
Total best estimate liability	1,509.0	968.0
Value of future profit margins	105.2	5.4
Net life insurance contract liability	1,614.2	973.4
Life insurance contract operating expenses		
Maintenance expenses – commission	0.7	0.6
Maintenance expenses – other	5.6	3.8
Total life insurance contract operating expenses	6.3	4.4
Analysis of life contract profit		
Profit margin release on life insurance contracts	6.5	0.7
Loss recognition in respect of life insurance contracts[1]	(72.9)	(48.2)
Loss recognition in respect of life investment contracts	(111.6)	(103.7)
Difference in actual and assumed experience in respect of life insurance contracts	77.4	59.1
Difference in actual and assumed experience in respect of life investment contracts	297.6	373.5
Profit arising from difference between actual and assumed experience	197.0	281.4
Investment earnings on assets in excess of life contract liabilities	154.1	231.3
Life contract profit after tax	351.1	512.7

[1] Under MoS, any profits expected over the life of a contract are recognised over the life of the contract; however, if on the liability valuation basis the contract is expected to be loss making, the capitalised value of these future losses is recognised at the point of sale. Retail insurance contracts are in loss recognition because the liability valuation basis uses a risk-free discount rate but the rates offered to customers are higher.

Methodology applied in the valuation of life contract liabilities

Life investment contracts are policies regulated by 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 under AASB 4 and are measured using the margin on services (MoS) methodology. This includes inwards reinsurance of longevity and mortality risks.

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

Key assumptions applied in the valuation of life contract liabilities

Discount rates – under APRA Prudential Standards, life insurance contract liabilities are calculated by discounting expected future cash flows at a risk-free rate, set at the Commonwealth Government Bond curve or for foreign-denominated liabilities, a curve derived from the yields of highly liquid AAA-rated sovereign risk securities in the currency of the policy liabilities plus an illiquidity premium where applicable. The illiquidity premium is determined by reference to observable market rates including Australian sovereign debt, corporate, securitised and collateralised debt publicly placed in the domestic market, and market swap rates. Life investment contract liabilities are calculated under the fair value through profit and loss provisions of **AASB 139 Financial Instruments: Recognition and Measurement**. 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 2014. Discount rates applied for Australian liabilities were between 3.0-5.4% (2013: 3.2-4.8%) per annum.

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

Inflation estimates are 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 for Australia is 1.7% for short-term inflation and 2.9% for long-term (2013: 1.7% short-term, 2.5% long-term) per annum.

No surrenders or voluntary discontinuances are assumed for life investment contracts. Where policy holders have the option to commute a life insurance contract, the value of this option is included within the life contract liabilities.

Mortality – base mortality rates for individual lifetime annuities are determined as a multiple of annuitant experience based on IML00 and IFL00[1] tables, adjusted for Challenger's own recent experience. Base mortality rates for wholesale mortality and longevity reinsurance are determined as a multiple of pensioner mortality rates (SAPS2[2] tables) or population rates as appropriate. Rates are adjusted for expected future mortality improvements based on observed and expected improvements. Rates of future mortality improvement for individual lifetime annuities applied are between 1.0-4.0% (2013: 1.0-4.0%) per annum.

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 Act 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 make distributions when capital adequacy requirements are met.

Statutory fund information

The Company 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 and longevity reinsurance. Life contract liabilities for funds 1, 2 and 3 are $4.8 million, $7,815.6 million and $3.9 million respectively (2013: $4.9 million, $7,114.7 million, $3.7 million).

[1] IML00 and IFL00 are mortality tables developed by the Institute and Faculty of Actuaries (UK) based on United Kingdom annuitant lives experience from 1999–2002. The tables refer to male and female lives respectively and incorporate factors that allow for mortality improvements since the date of the investigation.

[2] Self-administered pension schemes mortality investigation developed by the Institute and Faculty of Actuaries (UK) based on United Kingdom data collected between 2004–2012.

22. Life contract liabilities (continued)

Current/non-current split for total life contracts

There is a fixed settlement date for the majority of life contract liabilities. Approximately $1,483.3 million (2013: $1,719.0 million) of life contract liabilities have a contractual maturity within 12 months of the reporting date. Based on assumptions applied for the 30 June 2014 valuation of life contract liabilities, $1,683.6 million of principal payments on fixed term and lifetime business are expected in the year to 30 June 2015 (2014: $1,947.0 million).

Life insurance risk

The Group is exposed to longevity risk on its individual lifetime annuities and wholesale longevity reinsurance, being the risk that policyholders may live longer than expectations, and mortality risk on the wholesale mortality reinsurance, being that the risk that death rates in the reference portfolios exceed expectations. The Group manages the longevity risk by regular reviews of the portfolio to confirm continued survivorship of policyholders receiving income plus regular review of longevity experience to ensure that longevity assumptions remain appropriate. In addition, the Group has entered into reinsurance arrangements to manage longevity risk in respect of closed books of individual lifetime annuities. The Group manages the mortality risk by the regular reviews 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, 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/(loss) after tax and equity impact			
	Gross		Net		Gross		Net	
	30 June 2014 $M	30 June 2013 $M	30 June 2014 $M	30 June 2013 $M	30 June 2014 $M	30 June 2013 $M	30 June 2014 $M	30 June 2013 $M
50% increase in the rate of mortality improvement	92.0	61.0	57.3	19.6	(64.4)	(42.7)	(40.1)	(13.7)
10% increase in maintenance expenses	4.2	2.9	4.2	2.9	(2.9)	(2.0)	(2.9)	(2.0)

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 28 Financial risk management.

	1 year or less $M	1-3 years $M	3-5 years $M	>5 years $M	Total $M
Undiscounted life insurance contract liabilities					
2014	204.1	307.1	236.0	1,610.9	2,358.1
2013	111.1	167.8	145.7	1,015.5	1,440.1

Actuarial information

Mr A Bofinger FIAA, as the Appointed Actuary of CLC, is satisfied as to the accuracy of the data used in the valuations of life contract liabilities in the financial report and the tables in this note. The life contract liabilities have been determined at the reporting date in accordance with the Life Act.

23. Special Purpose Vehicles

Special Purpose Vehicles (SPV) are entities that fund pools of residential mortgage-backed loans via the issuance of RMBS. 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 2014 $M	30 June 2013 $M
Cash and cash equivalents	216.6	278.7
Mortgage loan assets	2,978.9	4,039.4
Derivative assets	1.3	5.5
Other assets	0.3	0.9
Total assets	3,197.1	4,324.5
Payables[1]	264.3	493.2
Derivative liabilities	1.8	1.9
Interest bearing financial liabilities	2,931.4	3,825.8
Total liabilities	3,197.5	4,320.9
Net assets	(0.4)	3.6
Cash flow hedge reserve	(0.4)	3.6
Total equity attributable to residual income unit holders	(0.4)	3.6

[1] Payables differ from the SPV Payables per Note 18 Payables by the value of the cumulative eliminations between the SPV and other members of the Group.

The SPV mortgage loan asset value is stated net of impairment provisions measured as any shortfall between the carrying amount of the loans and the present value of expected future cash flows, discounted at the loans' original effective interest rate and adjusted for lenders' mortgage insurance coverage. A reconciliation of the impairment provision is as follows:

	30 June 2014 $M	30 June 2013 $M
Balance at the beginning of the year	60.6	57.6
Additional provisions and adjustments to estimates	8.1	15.5
Utilisation of provision against incurred losses	(6.0)	(12.5)
Balance at the end of the year	62.7	60.6

24. Contributed equity

	30 June 2014 No. of shares M	30 June 2014 $M	30 June 2013 No. of shares M	30 June 2013 $M
Ordinary shares issued	530.9	1,335.5	530.9	1,335.5
CPP Trust shares treated as Treasury shares	(12.5)	(66.2)	(8.7)	(40.2)
CPP deferred share purchase treated as Treasury shares	(7.8)	(31.8)	(6.6)	(23.4)
Total contributed equity	510.6	1,237.5	515.6	1,271.9
Movement in contributed equity:				
Ordinary shares				
Balance at the beginning of the year	530.9	1,335.5	544.7	1,385.5
Cancelled under share buy-back	–	–	(13.8)	(50.0)
Balance at the end of the year	530.9	1,335.5	530.9	1,335.5
CPP Trust				
Balance at the beginning of the year	8.7	40.2	15.7	72.4
Shares purchased (including settled forwards)	7.6	43.2	–	–
Vested shares released to employees	(3.8)	(17.2)	(7.0)	(32.2)
Balance at the end of the year	12.5	66.2	8.7	40.2
CPP deferred share purchases				
Balance at the beginning of the year	6.6	23.4	–	–
CPP deferred share purchases	3.0	14.0	6.6	23.4
Settled forward purchases	(1.8)	(5.6)	–	–
Balance at the end of the year	7.8	31.8	6.6	23.4

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. Dividends paid from the Company to the CPP Trust are eliminated on consolidation.

CPP deferred share purchases – the shares purchased under forward agreements are treated as treasury shares from the date of the agreement. Shares are transferred to the CPP Trust on the future settlement date.

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 an Internal Capital Adequacy Assessment Process (ICAAP) at both the Group and the prudentially-regulated CLC level. The objective of the ICAAP 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 ICAAPs are approved by the respective boards and are reviewed at least annually.

ICAAP Summary Statement – Challenger Limited

The Group is a Level 3 Head under the APRA conglomerates framework. 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. APRA is currently developing a supervisory framework for Level 3 (conglomerate) groups, which was due to be effective from 1 January 2015. Draft Level 3 standards have been issued by APRA. However, APRA is yet to confirm the implementation date. In August 2014, APRA deferred a decision on its final standards and implementation until the Government response to the recommendations of the Financial System Inquiry has been announced.

Under the draft standards, the Group is required to have an ICAAP Summary Statement and so the Group ICAAP Summary Statement replaced the Group capital management plan during the period. The Group's ICAAP Summary Statement aims to maintain an investment grade credit rating and robust capital ratios in order to support its business objectives, protect regulated entities within the Group from operation and other risks outside those regulated entities and maximise shareholder returns. 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 at the statement of financial position are 'BBB+' (stable) and 'A' (stable) respectively. There were no changes to either the Group or CLC ratings during the period and they reflect the financial strength of the Company and CLC. In particular, they demonstrate Challenger's strong business profile, earnings and capital position.

Challenger has historically targeted a combined dividend and buy-back payout ratio of approximately 50% of normalised profit after tax over the medium term, subject to prevailing market conditions and alternate uses of capital.

The Challenger Board regularly reviews the mix between dividends and share buy-back as part of the Group's capital management plan. In August 2013, the Board increased the targeted dividend payout ratio by 5% to a range of 35-40% of normalised net profit after tax. In February 2014, the Board increased the targeted dividend payout ratio again by a further 5% to a range of 40-45%. Challenger initiated its buy-back program in 2008 and to date has bought back 150 million shares (approximately $0.5 billion) since initiating the program, which has enhanced growth in earnings and dividends per share. During 2014, no shares were bought back; instead capital of $25.0 million was allocated to the acquisition of Bendzulla. With the increased forecast in dividend franking levels, as outlined in Section 5 of the Directors' report, the Board has determined that the dividend payout ratio will increase again in 2015, to around 45-50% of normalised net profit after tax. The actual dividend payout ratio will depend on prevailing market conditions and capital allocation priorities. As a result, no share buy-backs are anticipated in 2015.

There were no other material changes to the Group's capital management process during the period.

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 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 the effective date of LAGIC.

Prescribed capital amount (PCA)

CLC holds capital in order to ensure that under a range of adverse scenarios it can continue to meet its regulatory and contractual obligations to its customers. CLC is regulated by APRA and is required to hold a minimum level of regulatory capital.

CLC's regulatory capital base and PCA have been calculated based on the LAGIC regulatory capital standards issued by APRA.

CLC's excess capital above the PCA at 30 June 2014 was $902.6 million, up $5.2 million for the year. CLC's PCA ratio at 30 June 2014 was 1.66 times and the common equity Tier 1 (CET1) ratio was 1.31 times.

The introduction of the LAGIC standards increased CLC's regulatory capital requirement by $322.8 million on 1 January 2013. APRA has provided a three year transition period to meet these new requirements. Therefore CLC's 30 June 2014 excess capital position includes a LAGIC transition balance of $215.2 million (30 June 2013 includes $322.8 million). A further $107.6 million of the remaining LAGIC transition balance will amortise on each of 1 January 2015 and 1 January 2016.

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 numerous factors. CLC's PCA ratio is currently higher than this range of 1.4 to 1.6 times, as CLC's capital position contemplates the amortisation of the LAGIC transition balance over the next 18 months.

As noted above, the PCA ratio at 30 June 2014 was 1.66 times, down from 1.78 times at 30 June 2013, reflecting amortisation of the first transition balance ($107.6 million on 1 January 2014), changes in asset allocation, net AUM growth and retained earnings. Excluding the full LAGIC transition balance ($215.2 million), CLC's PCA ratio at 30 June 2014 was 1.44 times (2013: 1.39 times).

24. Contributed equity (continued)

Capital management (continued)

Subordinated debt

CLC's total regulatory capital base includes $476.8 million of admissible subordinated debt. Subordinated debt tranches issued prior to 1 January 2013 will continue to be fully eligible as Tier 2 regulatory capital under LAGIC until each tranche's first call date after 1 January 2013, and will then amortise over four years. For tranches already past their call date, under LAGIC the first coupon date is considered the first call date.

CLC's subordinated debt includes $129.4 million which had a call date on 7 June 2013. As a result, under APRA's transition arrangements, only $77.6 million (i.e. 60% of the total amount) is eligible as Tier 2 regulatory capital on 30 June 2014.

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 (CET1) representing 80% of the PCA. At a CLC consolidated level, APRA has provided a two year transition period from 1 January 2013 to meet the 80% Tier 1 requirement. CLC is currently meeting these requirements at both the statutory and consolidated level. The CET1 ratio was 1.31 for the PCA at 30 June 2014 (2013: 1.35).

CLC's target surplus

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

As noted above, the PCA ratio at 30 June 2014 was 1.66 times (2013: 1.78 times). Excluding the remaining LAGIC transition balance ($215.2 million), CLC's PCA ratio at 30 June 2014 was 1.44 times (2013: 1.39 times).

Details of the CLC capital adequacy multiple are provided below:

	30 June 2014 $M	30 June 2013 $M
CLC's excess capital under LAGIC		
Common equity Tier 1 regulatory capital	1,783.1	1,563.5
Tier 2 regulatory capital – subordinated debt[1]	476.8	488.8
CLC total regulatory capital base	2,259.9	2,052.3
Prescribed capital amount		
Asset risk charge	1,530.5	1,452.4
Insurance risk charge	83.9	31.6
Operational risk charge	22.8	18.5
Aggregation benefit	(64.7)	(24.8)
Prescribed capital amount – excluding transition relief	1,572.5	1,477.7
LAGIC transition relief[2]	(215.2)	(322.8)
CLC prescribed capital amount	1,357.3	1,154.9
CLC excess over prescribed capital amount	902.6	897.4
Capital adequacy ratio (times)	1.66	1.78

[1] Differs from $525.9 million disclosed in Note 19 Interest bearing financial liabilities due to $2.7 million of accrued interest and ($51.7 million) of inadmissible Tier 2 regulatory capital.

[2] LAGIC transition relief reduces by one third ($107.6 million) on each of 1 January 2014, 1 January 2015 and 1 January 2016.

25. Reserves

	30 June 2014 $M	30 June 2013 $M
Share-based payments reserve		
Balance at the beginning of the year	30.0	35.6
Transfer from equity option premium reserve	–	1.7
Share-based payments for the period	25.3	16.6
Releases from share-based payments reserve	(17.2)	(21.9)
Tax on equity	16.8	(2.0)
Balance at the end of the year	54.9	30.0
Cash flow hedge reserve – SPV[1]		
Balance at the beginning of the year	3.6	(0.9)
(Charged to)/released from equity	(4.0)	4.5
Balance at the end of the year	(0.4)	3.6
Foreign currency translation reserve[1]		
Balance at the beginning of the year	(2.0)	(8.4)
Loss on translation of foreign entities[2]	(11.8)	(4.3)
Gain on hedge of net investment in foreign entities[2]	15.2	10.7
Recycled to the profit and loss	(5.4)	–
Balance at the end of the year	(4.0)	(2.0)
Adjusted controlling interests reserve[1]		
Balance at the beginning of the year	18.2	17.7
Change in holdings in controlled entities	1.1	0.5
Balance at the end of the year	19.3	18.2
Equity option premium reserve		
Balance at the beginning of the year	–	65.0
Expiry of equity option transferred to retained earnings	–	(63.3)
Transfer to share-based payments reserve	–	(1.7)
Balance at the end of the year	–	–
Total reserves	69.8	49.8

[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 conferred 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 – SPV – 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 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. Retained earnings

	30 June 2014 $M	30 June 2013 $M
Balance at the beginning of the year	625.7	270.1
Profit attributable to equity holders	340.6	416.8
Expiration of equity options[1]	–	44.4
Dividends paid	(120.3)	(105.6)
Total retained earnings	846.0	625.7

[1] The equity options issued to Colony Marlin-Holdings LLC 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.

27. Non-controlling interests

	30 June 2014 $M	30 June 2013 $M
Representing the following shares of equity in the applicable entities		
Contributed equity	73.4	357.6
Reserves	19.0	(22.9)
Opening retained profits/(losses)[1]	1.3	(32.4)
Profit for the year	29.1	44.5
Total non-controlling interests	122.8	346.8

[1] Includes pre-acquisition retained profits/(losses).

28. 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 these 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 implementing 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 certain of its responsibilities. In particular, setting the risk appetite and ensuring the Group 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 Basis of preparation and summary of significant accounting policies.

Market risk

Market risk is the risk that the fair value and/or future cash flows from a financial instrument will fluctuate as a result of changes in market factors. Market risk comprises (amongst others) interest rate risk (due to fluctuations in market interest rates), price risk (due to fluctuations in the fair value of equities or credit spreads) and currency risk (due to fluctuations in foreign currency exchange rates).

Interest rate risk

Interest rate risk is the risk of fluctuations in the Group's earnings and equity arising from movements in market 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 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 30-70% 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 of greater than five years and targets average hedge duration of three years.

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 capital adequacy requirements, which in turn include consideration of how the interest rate sensitivity of assets and liabilities are matched.

For the SPV, the impact of a rising/falling bank bill swap rate (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 rates 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 to a floating rate exposure at 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 statement of financial position 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 which includes investment properties with leases, where the future income stream is duration-hedged for interest rate movements.

	Change in variable	Profit/ (loss) 30 June 2014 $M	Change in equity 30 June 2014 $M	Profit/ (loss) 30 June 2013 $M	Change in equity 30 June 2013 $M
Non-SPV	+100bps	5.0	5.0	7.2	7.2
	–100bps	(5.0)	(5.0)	(7.2)	(7.2)
SPV	+100bps	(2.6)	(2.6)	(3.6)	(3.6)
	–100bps	2.6	2.6	3.6	3.6
Total	+100bps	2.4	2.4	3.6	3.6
	–100bps	(2.4)	(2.4)	(3.6)	(3.6)

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.

28. Financial risk management (continued)

Price risk

Price risk is the risk that the fair value of a financial instrument will fluctuate as a result 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 fixed income securities. The Group is required to fair value all equities and fixed income securities held to back life contract liabilities.

Equity risks will arise as a natural result of the CLC's Asset Allocation Plan. The Group's primary tools for managing investment price risks are CLC's Internal Capital Adequacy Assessment Process (ICAAP) and Asset Allocation Plan.

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/ (loss) 30 June 2014 $M	Change in equity 30 June 2014 $M	Profit/ (loss) 30 June 2013 $M	Change in equity 30 June 2013 $M
Property securities	+10%	32.8	(32.8)	31.4	31.4
	–10%	(32.8)	32.8	(31.4)	(31.4)
Infrastructure investment	+10%	25.2	(25.2)	21.2	21.2
	–10%	(25.2)	25.2	(21.2)	(21.2)
Other assets	+10%	20.6	(20.6)	16.1	16.1
	–10%	(20.6)	20.6	(16.1)	(16.1)
Total assets	+10%	78.6	(78.6)	68.7	68.7
	–10%	(78.6)	78.6	(68.7)	(68.7)

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 price movements resulting from credit spreads fluctuations through its fixed income securities net of subordinated debt. As at 30 June 2014, a 50 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 $78.9 million (2013: $91.9 million). The increase over the 2013 number reflects the increase in fixed income 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, Japanese Yen, British Pound and US Dollar and against the Australian Dollar. In order to protect against foreign currency 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 foreign denominated controlled entities 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. Effectiveness is monitored on a regular basis to ensure that the hedge remains between 80-125% 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 currencies. 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 profit and loss.

The following table details the Group's net exposure to foreign currency as at the reporting date in Australian dollar equivalent amounts.

30 June 2014	GBP $M	USD $M	Euro $M	JPY $M	Other $M
Financial assets	549.7	1,505.9	745.3	224.6	133.7
Financial liabilities	(107.3)	(281.9)	(38.2)	–	–
Foreign currency contracts and cross currency swaps	(432.2)	(1,225.5)	(713.2)	(226.5)	(108.9)
Net exposure in Australian dollars[1]	10.2	(1.5)	(6.1)	(1.9)	24.8

30 June 2013	GBP $M	USD $M	Euro $M	JPY $M	Other $M
Financial assets	554.5	1,668.2	829.2	255.8	87.2
Financial liabilities	(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[1]	(14.5)	(3.2)	(49.6)	1.0	0.2

[1] 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 the Group's major foreign currency exposure exchange rates against the Australian dollar 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 2014 $M	Change in equity 30 June 2014 $M	Profit/(loss) 30 June 2013 $M	Change in equity 30 June 2013 $M
British Pound (GBP)	+10%	0.7	0.7	(1.0)	(1.0)
	–10%	(0.7)	(0.7)	1.0	1.0
US Dollar (USD)	+10%	(0.1)	(0.1)	(0.2)	(0.2)
	–10%	0.1	0.1	0.2	0.2
Euro (EUR)	+10%	(0.4)	(0.4)	(3.6)	(3.6)
	–10%	0.4	0.4	3.6	3.6
Japanese Yen (JPY)	+10%	–	–	–	–
	–10%	–	–	–	–
Other	+10%	1.7	1.7	–	–
	–10%	(1.7)	(1.7)	–	–

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 foreign currency 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 other 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. Where external credit ratings are not available, internal credit ratings are assigned by appropriately qualified and experienced credit personnel who operate separately from the risk originators.

Each business unit is responsible for managing credit risks that arise with oversight from a centralised credit risk management team.

28. Financial risk management (continued)

Credit exposure by credit rating

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 not factoring any collateral or other credit protection in place. 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		
30 June 2014	AAA $M	AA $M	A $M	BBB $M	$M	Other $M	Total $M
Cash and cash equivalents	391.4	–	–	–	–	–	391.4
Cash and cash equivalents – SPV	216.6	–	–	–	–	–	216.6
Receivables	17.5	1.4	3.7	6.3	15.1	104.5	148.5
Mortgage assets – SPV	1,687.2	845.6	444.0	–	2.1	–	2,978.9
Fixed income securities	3,247.5	928.1	1,240.8	1,575.7	1,470.4	61.5	8,524.0
Derivative assets	–	312.2	0.9	4.8	–	0.1	318.0
Total assets with credit exposures	5,560.2	2,087.3	1,689.4	1,586.8	1,487.6	166.1	12,577.4
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
Mortgage assets – SPV	2,339.2	1,654.3	32.9	–	12.5	0.5	4,039.4
Fixed income securities	1,855.3	1,138.2	1,532.5	1,348.1	1,207.7	163.3	7,245.1
Derivative assets	–	48.7	264.0	15.8	–	–	328.5
Total assets with credit exposures	5,509.5	2,846.8	1,850.2	1,376.1	1,224.5	448.6	13,255.7

SPV mortgage assets are funded via securitised 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					
As at 30 June 2014	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
Receivables	146.0	2.5	–	–	–	–	148.5
Mortgage assets – SPV	2,720.9	145.4	80.5	9.8	–	22.3	2,978.9
Total receivables	2,866.9	147.9	80.5	9.8	–	22.3	3,127.4
As at 30 June 2013							
Receivables	330.1	3.3	–	–	–	–	333.4
Mortgage assets – 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	–	27.7	4,372.8

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 account 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 $400.0 million and $US150.0 million that are required to be held at fair value 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 2014 was a loss of $19.1 million (2013: loss $42.0 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 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 Licence (AFSL) 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 Regulatory Guide 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, medium 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.

28. Financial risk management (continued)

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 time value of money discounting reflected in the statement of financial position values.

30 June 2014	1 year or less $M	1-3 years $M	3-5 years $M	> 5 years $M	Total $M
Payables	418.5	15.0	–	–	433.5
Payables – SPV	9.8	–	–	–	9.8
Interest bearing financial liabilities	1,066.7	1,029.4	171.7	1,064.3	3,332.1
Interest bearing financial liabilities – SPV	785.9	1,055.7	649.7	1,016.4	3,507.7
External unit holders' liabilities	1,072.4	–	–	–	1,072.4
Life contract liabilities	2,024.0	2,638.5	1,233.2	907.1	6,802.8
Derivative liabilities	47.7	85.6	64.8	156.9	355.0
Total undiscounted liabilities	5,425.0	4,824.2	2,119.4	3,144.7	15,513.3
30 June 2013					
Payables	168.4	22.3	–	–	190.7
Payables – SPV	17.1	–	–	–	17.1
Interest bearing financial liabilities	565.4	558.4	774.0	1,140.3	3,038.1
Interest bearing financial 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 liabilities	2,269.5	2,114.5	1,419.1	982.1	6,785.2
Derivative liabilities	155.3	49.1	39.4	68.4	312.2
Total undiscounted liabilities	5,481.8	4,641.1	3,106.0	3,880.1	17,109.0

The Group was due to receive future cash inflows from interest rate swaps currently in a fair value liability position.

29. Fair values of financial assets and liabilities

Fair value determination and classification

Fair value reflects the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The majority of the Group's financial instruments are held in the life insurance statutory funds of CLC and, as a result, are required by AASB 1038 Life Insurance Contracts to be designated at fair value through profit and loss where this is permitted under AASB 139 Financial Instruments: Recognition and Measurement.

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

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

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

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

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

Valuation techniques

The Group's listed fixed and unlisted income securities, government/semi-government securities and over-the-counter derivative financial instruments are all classified Level 2. This recognises the availability of a quoted price but not from an active market as defined by the standard. Fixed income securities where market observable inputs are not available are classified Level 3. The Group derivative financial instruments are traded over-the-counter so, whilst they are not exchange traded, there is a market observable price. All of the listed fixed income and government/semi-government securities have prices determined by a market. Externally rated unlisted fixed income securities are 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.

Equity, infrastructure and property securities that are exchange traded are classified Level 1. Where quoted prices are available, but are not from an active market, they are classified Level 2. If market observable inputs are not available, they are classified Level 3. Valuations can make use of 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 financial liabilities classified as Level 3 include the subordinated debt notes issued by CLC. These are valued using a benchmark credit spread based on a pool of similar securities. External unit holders' liabilities are valued at the face value of the amounts payable and classified as Level 2. The portion of life investment contract liabilities classified as Level 2 represents products or product options for which the liability is determined based on an unmodified account balance, rather than a discounted cash flow as applied to the rest of the portfolio.

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

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the statement of financial position at fair value. These balances are carried at amortised cost. All other financial instruments are either designated at fair value through the profit and loss at initial recognition, or the carrying amount materially approximates the fair value.

	30 June 2014		30 June 2013	
Difference between amortised cost and fair value	Carrying value $M	Fair value $M	Carrying value $M	Fair value $M
Mortgage assets – SPV[1]	2,978.9	3,061.8	4,039.4	4,129.8
Interest bearing financial liabilities – SPV[2]	2,931.4	2,832.0	3,825.8	3,693.1

[1] Mortgage assets – SPV would be predominantly classified as Level 3 in the fair value hierarchy.

[2] Interest bearing financial liabilities – SPV would be predominantly classified as Level 2 in the fair value hierarchy.

29. Fair values of financial assets and liabilities (continued)

Valuation process

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

All financial instruments and investment properties are measured on a recurring basis. The below table summarises the financial instruments and investment properties measured at fair value at each level of the fair value hierarchy as at the statement of financial position date:

30 June 2014	Level 1 $M	Level 2 $M	Level 3 $M	Total $M
Derivative assets	–	318.0	–	318.0
Fixed income securities[1]	–	7,182.4	1,341.6	8,524.0
Equity securities	171.4	46.0	164.4	381.8
Infrastructure investments[1]	109.2	–	543.0	652.2
Property securities[2]	364.9	–	104.4	469.3
Investment property	–	222.7	2,144.3	2,367.0
Assets	645.5	7,769.1	4,297.7	12,712.3
Derivative liabilities	0.2	222.1	0.2	222.5
Interest bearing financial liabilities	–	141.6	529.1	670.7
External unit holders' liabilities	–	1,072.4	–	1,072.4
Life investment contract liabilities	–	100.9	6,109.2	6,210.1
Liabilities	0.2	1,537.0	6,638.5	8,175.7
30 June 2013[3]				
Derivative assets	–	328.5	–	328.5
Fixed income securities	–	5,556.9	1,688.2	7,245.1
Equity securities	115.8	38.8	173.2	327.8
Infrastructure investments	89.7	–	491.4	581.1
Property securities	147.1	–	301.2	448.3
Assets	352.6	5,924.2	2,654.0	8,930.8
Derivative liabilities	–	385.0	–	385.0
Interest bearing financial liabilities	–	147.6	598.3	745.9
External unit holders' liabilities	–	1,751.4	–	1,751.4
Life investment contract liabilities	–	106.1	6,043.9	6,150.0
Liabilities	–	2,390.1	6,642.2	9,032.3

1 The Group has exposures to structured entities (entities designed so that voting or similar rights are not the dominant factor in determining who controls the entity, for example when any voting rights relate purely to administrative tasks) via investments in asset-backed finance vehicles (where it may act as a lender or purchaser of notes and/or residual income units) and securitisations (such as mortgages, finance leases and other types of collateralised vehicles). The maximum exposure to loss is limited to the reported fair value of the underlying securities plus any guaranteed undrawn commitments to the counterparties.
At 30 June 2014 the carrying value of asset-backed financing assets was $70.8 million (plus $47.4 million undrawn commitments) and securitisations was $3,007.6 million (plus $34.4 million undrawn commitments).

2 Refer Note 12 Investment and development property for valuation techniques and key unobservable inputs.

3 AASB13 introduced fair value information disclosure requirements for non-financial assets and liabilities. Retrospective application was not required therefore comparatives have not been presented.

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 2014		30 June 2013	
	Assets $M	Liabilities $M	Assets $M	Liabilities $M
Balance at the beginning of the year	2,654.0	6,642.2	2,165.2	6,216.5
Fair value (losses) and gains	(29.4)	223.9	513.3	327.4
Acquisitions	784.7	2,043.6	1,672.6	1,811.7
Maturities and disposals	(1,110.6)	(2,271.1)	(1,592.8)	(1,715.5)
Transfers to/from other categories[1,2]	(145.3)	–	(104.3)	2.1
Balance at the end of the year[3]	2,153.4	6,638.6	2,654.0	6,642.2
Unrealised (losses)/gains included in the income statement for assets and liabilities held at the statement of financial position date	(48.3)	(223.9)	214.1	(327.4)

[1] The Group recognises transfers between levels of the fair value hierarchy as at the end of the reporting period during which the transfer has occurred.

[2] Transfers to/from other categories are due to changes in the market observability of inputs used in the valuation of financial instruments. There were no transfers between Level 1 and Level 2 during the reporting period.

[3] Does not include investment property.

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:

30 June 2014	Level 3 value $M	Positive impact $M	Negative impact $M	Reasonable change in non-observable input
Fixed income securities	1,341.6	66.2	(13.2)	Primarily credit spreads
Interest bearing financial liabilities	(529.1)	(22.9)	24.2	Primarily credit spreads
Net fixed income	812.5	43.3	11.0	
Equity, infrastructure, property assets	811.8	42.3	(41.9)	Primarily discount rate on cash flow models
Investment contract liabilities	(6,109.4)	4.5	(4.5)	Primarily expense assumptions
Total Level 3	(4,485.1)	90.1	(35.4)	
30 June 2013				
Fixed income securities	1,688.2	59.1	(16.0)	Primarily credit spreads
Interest bearing financial liabilities	(598.3)	(25.4)	23.5	Primarily credit spreads
Net fixed income	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	(40.3)	

30. Derivative financial instruments

The table below shows the notional value and net fair values by duration of the Group's derivative financial instruments:

	30 June 2014			30 June 2013		
	Notional value $M	Net fair value assets $M	Net fair value liabilities $M	Notional value $M	Net fair value assets $M	Net fair value liabilities $M
Interest rate swaps						
Less than one year	2,210.4	9.7	(0.5)	3,103.2	12.5	(0.8)
One to three years	2,950.9	61.2	(8.7)	1,830.3	53.9	(5.7)
Three to five years	1,610.9	51.6	(9.0)	1,522.6	77.5	(8.5)
Greater than five years	5,405.4	152.5	(106.4)	2,765.2	104.4	(83.6)
Total interest rate swaps	12,177.6	275.0	(124.6)	9,221.3	248.3	(98.6)
Inflation-linked swaps						
Less than one year	253.0	–	–	250.0	–	(6.3)
Greater than five years	15.4	4.6	(4.6)	11.6	0.8	(0.8)
Total inflation-linked swaps	268.4	4.6	(4.6)	261.6	0.8	(7.1)
Futures contracts						
Less than one year	4,789.6	–	(0.2)	997.7	–	(0.1)
One to three years	150.0	–	–	–	–	–
Total futures contracts	4,939.6	–	(0.2)	997.7	–	(0.1)
Forward currency contracts						
Less than one year	2,275.2	15.9	(4.1)	3,623.0	33.7	(142.9)
One to three years	–	–	–	28.7	6.5	(0.1)
Total forward currency contracts	2,275.2	15.9	(4.1)	3,651.7	40.2	(143.0)
Cross-currency swaps						
Less than one year	368.1	17.2	(22.3)	295.1	7.9	(22.3)
One to three years	245.6	1.7	(25.6)	593.3	19.3	(42.4)
Three to five years	96.4	–	(16.2)	210.4	–	(32.5)
Greater than five years	211.1	0.1	(22.1)	274.2	0.1	(33.5)
Total cross-currency swaps	921.2	19.0	(86.2)	1,373.0	27.3	(130.7)
Equity swaps						
Less than one year	–	0.1	–	–	2.2	–
One to three years	–	–	–	0.5	3.7	–
Total equity swaps	–	0.1	–	0.5	5.9	–
Credit default swaps						
Less than one year	37.1	0.1	–	27.3	0.1	–
One to three years	116.5	1.9	(0.1)	10.9	–	–
Three to five years	107.0	0.1	(0.9)	186.8	0.4	(3.6)
Total credit default swaps	260.6	2.1	(1.0)	225.0	0.5	(3.6)
Options						
Less than one year	–	–	–	–	–	–
One to three years	0.4	–	–	–	–	–
Three to five years	0.5	–	–	–	–	–
Total options	0.9	–	–		–	–
Total	20,843.5	316.7	(220.7)	15,730.8	323.0	(383.1)

	30 June 2014			30 June 2013		
	Notional value $M	Net fair value assets $M	Net fair value liabilities $M	Notional value $M	Net fair value assets $M	Net fair value liabilities $M
Interest rate swaps – SPV						
Less than one year	17.6	–	(0.1)	76.4	0.5	(0.7)
One to three years	24.6	–	(0.3)	22.3	–	(0.3)
Three to five years	1.7	–	(0.1)	1.6	–	(0.1)
Total interest rate swaps – SPV	43.9	–	(0.5)	100.3	0.5	(1.1)
Cross-currency swaps – SPV						
Greater than five years	1,350.6	1.3	(1.3)	1,833.1	5.0	(0.8)
Total cross-currency swaps – SPV	1,350.6	1.3	(1.3)	1,833.1	5.0	(0.8)
Total cash flow hedge derivatives – SPV	1,394.5	1.3	(1.8)	1,933.4	5.5	(1.9)
Total derivative financial instruments[1]		318.0	(222.5)		328.5	(385.0)

[1] The Group's derivative financial instruments are subject to enforceable netting arrangements under International Swaps and Derivatives Association (ISDA) Master Agreements with derivative counterparties. This allows for net settlement of instruments with a counterparty in the event of default or other specified circumstances. The potential effect on the Group's financial position in these circumstances is such that the instruments would settle as one arrangement. No account of this offsetting provision has been taken at 30 June 2014 or in the comparative period.

Derivatives designated as hedges of net investment in foreign currency operations

As described in Note 1(xvi) Derivative financial instruments and hedging, 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 2014, a post-tax gain of $15.2 million (2013: $10.7 million) was recognised in equity for the hedging of exposure to the net investment in foreign currency operations.

Derivatives designated as cash flow hedges

As described in Note 1(xvi) Derivative financial instruments and hedging, 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 variability in cash flows attributable to a specific risk associated with a recognised asset or liability or probable future transaction. As described in Note 28 Financial risk management, SPVs enter into interest rate swap agreements to hedge the interest rate risk between variable rate loans, which generally reprice with changes in official interest rates, and issued RMBS that reprice with changes in the 30-day and 90-day bank bill swap rate. Cross-currency swaps are also entered into to hedge currency movements on foreign denominated RMBS. The SPVs apply hedge accounting to both types of transaction, with the fair value change on the effective portion of the derivative being recognised in equity.

For the year ended 30 June 2014, a post-tax loss of $4.0 million (2013: 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 comparative period.

31. Commitments

	30 June 2014 $M	30 June 2013 $M
Commitments		
Non-cancellable operating leases – Group as lessee	148.0	170.4
Capital expenditure	26.4	34.5
Non-cancellable operating leases – Group as lessor	(1,186.0)	(1,417.7)
Other	12.9	22.6
Total commitments	(998.7)	(1,190.2)
Operating leases – Group as lessee		
Amounts due in less than one year	24.3	22.5
Amounts due between one and two years	18.7	24.3
Amounts due between two and five years	21.6	35.4
Amounts due in greater than five years	83.4	88.2
Total operating leases – Group as lessee	148.0	170.4
Capital expenditure commitments		
Amounts due in less than one year	8.6	15.7
Amounts due between one and five years	13.9	13.2
Amounts due in greater than five years	3.9	5.6
Total capital expenditure commitments	26.4	34.5
Operating leases – Group as lessor		
Amounts due in less than one year	(172.6)	(193.7)
Amounts due between one and two years	(157.9)	(181.3)
Amounts due between two and five years	(391.9)	(446.5)
Amounts due in greater than five years	(463.6)	(596.2)
Total operating leases – Group as lessor	(1,186.0)	(1,417.7)
Other commitments		
Amounts due in less than one year	12.9	22.6
Total other commitments	12.9	22.6

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 two 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 above. Refer to Note 21 Provisions for details. At 30 June 2014, the total of the gross future minimum payments expected to be received under non-cancellable subleases was $11.4 million (2013: $19.2 million).

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.

Other contracted commitments

This represents the Group's acquisition of a 100% interest in Golden Grove Shopping Centre, South Australia. The Contract of Sale was exchanged in June 2014 and settlement occurred on 31 July 2014.

32. 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. The Group's interests in controlled entities are disclosed in Note 37 Controlled entities.

Other related parties

During the year, there were transactions between the Group and Challenger-sponsored managed 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 38 Investment in associates) for the provision of distribution and administration services. The Group earned fee income during the year of $32.6 million (2013: $36.5 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 L Polson	Independent Chair
Brian R Benari	Managing Director and Chief Executive Officer
Graham A Cubbin	Independent Non-Executive Director
Steven Gregg	Independent Non-Executive Director
Jonathan H Grunzweig	Independent Non-Executive Director
Russell R Hooper	Independent Non-Executive Director
JoAnne M Stephenson	Independent Non-Executive Director
Brenda M Shanahan	Independent Non-Executive Director
Leon Zwier	Independent Non-Executive Director

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 or specified key executives as at 30 June 2014 (30 June 2013: nil).

33. Employee entitlements

	30 June 2014 $M	30 June 2013 $M
Employee entitlements provision (refer Note 21 Provisions)	10.2	9.1

The total number of employees of the Group at 30 June 2014 was 539 (30 June 2013: 487).

Challenger Performance Plan

The Challenger Performance Plan is a flexible plan that provides for the award of 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 gives a right to 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 give a right to ordinary fully paid shares upon vesting.

Hurdled performance share rights (HPSR)

This instrument is a performance share right which gives a right to a fully paid share in the Company at certain vesting dates, 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 for awards granted prior to 30 June 2014 is typically over four years with three vesting parcels at the end of the second, third and fourth years. Effective 1 July 2014, the Board determined that any new Long-term incentive (LTI) awards will not be eligible to vest until the third anniversary following grant. Subject to continued employment and meeting the absolute total shareholder return (TSR) performance target, two thirds of an LTI award will be eligible to commence vesting on the third anniversary and the final third on the fourth anniversary following grant. This change has the effect of increasing the vesting period.

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 the higher absolute TSR performance requirements which reflect another year of compound growth. For awards from 1 July 2014, any unvested awards have the opportunity to vest on the fifth anniversary following grant. Any unvested awards lapse at the end of the fifth anniversary following grant. This approach is applied to ensure that key management personnel and employees are motivated to deliver strong long-term performance. Challenger's vesting period is now greater than the majority of market participants. Hurdled performance rights are converted to ordinary fully paid shares upon vesting.

Deferred performance share rights

The following table sets out the details of the deferred performance share rights granted under the Challenger Performance Plan during 2014 and movements on previous issues:

Grant date	Latest date for vesting[1]	Reference price $	Fair value at grant $	Out-standing at 1 July 2013	Granted during the year	Vested during the year	Expired during the year	Out-standing at 30 June 2014
17 Sep 13	01 Sep 16	4.086	4.46	–	122,372	–	–	122,372
17 Sep 13	01 Sep 15	4.086	4.71	–	1,196,066	–	3,825	1,192,241
17 Sep 13	01 Sep 14	4.086	4.96	–	1,195,988	–	3,822	1,192,166
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
11 Jun 13	01 Mar 15	3.573	3.45	25,888	–	–	–	25,888
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 14	3.573	3.64	25,887	–	25,887	–	–
11 Jun 13	01 Sep 13	3.306	3.74	15,722	–	15,722	–	–
12 Sep 12	01 Sep 14	3.448	3.02	1,182,420	–	–	13,658	1,168,762
12 Sep 12	01 Sep 13	3.448	3.18	1,182,376	–	1,174,494	7,882	–
02 Nov 11	01 Sep 13	4.612	4.10	2,000	–	2,000	–	–
12 Sep 11	01 Sep 13	4.747	4.20	843,513	–	840,880	2,633	–
Total				3,345,632	2,514,426	2,058,983	31,820	3,769,255

[1] At the date of vesting, deferred performance share rights are transferred to the individual and released from the CPP Trust.

Hurdled performance share rights

The following table sets out details of the hurdled performance share rights granted under the Challenger Performance Plan during 2014 and movements on previous issues:

Grant date	Expected date for vesting[2]	Reference price $	Fair value at grant $	Out-standing at 1 July 2013	Granted during the year	Vested during the year	Expired during the year	Out-standing at 30 June 2014
17 Sep 13	01 Sep 17	4.09	2.69	–	2,211,390	–	–	2,211,390
17 Sep 13	01 Sep 16	4.09	3.23	–	2,211,305	–	–	2,211,305
17 Sep 13	01 Sep 15	4.09	3.79	–	2,211,305	–	–	2,211,305
11 Jun 13	01 Jun 17	3.93	1.33	200,000	–	–	–	200,000
12 Sep 12	01 Sep 16	3.45	1.42	8,033,000	–	–	70,000	7,963,000
16 Mar 12	16 Feb 16	4.36	1.16	1,250,000	–	416,666	–	833,334
14 Dec 11	01 Sep 15	4.75	1.56	750,000	–	–	–	750,000
12 Sep 11	01 Sep 15	4.75	1.93	6,373,000	–	–	15,000	6,358,000
14 Dec 10	01 Dec 14	4.17	2.38	216,450	–	144,300	–	72,150
08 Sep 10	15 Sep 14	3.72	2.02	4,928,500	–	1,141,438	36,500	3,750,562
Total				21,750,950	6,634,000	1,702,404	121,500	26,561,046

[2] At the date of vesting, hurdled performance share rights are transferred to the individual and released from the CPP Trust.

33. Employee entitlements (continued)

All deferred performance share rights and hurdled performance share rights granted during the year have been independently externally valued. A Black Scholes model is used to value the deferred performance share rights. The hurdled performance rights are valued by using a Monte Carlo simulation model using the TSR share price hurdles. Key inputs into the valuation models are as follows:

Input	17 Sep 13 PSR[1]	17 Sep 13 Hurdled PSR[1]
Dividend yield (%)	5.30	5.30
Risk-free rate (%)	2.74–2.96	2.74–3.39
Volatility[2] (%)	28	28
Valuation ($)	4.46–4.96	2.69–3.79

[1] Staggered deferred vesting applies to these grants.

[2] Forecast volatility rate implied from historic trend.

34. Reconciliation of profit to operating cash flow

	30 June 2014 $M	30 June 2013 $M
Profit for the year	369.7	461.3
Adjusted for		
Net realised gain on disposal of investment assets	(80.2)	(193.2)
Net unrealised gain on revaluation of investment assets	(239.2)	(70.1)
Share of associates' net profit	(15.9)	(13.4)
Change in life contract liabilities	424.8	289.5
Depreciation and amortisation expense	20.0	16.3
Share-based payments	25.3	16.6
Operating cash flow not recognised in revenue		
Dividends from associates	16.1	8.8
Change in operating assets and liabilities, net of acquisition/disposal of controlled entities		
Decrease/(increase) in receivables	15.1	(1.0)
Decrease in other assets	10.3	11.1
Decrease in payables	(13.9)	(20.7)
Decrease in provisions	(0.5)	(0.4)
Increase in life contract liabilities	276.2	280.8
Decrease in external unit holders' liabilities	(679.0)	(99.8)
Increase in net tax liabilities	18.6	103.3
Net cash flows from operating activities	147.4	789.1

35. Remuneration of auditor

	30 June 2014 $000	30 June 2013 $000
Amounts received or due and receivable by Ernst & Young for:		
Full year audit and half year review of the Group financial report	1,364.0	1,318.1
Other audit services – audit and review of trusts and funds	1,015.3	875.3
Other services in relation to the Group		
Taxation services	489.6	354.8
Other assurance services	535.7	423.7
Total auditor remuneration	3,404.6	2,971.9

Auditor's remuneration for the Group is paid by Challenger Group Services Limited, a wholly owned entity within the Group.

36. Acquisitions of subsidiaries and businesses

Entities or businesses acquired or consolidated due to acquisition of control during the year

On 5 February 2014, Challenger acquired Bendzulla Actuarial Pty Ltd (Bendzulla), the leading provider of self-managed superannuation fund (SMSF) actuarial certificates in Australia. An actuarial certificate is required by an SMSF when one (or more) members is in the retirement phase simultaneous with one (or more) being in the accumulation phase.

Bendzulla's market share of actuarial certificates is over 60%, with approximately 60,000 certificates per annum delivered via client relationships with over 5,500 Australian accounting firms. Whilst not material to the balance sheet or profit of the Group, the Bendzulla acquisition is a strategic investment for Challenger in terms of SMSF retiree research, product and service development and education. The Bendzulla product and service offering will be expanded to assist SMSFs and their advisers manage retirement risks.

From the date of acquisition, Bendzulla contributed $4.1 million of revenue and $2.3 million of profit before tax. If the combination had taken place at the beginning of the period, the contribution to revenue would have been $11.0 million and the profit before tax contribution would have been $5.0 million.

Transaction costs of $0.5 million in relation to the acquisition have been expensed and are not included in the numbers above.

Bendzulla consists of two legal entities, Bendzulla Professional Services Pty Ltd and Bendzulla Actuarial Pty Ltd.

Details of the fair values of the assets and liabilities acquired and goodwill on acquisition are as follows:

	$M
Cash and other assets	25.0
Total purchase consideration	25.0
Less: fair value of net identifiable assets acquired	0.8
Goodwill on acquisition	24.2

The balance sheet of Bendzulla at acquisition date is as follows:

	Acquiree's carrying amount $M	Fair value $M
Assets		
Cash and cash equivalents	1.1	1.1
Receivables	0.9	0.9
Property, plant and equipment	0.1	0.1
Deferred tax assets	–	0.1
Customer list intangible asset	–	0.2
Other assets	0.3	0.3
Total assets	2.4	2.7
Liabilities		
Payables	0.6	0.6
Provisions	0.3	0.3
Current tax liability	1.0	1.0
Total liabilities	1.9	1.9
Net assets	0.5	0.8

Other significant entities and businesses acquired or consolidated due to acquisition of control

There were no other significant entities or businesses acquired or consolidated due to acquisition of control during the period.

Significant entities and businesses disposed of or deconsolidated due to loss of control

There were no significant entities or businesses disposed of or deconsolidated due to loss of control during the financial year.

37. Controlled entities

The material controlled entities, based on contribution to the the Company's income statement, total assets and total liabilities, are:

Bendzulla Actuarial Pty Ltd[1]
Bendzulla Professional Services Pty Ltd[1]
CFSG Holdings No.2 Victoria Pty Limited
Challenger Diversified Properties Group
Challenger Financial Services Group
Challenger FM 2 Holdings Pty Ltd
Challenger Funds Management Holdings Pty Limited
Challenger Group Holdings Limited
Challenger Group Pty Limited
Challenger Group Services (UK) Limited
Challenger Group Services Pty Limited
Challenger High Yield Fund
Challenger Holding (Vagyonkezeló) KFT (Hungary)
Challenger Jersey I3 Limited (Jersey)
Challenger Life Company Holdings Pty Ltd
Challenger Life Debt Investments (Europe) Limited (UK)
Challenger Life Fund Property Investments Pty Ltd
Challenger Life Offshore Investments Limited (Jersey)
Challenger Life Subsidiary Holdings Ltd
Challenger Luxembourg Holding No.1A SARL – (Luxembourg)
Challenger Luxembourg Holding No.2 SARL – (Luxembourg)
Challenger Management Services Limited
Challenger Millennium NPL Trust
Challenger Millennium Series 2007-1E Trust
Challenger Millennium Series 2007-2L Trust
Challenger Millennium Series 2008-1 Trust
Challenger Millennium Series 2008-2 Trust
Challenger Millennium Series 2009-1 Trust
Challenger Millennium Series 2013-1 Trust[1]
Challenger Millennium Warehouse C Trust
Challenger Millennium Warehouse F Trust
Challenger Millennium Warehouse JP Trust
Challenger NZ Millennium Series 2007-AP Trust
Interstar Millennium Series 2002-1G Trust
Interstar Millennium Series 2003-3G Trust
Challenger Mortgage Management Pty Limited
Challenger SkyBridge Fund (LP) Jersey Ltd (Jersey)
Challenger Strategic Property Partner[1]
Challenger Treasury Limited
Challenger UK Tank Storage Limited (UK)
Challenger UK Terminals Ltd (Jersey)
Challenger Welcome Break Limited (Jersey)
Challenger Wind Holdings Pty Limited
Clashfern Investments (UK) Limited (UK)
CLS US Holdings, LLC (USA)
Fidante Partners Limited
Fidante Partners Services Limited
Godo Kaisha Kenedix Master Tokumei Kumiai (Japan)
Godo Kaisha Sub Tokumei Kumiai One (Japan)
Godo Kaisha Sub Tokumei Kumiai Two (Japan)
Howard Commercial Lending Limited
LANV Pty Ltd
Oaklands Hill Pty Ltd
River and Mercantile Global Equity Fund[1]
RRETRO Fund Ltd (Cayman Islands)[2]
Waterford County Pty Limited[2]
Wyetree European Recovery Fund (Ireland)[1]
Interstar Millennium Series 2004-1E Trust
Interstar Millennium Series 2004-2G Trust
Interstar Millennium Series 2004-4E Trust
Interstar Millennium Series 2004-5 Trust
Interstar Millennium Series 2005-1G Trust
Interstar Millennium Series 2005-2L Trust
Interstar Millennium Series 2005-3E Trust
Interstar Millennium Series 2006-1 Trust
Interstar Millennium Series 2006-2G Trust
Interstar Millennium Series 2006-3L Trust
Interstar Millennium Series 2006-4H Trust
Interstar NZ Millennium Series 2004-A Trust
Interstar Titanium 2006-1 Trust

417 St Kilda Road Trust
417 St. Kilda Holding Trust A
417 St. Kilda Holding Trust B
Balloon Inflation Linked Bond Trust[2]
Belconnen Property Trust
Challenger Australia Listed Property Holding Trust
Challenger Bunbury Trust[1]
Challenger CKT Holding Trust
Challenger European Property Holding Trust
Challenger German Property Trust
Challenger Guernsey Trust
Challenger Howard Property Trust for 417 St Kilda Road
Challenger Infrastructure Unit Holding Trust
Challenger Infrastructure Unit Trust
Challenger Intermediate Unit Trust[1]
Challenger Karratha Trust
Challenger Kenedix Japan Trust
Challenger MEIF Holding Trust
Challenger MEIF Trust
Challenger North of England Gas Holding Trust
Challenger Property Income Trust
Challenger Property Trust No.18
Challenger Property Trust No.19
Challenger Property Trust No.27
Challenger Property Trust No.30
Challenger Property Trust No.31
Challenger Property Trust No.32
Challenger Property Trust No.35
Challenger Property Trust No.36
Challenger Seattle Trust
Challenger Towers Holding Trust
Challenger UK Tank Storage Holding Trust
Challenger Wind Trust
CLC Commercial Mortgages Trust
CLC Leveraged Loan Trust
County Court Property Trust
Crown Domestic Sovereign Bond Trust[2]
Discovery House Trust
Harris Global Sovereign Bond Trust[2]
Hayes Park Property Trust
Hotels Investment Trust
Rendezvous Hotels Flinders Street Trust
Riverside Trust No.1
Riverside Trust No.2
Senator House Property Trust
Talavera Herring Unit Trust
TLG Holding Unit Trust
TLG Unit Trust
Village Property Trust
World Business Centre Heathrow Property Trust

[1] Consolidated in 2014.
[2] Percentage holding is less than 100%.

Note: All material entities are incorporated in Australia, unless otherwise stated. Share holdings in all entities is 100%, unless otherwise stated.

38. Investment in associates

Name of company	Principal activity	Country of domicile	30 June 2014 %[1]	30 June 2013 %[1]	30 June 2014 $M	30 June 2013 $M
Alphinity Investment Management Pty Ltd	Funds Management	Australia	30	30	1.7	1.2
Ardea Investment Management Pty Ltd	Funds Management	Australia	30	30	3.6	3.2
Bentham Asset Management Pty Ltd	Funds Management	Australia	49	49	0.6	0.5
Challenger MBK Fund Management Pte Ltd	Funds Management	Singapore	50	50	1.6	3.1
Five Oceans Asset Management Pty Ltd	Funds Management	Australia	34	34	–	5.2
Greencape Capital Pty Ltd	Funds Management	Australia	35	35	13.5	14.5
Kapstream Capital Pty Ltd	Funds Management	Australia	25	25	6.3	5.7
Kinetic Investment Partners Pty Ltd	Funds Management	Australia	20	20	0.5	0.4
Metisq Capital Holdings Pty Ltd	Funds Management	Australia	49	49	6.5	6.3
Merlon Capital Partners Pty Ltd	Funds Management	Australia	30	30	0.8	1.3
Novaport Capital Pty Ltd	Funds Management	Australia	49	49	1.8	1.2
Tempo Asset Management Pty Ltd	Funds Management	Australia	40	–	0.4	–
Wavestone Capital Pty Ltd	Funds Management	Australia	33	33	2.1	2.6
Impairment[2]					–	(5.2)
					39.4	40.0

	30 June 2014 $M	30 June 2013 $M
Movements in carrying amount of investment in associates		
Opening balance	40.0	51.2
Purchase/(sale) of investments in associates	0.5	(8.2)
Share of associates' net profit	15.9	13.4
Impairment	–	(5.2)
Transfer to equity investment	–	(0.9)
Dividend/capital redemptions	(17.0)	(10.3)
Carrying amount at the end of the financial year	39.4	40.0
Share of associates' profit or loss		
Profit before tax	15.9	13.4
Profit after tax for the year	15.9	13.4
Share of the associates' statement of financial position		
Current assets	23.5	22.4
Non-current assets	5.9	5.6
Total assets	29.4	28.0
Current liabilities	12.8	11.9
Non-current liabilities	2.1	2.0
Total liabilities	14.9	13.9

[1] Represents ownership and voting rights percentages.

[2] In 2013, this impairment relates to the Fidante Partners boutiques.

39. Parent entity

The statement of comprehensive income and statement of financial position for the Company are as follows:

	30 June 2014 $M	30 June 2013 $M
Statement of comprehensive income for the year ended		
Revenue	189.0	300.1
Profit before income tax	189.0	300.1
Income tax benefit	5.8	18.8
Profit and total comprehensive income for the year	194.8	318.9

	30 June 2014 $M	30 June 2013 $M
Statement of financial position as at		
Assets		
Cash and cash equivalents	1.4	1.6
Receivables	939.2	795.2
Current tax asset	–	0.3
Deferred tax assets	9.7	43.7
Investment in controlled entities	1,211.8	1,186.5
Total assets	2,162.1	2,027.3
Liabilities		
Payables	201.8	178.0
Current tax liability	30.2	–
Total liabilities	232.0	178.0
Net assets	1,930.1	1,849.3
Equity		
Contributed equity	1,335.4	1,335.4
Share-based payments reserve	31.9	23.9
Retained earnings	562.8	490.0
Total equity	1,930.1	1,849.3

Refer Note 41 Contingent liabilities, contingent assets and credit commitments for details of any contingent liabilities applicable to the parent entity.

40. Subsequent events

Challenger Life is growing strongly and expects to continue to increase the size of its retail annuity business. In order to support Challenger's growth profile, the following capital management initiatives have been approved by the Challenger Limited Board on 19 August 2014:

- equity placement of Challenger ordinary shares to institutional holders raising $250 million;
- Share Purchase Plan (SPP) allowing retail investors to participate and is expected to raise $30 million; and
- the intention to launch Challenger Capital Notes (Notes) targeting to raise $250 million[1]. The Notes will be issued by Challenger Limited with the proceeds used for Additional Tier 1 equity issued by Challenger Life Company Limited (CLC).

The equity placement is underwritten but the SPP and Challenger Capital Notes will not be underwritten.

The majority of the proceeds from the equity placement and SPP are planned to be injected into CLC as Common Equity Tier 1 capital. The capital initiatives will support new business growth and Challenger will continue to target RoE of 18% pre-tax.

Following these capital initiatives, CLC's regulatory capital position will be materially strengthened. On a pro forma basis at 30 June 2014, CLC's PCA ratio would increase to 2.1 times[2] including the LAGIC transition balance, or 1.8 times[2] excluding it.

At the date of this report and other than as disclosed above, 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.

41. 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 2014. 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;
3. Australian Financial Services Licence deeds of undertaking as an eligible provider; and
4. Guarantees to support contractual commitments on warrants to certain third parties.

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

CLC has made capital commitments to external counterparties for future investment opportunities such as development or investment purchases. As at 30 June 2014 there are potential future commitments totalling $217.1 million (30 June 2013: $79.5 million) in relation to these opportunities. Currently there are no requests from any of these parties to make payments.

Contingent tax assets and liabilities

From time to time the Group has interactions with the 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.

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.

[1] Subordinated, unsecured convertible notes issued by Challenger Limited (in Australia) with proceeds used for Additional Tier 1 capital issued by CLC. Targeting $250 million with ability to raise more or less, subject to market conditions.

[2] CLC pro forma PCA ratio assumes an increase in Tier 1 capital ($250 million), Share Purchase Plan ($30 million) and Challenger Capital Notes ($250 million).

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 2014 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) Statement of compliance, 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 2014.

On behalf of the Board

G A Cubbin
Director

Sydney
19 August 2014

B R Benari
Director

Sydney
19 August 2014

Independent auditor's report

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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 2014, 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.

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 2014 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 41 to 65 of the directors' report for the year ended 30 June 2014. 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 2014, complies with section 300A of the Corporations Act 2001.

Ernst & Young

D Jewell
Partner

Sydney
19 August 2014

Five-year history

	30 June 2014	30 June 2013	30 June 2012	30 June 2011	30 June 2010
Earnings $M					
Normalised cash operating earnings	481.3	452.2	435.7	400.8	338.0
Net fee income	110.2	99.4	83.0	88.4	102.0
Other income	1.8	4.9	8.8	4.8	7.6
Total net income	593.3	556.5	527.5	494.0	447.6
Personnel expenses	(144.4)	(130.3)	(128.9)	(123.9)	(135.0)
Other operating expenses	(61.0)	(61.4)	(60.3)	(56.3)	(46.8)
Total operating expenses	(205.4)	(191.7)	(189.2)	(180.2)	(181.8)
Discontinued operations	–	–	–	–	39.1
Normalised EBIT	387.9	364.8	338.3	313.8	304.9
Interest and borrowing costs	(4.1)	(4.6)	(3.3)	(2.7)	(14.1)
Normalised net profit before tax	383.8	360.2	335.0	311.1	290.8
Tax on normalised profit	(55.1)	(51.7)	(38.2)	(63.1)	(58.3)
Normalised net profit after tax	328.7	308.5	296.8	248.0	232.5
Investment experience after tax	11.9	99.8	(148.3)	(28.7)	51.3
Significant items after tax	–	8.5	–	42.1	(1.3)
Profit attributable to equity holders	340.6	416.8	148.5	261.4	282.5
Normalised cost to income ratio (%)	34.6%	34.4%	35.9%	36.5%	40.6%
Normalised effective tax rate (%)	14.4%	14.4%	11.4%	20.3%	20.1%
EPS (cents)					
Basic EPS – normalised profit	64.0	58.6	57.5	51.7	45.5
Basic EPS – statutory profit	66.3	79.2	28.8	54.5	55.3
Diluted EPS – normalised profit	60.6	58.0	55.7	48.1	42.7
Diluted EPS – statutory profit	62.8	78.3	27.8	50.7	51.9
Capital management (%)					
Normalised return on equity (RoE) – pre-tax	18.8%	19.6%	21.2%	22.3%	20.7%
Normalised return on equity (RoE) – post-tax	16.1%	16.8%	18.8%	17.7%	16.5%
Statutory return on equity (RoE) – post-tax	16.7%	22.7%	9.4%	18.7%	20.1%
Statement of financial position ($M)					
Total assets	17,323.3	17,784.8	17,778.6	17,836.2	18,375.9
Total liabilities	15,047.2	15,490.6	15,734.1	16,036.8	16,656.2
Net assets[1] – closing	2,276.1	2,294.2	2,044.5	1,799.4	1,719.7
Net assets[2] – closing	2,153.3	1,947.4	1,692.2	1,488.3	1,339.6
Net assets[2] – average[3]	2,044.4	1,835.7	1,577.2	1,397.8	1,407.7
Net tangible assets	1,607.5	1,426.3	1,172.8	969.5	813.0
Net tangible assets per basic share ($)	3.15	2.77	2.22	2.03	1.72

[1] Including minority interests.
[2] Excluding minority interests.
[3] Average net assets calculated on a monthly basis.

	30 June 2014	30 June 2013	30 June 2012	30 June 2011	30 June 2010
Underlying operating cash flow ($M)	321.0	321.5	282.3	276.4	221.7
Dividends (CPS)					
Dividend – interim unfranked	12.5	9.5	7.5	7.0	6.0
Dividend – final franked[1]	13.5	10.5	10.5	9.5	8.5
Total dividend – franked[1]	26.0	20.0	18.0	16.5	14.5
Dividend payout ratio – normalised profit/(loss) (%)	40.6%	34.1%	31.3%	31.9%	31.9%
Dividend payout ratio – statutory profit/(loss) (%)	39.2%	25.2%	62.5%	30.3%	26.2%
Sales and annuity book net flows ($M)					
Retail annuity sales	2,798.8	2,179.2	1,954.3	1,903.4	933.1
Institutional annuity sales	581.6	951.8	703.5	59.3	1,252.9
Total annuity sales	3,380.4	3,131.0	2,657.8	1,962.7	2,186.0
Life retail net flows[2]	887.1	598.1	582.9	468.1	(1.6)
Life retail annuity book	7,824.4	7,123.3	6,553.0	5,629.0	4,745.8
Life retail net book growth[2] (%)	12.5%	9.1%	10.4%	9.9%	–
Life institutional net book growth (%)	(40.6%)	(2.2%)	35.2%	4.7%	–
Funds management – net flows	2,147.4	6,978.6	4,226.0	2,397.0	3,831.0
Assets under management ($M)					
Life	11,087	10,787	9,773	8,387	7,578
Funds management	47,127	41,103	31,017	23,608	20,221
Elimination of cross-holdings	(7,488)	(7,120)	(7,346)	(4,086)	(3,851)
Total assets under management	50,726	44,770	33,444	27,909	23,948
Other					
Headcount – closing FTEs	539	487	479	455	460
Weighted average number of ASX listed basic shares on issue (million)	513.8	526.1	516.4	479.4	510.8
Number of ASX listed shares on issue – closing (million)	530.9	530.9	544.7	496.7	499.6
Share price closing ($)	7.44	4.01	3.25	4.89	3.52
Market capitalisation at 30 June ($M)[3]	3,949.9	2,128.9	1,770.3	2,428.8	1,758.6

[1] Final 2014 dividend franked at 40%, prior periods unfranked. Total 2014 franking at 21%.

[2] Retail annuity net flows and net book growth exclude the High Yield Fund maturity in 2014 ($284.0 million outflow) and conversion in 2011 ($444.0 million inflow).

[3] Calculated as share price multiplied by ordinary share capital.

Investor information

Distribution of shares (as at 31 August 2014)

Range	Number of shareholders	Number of shares	% of issued capital
1 – 1,000	9,945	4,965,696	0.88
1,001 – 5,000	10,391	25,508,606	4.52
5,001 – 10,000	2,218	16,477,589	2.92
10,001 – 100,000	1,412	32,118,749	5.69
100,001 and over	110	484,992,477	85.99
Total	24,076	564,063,117	100.00

Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum $500.00 parcel at $7.85 per unit	64	489	8003

Substantial shareholders

The number of shares held by substantial shareholders and their associates, based on substantial shareholder notifications, and the 20 largest individual shareholders are as follows:

	Number of shares	% of issued capital
Substantial shareholder as at 31 August 2014		
Caledonia (Private) Investments Pty Ltd and Associates	32,520,035	6.13
20 largest individual shareholders as at 31 August 2014		
1. HSBC Custody Nominees (Australia) Limited	128,676,400	22.81
2. J P Morgan Nominees Australia Limited	106,305,965	18.85
3. National Nominees Limited	72,744,353	12.90
4. UBS Nominees Pty Ltd	29,355,682	5.20
5. Citicorp Nominees Pty Limited	27,321,500	4.84
6. BNP Paribas Noms Pty Ltd <DRP>	15,746,144	2.79
7. CPU Share Plans Pty Ltd <CGF Performance Plan A/C>	12,525,638	2.22
8. PAN Australian Nominees Pty Limited	10,942,646	1.94
9. National Nominees Limited <DB A/C>	10,333,272	1.83
10. AMP Life Limited	8,297,552	1.47
11. BNP Paribas Nominees Pty Ltd <Agency Lending Collateral>	6,025,640	1.07
12. HSBC Custody Nominees (Australia) Limited <NT – Comnwlth Super Corp A/C>	3,845,203	0.68
13. HSBC Custody Nominees (Australia) Limited – GSCO ECA	3,527,918	0.63
14. UBS Wealth Management Australia Nominees Pty Ltd	3,406,604	0.60
15. Argo Investments Limited	3,390,311	0.60
16. CS Fourth Nominees Pty Ltd	2,540,281	0.45
17. Morgan Stanley Australia Securities	2,495,961	0.44
18. ECapital Nominees Pty Limited <Sett A/C>	2,133,601	0.38
19. Warbont Nominees Pty Ltd <Settlem Entrepot A/C>	2,132,965	0.38
20. QIC Limited	2,049,955	0.36
Total Top 20 holders – issued capital	453,797,591	80.45
Total remaining holders balance	110,265,526	19.55

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 1800 780 782
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

Level 15
255 Pitt Street
Sydney NSW 2000
Telephone: 02 9994 7000
Facsimile: 02 9994 7777

Directors

Peter Polson (Chair)
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: +61 1800 780 782
Website: www.computershare.com.au

Auditor

Ernst & Young
680 George Street
Sydney NSW 2000

Website

www.challenger.com.au

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Investor Services
13 35 66

Adviser Services
1800 621 009

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