

Annual Report 2015

Challenger Limited provides
Australians with financial
security for retirement.

CHALLENGER.COM.AU

Key Dates

30 September 2015

Final dividend payment date

27 October 2015

2015 Annual General Meeting

16 February 2016

Half year financial results
Interim dividend announcement

29 March 2016

Interim dividend payment date

16 August 2016

Full year financial results
Final dividend announcement

28 September 2016

Final dividend payment date

27 October 2016

2016 Annual General Meeting

Dates may be subject to change.
A full listing of key dates can be found at:



challenger.com.au/share/keydates

2015 ANNUAL GENERAL MEETING

Location:

Wesley Centre, 220 Pitt Street, Sydney

Date:

27 October 2015

Time:

10.30am (Sydney time)

Full details of the meeting will be included in the Notice of Annual General Meeting, which will be sent to shareholders in September 2015.

ABOUT THIS REPORT

The 2015 Annual Report, including the full financial report for the year ended 30 June 2015 can be downloaded from Challenger's online Shareholder Centre at:



challenger.com.au/share

2015 ANNUAL REVIEW

The 2015 Annual Review can be viewed online at:



challenger.com.au/annualreview2015

2015 CORPORATE GOVERNANCE STATEMENT

The 2015 Corporate Governance Statement can be viewed online at:



challenger.com.au/corporategovernance

2015 SUSTAINABILITY REPORT

The 2015 Sustainability Report can be viewed online at:



challenger.com.au/sustainabilityreport

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Five-year history

	30 June 2015	30 June 2014	30 June 2013	30 June 2012	30 June 2011
Earnings (\$M)					
Normalised cash operating earnings (COE)	543.8	481.3	452.2	435.7	400.8
Net fee income	117.5	110.2	99.4	83.0	88.4
Other income	1.3	1.8	4.9	8.8	4.8
Total net income	662.6	593.3	556.5	527.5	494.0
Personnel expenses	(154.8)	(144.4)	(130.3)	(128.9)	(123.9)
Other expenses	(69.4)	(61.0)	(61.4)	(60.3)	(56.3)
Total expenses	(224.2)	(205.4)	(191.7)	(189.2)	(180.2)
Normalised EBIT	438.4	387.9	364.8	338.3	313.8
Interest and borrowing costs	(3.8)	(4.1)	(4.6)	(3.3)	(2.7)
Normalised profit before tax	434.6	383.8	360.2	335.0	311.1
Normalised tax	(100.6)	(55.1)	(51.7)	(38.2)	(63.1)
Normalised profit after tax	334.0	328.7	308.5	296.8	248.0
Investment experience after tax	(35.0)	11.9	99.8	(148.3)	(28.7)
Significant items after tax	-	-	8.5	-	42.1
Profit attributable to equity holders	299.0	340.6	416.8	148.5	261.4
Normalised cost to income ratio (%)	33.8%	34.6%	34.4%	35.9%	36.5%
Normalised effective tax rate (%)	23.1%	14.4%	14.4%	11.4%	20.3%
Earnings per share (EPS) (cents)					
Basic EPS – normalised profit	61.2	64.0	58.6	57.5	51.7
Basic EPS – statutory profit	54.8	66.3	79.2	28.8	54.5
Diluted EPS – normalised profit	57.2	60.6	58.0	55.7	48.1
Diluted EPS – statutory profit	51.4	62.8	78.3	27.8	50.7
Capital management (%)					
Normalised return on equity (RoE) – pre-tax	18.0%	18.8%	19.6%	21.2%	22.3%
Normalised return on equity (RoE) – post-tax	13.9%	16.1%	16.8%	18.8%	17.7%
Statutory return on equity (RoE) – post-tax	12.4%	16.7%	22.7%	9.4%	18.7%
Statement of financial position (\$M)					
Total assets	18,531.6	17,323.3	17,784.8	17,778.6	17,836.2
Total liabilities	15,893.0	15,047.2	15,490.6	15,734.1	16,036.8
Net assets ¹	2,638.6	2,276.1	2,294.2	2,044.5	1,799.4
Net assets ²	2,543.2	2,153.3	1,947.4	1,692.2	1,488.3
Net assets ² – average ³	2,410.4	2,044.4	1,835.7	1,577.2	1,397.8
Net tangible assets	1,993.8	1,607.5	1,426.3	1,172.8	969.5
Net tangible assets per basic share (\$)	3.60	3.15	2.77	2.22	2.03

¹Including minority interests.²Excluding minority interests.³Calculated on a monthly basis.

	30 June 2015	30 June 2014	30 June 2013	30 June 2012	30 June 2011
Underlying operating cash flow (\$M)	287.9	321.0	321.5	282.3	276.4
Dividends per share (cents)					
Dividend – interim ¹	14.5	12.5	9.5	7.5	7.0
Dividend – final ¹	15.5	13.5	10.5	10.5	9.5
Total dividend¹	30.0	26.0	20.0	18.0	16.5
Dividend payout ratio – normalised profit (%)	49.0%	40.6%	34.1%	31.3%	31.9%
Dividend payout ratio – statutory profit (%)	54.7%	39.2%	25.2%	62.5%	30.3%
Sales and annuity book net flows (\$M)					
Retail annuity sales	2,753.1	2,798.8	2,179.2	1,954.3	1,903.4
Institutional annuity sales	944.0	581.6	951.8	703.5	59.3
Total annuity sales	3,697.1	3,380.4	3,131.0	2,657.8	1,962.7
Life retail annuity net flows ²	738.2	887.1	598.1	582.9	468.1
Life retail annuity book	8,692.6	7,824.4	7,123.3	6,553.0	5,629.0
Life retail net book growth ² (%)	9.4%	12.5%	9.1%	10.4%	9.9%
Funds Management – net flows	7,738.9	2,147.4	6,978.6	4,226.0	2,397.0
Assets under management (\$M)					
Life	12,795	11,087	10,787	9,773	8,387
Funds Management	57,902	47,126	41,103	31,017	23,608
Elimination of cross-holdings ³	(10,908)	(7,488)	(7,120)	(7,346)	(4,086)
Total assets under management	59,789	50,725	44,770	33,444	27,909
Other					
Headcount – closing full time employees	560	539	487	479	455
Weighted average number of ASX-listed basic shares on issue (M)	545.7	513.8	526.1	516.4	479.4
Number of ASX-listed shares on issue – closing (M)	569.7	530.9	530.9	544.7	496.7
Share price – closing (\$)	6.72	7.44	4.01	3.25	4.89
Market capitalisation at 30 June (\$M) ⁴	3,828.4	3,949.9	2,128.9	1,770.3	2,428.9

¹ 2015 final dividend franked at 100% (2015 interim: 70%; 2014 final: 40%; previous periods: unfranked). Total 2015 franking at 86% (2014: 21%).

² Retail annuity net flows and net book growth exclude the High Yield Fund maturity in 2014 (\$284 million outflow) and conversion in 2011 (\$444 million inflow).

³ Life assets managed by Funds Management.

⁴ Calculated as share price multiplied by ordinary share capital.

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 2015.

1 Directors

The names and details of the Directors of the Company holding office during the financial year ended 30 June 2015 and as at the date of this report are listed below. Directors were in office for the entire period, unless otherwise stated.

Peter L Polson (appointed 6 November 2003)

Independent Chair.

Chair of Nomination Committee.

Member of Group Risk Committee, Group Audit Committee and Remuneration Committee.

Experience and qualifications:

Bachelor of Commerce (Witwatersrand University, South Africa), Master of Business Leadership (University of South Africa), Management Development Program (Harvard Graduate School of Education).

Mr Polson's experience spans international and domestic markets in banking, insurance and funds management. Mr Polson previously held the positions of Group Executive, Investment and Insurance Services at Commonwealth Bank and Chief Executive of Colonial First State Limited.

Directorships of other listed companies:

Chair of Customers Limited from 23 November 2010 to 4 July 2012.

Brian R Benari (appointed 17 February 2012)

Managing Director and Chief Executive Officer.

Experience and qualifications:

A qualified chartered accountant, Mr Benari joined the Company in March 2003 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:

Director of Homeloans Limited from 3 May 2007 to 17 February 2012.

Graham A Cubbin (appointed 6 January 2004)

Independent Non-Executive Director.

Chair of Remuneration Committee.

Member of Group Risk Committee, Group Audit Committee and Nomination Committee.

Experience and qualifications:

Bachelor of Economics (Hons) (Monash University), Fellow of the Australian Institute of Company Directors.

Mr Cubbin was a senior executive with Consolidated Press Holdings 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.

Directorships of other listed companies:

Non-executive director of Bell Financial Group Ltd (appointed 12 September 2007), STW Communications Group Ltd (appointed 20 May 2008), White Energy Company Limited (appointed 17 February 2010) and McPherson's Limited (appointed 28 September 2010 and appointed Chair on 1 July 2015).

Steven Gregg (appointed 8 October 2012)

Independent Non-Executive Director.

Member of Remuneration Committee and Nomination Committee.

Experience and qualifications:

Bachelor of Commerce (University of New South Wales).

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, because of his work in both the USA and the UK.

Directorships of other listed companies:

Non-executive director of Tabcorp Holdings Limited. Mr Gregg was a director of Austock Group Limited until May 2012 and Chair of Goodman Fielder Limited until its delisting in March 2015.

Jonathan H Grunzweig (appointed 6 October 2010)

Independent Non-Executive Director.

Member of Nomination Committee.

Experience and qualifications:

Bachelor of Arts (Cornell University, USA), Juris Doctor in Law (Harvard University).

Mr Grunzweig is Executive Director, Corporate Strategy of Colony Capital, Inc. Mr Grunzweig is charged with helping develop Colony's global growth strategy across markets, platforms and asset classes. Until the combination of Colony Capital and Colony Financial, Mr Grunzweig served as global CIO, overseeing the sourcing, structuring, execution and management of all investments and divestments on a global basis.

1 Directors (continued)

Brenda M Shanahan (appointed 1 April 2011)

Independent Non-Executive Director.

Member of Group Risk Committee, Group Audit Committee, Remuneration Committee and Nomination Committee.

Experience and qualifications:

Graduate in Economics and Commerce (Melbourne University), 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.

Directorships of other listed companies:

Non-executive director of Clinuvel Pharmaceuticals Ltd (appointed 6 February 2007) and Bell Financial Group Limited (appointed 5 June 2012).

JoAnne M Stephenson (appointed 8 October 2012)

Independent Non-Executive Director.

Chair of Group Risk Committee and Group Audit Committee and member of Nomination Committee.

Experience and qualifications:

Bachelor of Commerce and Bachelor of Laws (Honours) (University of Queensland), member of the Institute of Chartered Accountants in Australia and Fellow of 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.

Directorships of other listed companies:

Non-executive director of Asaleo Care Limited (appointed 30 May 2014).

Leon Zwier (appointed 15 September 2006)

Independent Non-Executive Director.

Member of Nomination Committee.

Experience and qualifications:

Bachelor of Laws (University of Melbourne). Mr Zwier is a partner in the law firm Arnold Bloch Leibler.

Russell R Hooper (appointed 6 November 2003, retired 27 February 2015)

Independent Non-Executive Director.

Member of Nomination Committee.

Mr Hooper retired on 27 February 2015.

Experience and qualifications:

Advanced Management Program (Harvard Business School), Fellow of the Australian Institute of Company Directors, Fellow of the Australian Society of Practising Accountants and Fellow of the Financial Services Institute of Australasia.

Mr Hooper has previous experience at chief executive level in life insurance and wealth management.

Directorships of other listed companies:

Director of Century Australia Investments Limited (retired 17 June 2013).

Board Committees

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

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

Each committee has its own charter, copies of which are available on the Company 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 2014 to 30 June 2015 are set out on the following page.

Directors' meetings

Director	Board		Group Risk Committee ¹		Group Audit Committee ¹		Remuneration Committee		Nomination Committee	
	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended
P Polson	11	11	4	4	4	4	5	5	2	2
B Benari	11	11	-	-	-	-	-	-	-	-
G Cubbin	11	10	4	4	4	4	5	5	2	2
S Gregg	11	11	-	-	-	-	5	5	2	2
J Grunzweig	11	11	-	-	-	-	-	-	2	1
R Hooper ²	8	7	-	-	-	-	-	-	2	2
B Shanahan	11	11	4	4	4	4	5	4	2	2
J Stephenson	11	10	4	4	4	4	-	-	2	2
L Zwier	11	9	-	-	-	-	-	-	2	1

¹ Formerly the Group Risk and Audit Committee, which was separated into the GRC and the GAC on 1 January 2015. The GRC and the GAC are constituted by the same members as the former Group Risk and Audit Committee.

² Russell Hooper retired from his role as Non-Executive Director of Challenger on 27 February 2015.

2 Company Secretary

Michael Vardanega (Bachelor of Commerce and Bachelor of Laws) is a qualified solicitor and was appointed to the position of General Counsel and Group Company Secretary on 1 March 2011. Mr Vardanega's responsibilities at Challenger encompass legal and regulatory affairs, corporate governance, company secretarial duties, government relations and corporate communications. Mr Vardanega joined Challenger in 2006 from commercial law firm Ashurst, where he was a member of the corporate advisory practice. He is

admitted to practise as a solicitor in New South Wales, and is a member of the Law Council of Australia, the Association of Corporate Counsel and a member of the Australian Institute of Company Directors.

Andrew Brown (Diploma in Law) has over 20 years' experience in the financial services industry and was appointed to the position of Company Secretary on 25 October 2012. Prior to joining the Company in 2003, Mr Brown held senior compliance management positions at MLC.

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 services. The following operating segments are responsible for the provision of these services:

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

Life also includes Accurium Pty Limited, Australia's leading provider of self-managed superannuation fund (SMSF) actuarial certificates (acquired in February 2014).

Funds Management – the Funds Management (FM) segment comprises Fidante Partners and Challenger Investment Partners.

Fidante Partners encompasses a number of associate investments in boutique investment managers. Fidante Partners provides administration and distribution services to the boutiques and shares in the profits of these businesses through equity ownership.

Challenger Investment Partners (CIP) develops and manages assets under Challenger's brand for CLC and third-party institutional investors. The investments managed by CIP are predominantly in fixed income and commercial property.

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

4 Review of operations

Challenger has continued to grow strongly during the 2015 financial year, delivering growth in funds under management and income across its operating segments.

4.1 Key performance indicators (KPIs)

KPIs for the year ended 30 June 2015 (with the year to 30 June 2014 being the prior comparative period (PCP), unless otherwise stated) include:

	30 June 2015	30 June 2014	change %
Profitability			
Statutory profit attributable to equity holders (\$M)	299.0	340.6	(12.2)
Normalised NPAT (\$M)	334.0	328.7	1.6

	30 June 2015	30 June 2014	change %
Profitability (continued)			
Statutory EPS (cents)	54.8	66.3	(17.4)
Normalised EPS (cents)	61.2	64.0	(4.4)
Total dividend (cents)	30.0	26.0	15.4
Total dividend franking	85.5%	20.8%	large
Normalised cost: income ratio	33.8%	34.6%	(0.8)
Statutory RoE after tax	12.4%	16.7%	(4.3)
Normalised RoE after tax	13.9%	16.1%	(2.2)
Growth			
Total Life retail sales (\$M)	2,753.1	2,798.8	(1.6)
Life retail net book growth (\$M)	738.2	887.1	(16.8)
Life retail net book growth%	9.4%	12.5%	(24.8)
Total FM net inflows (\$bn)	7.7	2.1	large
Total AUM (\$bn)	59.8	50.7	18.0

Challenger's statutory profit attributable to equity holders was lower for the year ended 30 June 2015 primarily as a result of fair value losses during the period relative to fair value gains in the prior year. The fair value losses for the year were mainly as a result of fixed income credit spreads expanding during the year, together with transaction costs associated with recent property acquisitions.

Normalised net profit after tax grew slightly compared to the prior year, reflecting higher earnings generated by the business. This was offset by a higher tax expense for the year, primarily as a result of the transitional TOFA tax deductions that concluded on 30 June 2014, with income tax reduced by \$30.0 million in 2014 and no corresponding reduction in 2015. Excluding the \$30.0 million TOFA tax deduction in 2014, normalised net profit after tax would have increased by 11.8% for the year ended 30 June 2015.

A final dividend of 15.5 cents was announced, franked at 100%, taking the total dividend for 2015 to 30.0 cents franked at 85.5%, up from 26.0 cents (21% franked).

While the full year dividend has increased compared to the prior year, statutory EPS has decreased for the year, reflecting the higher weighted average number of shares on issue following the capital raisings in August and October 2014 (described below) and the reduced profit attributable to equity holders as a result of the impact of fair value changes on Life's assets and liabilities.

Continued cost discipline has seen the normalised cost to income ratio fall to 33.8%, which reflects the scalability of the business model. Challenger's medium-term expected normalised cost to income ratio target is a range of 32-36%.

4 Review of operations (continued)

4.2 Capital management initiatives

With the continued growth in the business, the following capital initiatives were undertaken during the year:

- \$345.0 million was raised via the Challenger Capital Notes (Notes) in October 2014. The Notes are subordinated unsecured convertible notes issued by Challenger Limited. The Notes are quoted and tradable on the ASX (under code CGFPA) and pay franked distributions on a quarterly basis at a margin of 3.40% per annum over the Australian 90-day Bank Bill Rate. Distributions are paid to note holders as a combination of cash and franking credits.
- A \$250.0 million institutional equity placement was undertaken in August 2014, with 33.2 million shares issued at a price per share of \$7.53.
- The \$40.2 million Share Purchase Plan (SPP) was undertaken in October 2014 to provide eligible retail investors the opportunity to participate in the equity placement. 5.6 million shares were issued under the plan at a price per share of \$7.10.

The proceeds from the Notes (\$345.0 million) were used to acquire notes issued by CLC to the Company. The notes issued by CLC to the Company were approved by the Australian Prudential Regulation Authority (APRA) and qualify as Additional Tier 1 capital of CLC. The majority of the proceeds from the institutional equity placement and the SPP were injected into CLC as Common Equity Tier 1 (CET1) capital, with the remainder of the equity raised retained at Group level.

4.3 Normalised profit and investment experience

Normalised framework

CLC and its consolidated entities are required by AASB 1038 *Life Insurance Contracts* to value all assets and liabilities supporting the Life company 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 impact from changes in economic and actuarial assumptions.

A reconciliation between statutory revenue and the management view of revenue and net income is included in the financial report as part of Note 3 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 3 Segment information in the financial report.

Management analysis – normalised results

	30 June 2015 \$M	30 June 2014 \$M	change \$M	change %
Net income ¹	662.6	593.3	69.3	11.7
Comprising:				
– Life normalised COE	543.8	481.3	62.5	13.0
– FM net income	117.5	110.2	7.3	6.6
– Corporate and other net income	1.3	1.8	(0.5)	(27.8)
Operating expenses ¹	(224.2)	(205.4)	(18.8)	9.2
Normalised EBIT	438.4	387.9	50.5	13.0
Comprising:				
– Life normalised EBIT	456.7	404.2	52.5	13.0
– FM normalised EBIT	44.1	43.3	0.8	1.8
– Corporate and other normalised EBIT	(62.4)	(59.6)	(2.8)	4.7
Interest and borrowing costs	(3.8)	(4.1)	0.3	(7.3)
Tax on normalised profit	(100.6)	(55.1)	(45.5)	82.6
Normalised NPAT	334.0	328.7	5.3	1.6
Investment experience after tax	(35.0)	11.9	(46.9)	large
Statutory net profit after tax attributable to equity holders	299.0	340.6	(41.6)	(12.2)

¹ 'Net income' and 'Operating expenses' are internal classifications and are defined in Note 3 Segment information in the financial report. These differ from the statutory revenue and expenses classifications, as certain costs (including distribution expenses, property expenses, management fees and special purpose vehicle expenses and finance costs) are netted off against gross revenues. These classifications have been made in the Directors' report and in Note 3 Segment information to reflect how management measures business performance. Whilst the allocation of amounts to the above items and investment experience differs to the statutory view, both approaches result in the same total net profit after tax attributable to equity holders.

4 Review of operations (continued)

4.3 Normalised profit and investment experience (continued)

Management analysis – normalised results (continued)

Life normalised cash operating earnings (COE) and EBIT increased as a result of higher Life investment assets combined with a stable margin being earned on those assets. Life's average assets under management (AUM) increased by 13% as a result of the net book growth in annuities together with the capital injected into CLC following the capital initiatives undertaken during the year.

Funds Management net income increased (up \$7.3 million) due to higher funds under management (FUM). Funds Management average FUM increased by 24% as a result of strong inflows throughout the year and mark to market gains on investments; however, this was partially offset by a lower margin earned due to a change in the mix of the FUM.

Operating expenses increased for the year ended 30 June 2015 (up \$18.8 million) primarily due to an increase in employee numbers in order to support the Company's growth ambitions together with costs associated with distribution and asset origination initiatives. In 2015, Challenger's employee numbers increased by 21 (or 3.9%) to 560, of which 16 relate to the technology and operations work required to assist with annuities being placed on platforms with Colonial First State and VicSuper.

Normalised tax for the year was \$100.6 million, up \$45.5 million (82.6%) from 2014 due to higher earnings before interest and tax (up 13%) and the conclusion of the TOFA tax deductions on 30 June 2014. As a result, the normalised effective tax rate increased from 14.4% in 2014 to 23.1% in 2015.

Management analysis – investment experience

	30 June 2015 \$M	30 June 2014 \$M
Actual capital growth¹		
– Cash and fixed income	(95.2)	41.3
– Infrastructure	17.6	31.9
– Property (net of debt)	85.2	(8.7)
– Equity and other investments	32.9	32.4
Total actual capital growth	40.5	96.9
Normalised capital growth²		
– Cash and fixed income	(29.3)	(27.8)
– Infrastructure	21.2	21.1
– Property (net of debt)	52.3	38.7
– Equity and other investments	36.2	23.6
Total normalised capital growth	80.4	55.6

	30 June 2015 \$M	30 June 2014 \$M
Investment experience		
– Cash and fixed income	(65.9)	69.1
– Infrastructure	(3.6)	10.8
– Property (net of debt)	32.9	(47.4)
– Equity and other investments	(3.3)	8.8
	(39.9)	41.3
Annuity valuation experience ³	(10.1)	(23.1)
Investment experience before tax	(50.0)	18.2
Tax benefit/(expense)	15.0	(6.3)
Investment experience after tax	(35.0)	11.9

¹ 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.

² Normalised capital growth is determined by multiplying the normalised capital growth rate for each asset class by the average investment assets for the period. The normalised capital growth rates represent Challenger's 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 in order to allow for credit defaults. 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. For the 2016 financial year, the equity and other normalised growth rate is being reduced to +4.5% (from +6.0%) to reflect the current low growth environment and the mix of CLC's equity portfolio, which includes both listed and unlisted equities.

³ Annuity valuation experience 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.

Investment experience after tax relates to changes in the fair value of Life's assets and liabilities. Investment experience is a mechanism employed to remove the volatility arising from asset and liability valuation movements from Life business earnings so as to more accurately reflect the underlying performance of the Life business.

2015 investment experience comprises a \$39.9 million loss in relation to fair value movements on Life's assets and a \$10.1 million loss in relation to fair value movements on Life's liabilities. Strong property valuation gains (net of related transaction costs) were offset by negative fixed income investment fair value movements due to the expansion in domestic and offshore credit spreads.

4 Review of operations (continued)

4.4 Life segment results

The Life segment includes CLC, Australia's leading provider of annuities and guaranteed retirement income products and Accurium Pty Limited. CLC has won the Association of Financial Advisers/Plan for Life annuity provider of the year for the past seven years. CLC also won the annuity & income stream innovation and long-term income stream awards in 2014.

CLC is regulated by APRA, and its financial strength is rated by Standard & Poor's, with an 'A' credit rating and stable outlook. CLC is strongly capitalised, with significant excess capital above APRA's minimum regulatory requirements.

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

	30 June 2015 \$M	30 June 2014 \$M	change \$M	change %
Life normalised results				
Normalised COE	543.8	481.3	62.5	13.0
– Cash earnings	463.4	425.7	37.7	8.9
– Normalised capital growth	80.4	55.6	24.8	44.6
Operating expenses	(87.1)	(77.1)	(10.0)	13.0
Normalised EBIT	456.7	404.2	52.5	13.0

Life normalised EBIT increased by \$52.5 million (up 13%) due to higher normalised COE (up \$62.5 million or 13%), which was partially offset with operating expenses increasing by \$10 million (or 13%). The higher normalised COE was as a result of higher investment assets, with Life average investment assets increasing 12.7%.

Life retail annuity sales decreased slightly over the prior year (down 1.6%), primarily as a result of the suspension of the Care Annuity product in November 2014. Excluding the Care Annuity product, retail annuity sales increased by 5% compared to 2014. Life retail annuity sales continue to benefit from favourable macroeconomic trends, an ageing population and retirees taking a more conservative approach to investing in retirement.

	30 June 2015 \$M	30 June 2014 \$M	change \$M	change %
Life sales				
Retail annuity sales	2,753.1	2,798.8	(45.7)	(1.6)
– Lifetime	479.9	613.1	(133.2)	(21.7)
– Fixed-term	2,273.2	2,185.7	87.5	4.0
Retail annuity net flows	738.2	887.1	(148.9)	(16.8)
Institutional annuity sales	944.0	581.6	362.4	62.3

Retail annuity net flows (new annuity sales less capital repayments) decreased by 17% to \$738.2 million. The reduction reflects lower annuity sales following the suspension of the Care Annuity in November 2014 and increased capital repayments as a result of historical growth in the business. Based on the opening Life retail annuity book for the 2015 financial year (\$7,824 million), retail annuity net book growth for the year was 9.4%, which was down from 12.5% in 2014.

Institutional annuity sales represents Challenger's Guaranteed Index Return (GIR) product (disclosed in Note 10 External unit holders' liabilities). Institutional sales for the year largely represented the reinvestments of maturities.

4.5 Funds Management segment results

Challenger's Funds Management segment is Australia's seventh¹ largest investment manager and one of Australia's fastest growing.

Fidante Partners' multi-boutique platform comprises a number of separately branded investment management businesses. The model seeks to align 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.

	30 June 2015 \$M	30 June 2014 \$M	change \$M	change %
FM normalised results				
Net income	117.5	110.2	7.3	6.6
– Fidante Partners	62.3	64.9	(2.6)	(4.0)
– CIP	55.2	45.3	9.9	21.9
Operating expenses	(73.4)	(66.9)	(6.5)	9.7
Normalised EBIT	44.1	43.3	0.8	1.9

Funds Management normalised EBIT increased by 1.8% in 2015, with higher net income partially offset by higher expenses. Expenses increased by \$6.5 million, of which \$3.0 million related to one off costs relating to the sale of Kapstream, the acquisition of Dexion Capital and costs associated with Funds Management's European expansion.

Fidante Partners' net income includes distribution fees, administration fees and a share in the equity accounted profits for the boutique fund managers in which it has an equity interest. Fidante Partners net income reduced in 2015 despite strong growth in FUM, primarily as a result of lower performance fees (down \$10.0 million to \$9.0 million).

¹ Rainmaker – Consolidated FUM for Australian Fund Managers December 2014.

4 Review of operations (continued)

4.5 Funds Management segment results (continued)

CIP's net income increased due to higher performance and transaction fees (up \$22.0 million), partially offset by lower net management fees due to a change in FUM mix following the formation of Whitehelm Capital.

Funds Management normalised return on equity (RoE) (pre-tax) for 2015 was 35.9%, up 3.1 percentage points from 32.8% in 2014. RoE continues to benefit from strong FUM growth and capturing the benefits of scale.

	30 June 2015 \$bn	30 June 2014 \$bn	change \$bn	change %
FM FUM and flows				
Total FUM	57.9	47.1	10.8	22.9
– Fidante Partners	44.7	35.9	8.8	24.5
– CIP	13.2	11.2	2.0	17.9
Net flows	7.7	2.1	5.6	large
– Fidante Partners	6.1	2.4	3.7	large
– CIP	1.6	(0.3)	1.9	large

Fidante Partners FUM growth (up \$8.8 billion) was driven by strong net flows (up \$3.7 billion) and positive impact from investment markets (up \$3.1 billion), net of distributions.

CIP FUM growth (up \$2.0 billion) is primarily a result of the transfer of Life's fixed income asset backed securities (ABS) team to CIP (\$1.8 billion) and positive organic net flows (up \$0.9 billion), all of which are partially offset by the transfer of CIP's infrastructure business to Whitehelm (\$0.9 billion).

Fidante Partners net flows of \$6.1 billion benefit from the formation of Whitehelm Capital (\$3.9 billion) and \$2.2 billion of organic net flows across boutique managers.

4.6 Corporate and other segment results

The Corporate and other segment comprises central functions such as the group executive, finance, treasury, legal, human resources, risk management and strategy. The financial results also include interest received on Group cash balances and any interest and borrowing costs associated with Group debt facilities.

	30 June 2015 \$M	30 June 2014 \$M	change \$M	change %
Corporate and other normalised results				
Net income	1.3	1.8	(0.5)	(27.8)
Operating expenses	(63.7)	(61.4)	(2.3)	3.8
Normalised EBIT	(62.4)	(59.6)	(2.8)	4.7
Interest and borrowing costs	(3.8)	(4.1)	0.3	(7.3)
Normalised loss before tax	(66.2)	(63.7)	(2.5)	3.9

Normalised EBIT for the Corporate and other segment was lower (down \$2.8 million) as a result of higher personnel costs due to increased employee numbers.

4.7 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 15 Contributed equity for further information on the Group's Internal Capital Adequacy Assessment Process (Group ICAAP). As noted previously, several capital management initiatives were undertaken in the period to fund CLC's growth whilst providing capital flexibility to the Group.

The following table highlights the key capital metrics for CLC and the Group:

	30 June 2015	30 June 2014	change
Capital			
Net assets attributable to equity holders (\$M)	2,543.2	2,153.3	389.9
CLC excess capital over PCA (\$M)	1,009.4	902.6	106.8
Group cash (\$M)	98.6	141.2	(42.6)
CLC excess capital over PCA + Group cash (\$M)	1,108.0	1,043.8	64.2
CLC PCA ratio (times)	1.59	1.66	(0.07)
CLC Tier 1 ratio (times)	1.31	1.31	-

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 and disclosed based on the Life and General Insurance Capital (LAGIC) capital standards issued by APRA in October 2012, which became effective from 1 January 2013.

CLC maintains a 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 in order to provide 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 will change over time and is dependent on a number of factors.

4 Review of operations (continued)

4.7 Capital management (continued)

CLC regulatory capital base (continued)

The increase in excess regulatory capital resulted from increased retained earnings and the capital management initiatives undertaken in the period, partially offset by higher capital requirements as a result of CLC's increased investment in property and equity assets which require a higher PCA than fixed income investments. CLC's 30 June 2015 excess regulatory capital position anticipates the amortisation of the remaining LAGIC transition balance of \$107.6 million on 1 January 2016.

In addition to CLC's excess regulatory capital, Challenger maintains cash at a Group level which can be used to meet regulatory capital requirements. Challenger further maintains an undrawn Group corporate debt facility of \$350.0 million in order to provide additional financial flexibility. The facility remained undrawn throughout the period.

Subordinated debt

CLC's total regulatory capital base includes \$474.0 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 following the call date is considered the first call date.

CLC's subordinated debt includes \$158.9 million which had a call date on 7 June 2013. As a result, under APRA's transition arrangements, only \$63.6 million (i.e. 40% of the total amount) is eligible as Tier 2 regulatory capital at 30 June 2015.

The largest tranche of CLC's existing subordinated debt comprises \$376.6 million 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.

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 more than one APRA-regulated industry 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 have been announced.

4.8 Credit ratings

Challenger Limited and CLC are rated by Standard & Poor's (S&P). In December 2014, S&P reaffirmed both CLC and Challenger Limited's credit ratings.

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, share buy-back and dividend reinvestment plan

	30 June 2015	30 June 2014	change	change %
Dividends				
Interim dividend (cents) ¹	14.5	12.5	2.0	16.0
Final dividend (cents) ²	15.5	13.5	2.0	14.8
Total dividend (cents)	30.0	26.0	4.0	15.4

¹ Interim dividend declared on 16 February 2015 and paid on 31 March 2015 in respect of the half year ended 31 December 2014. The interim dividend was 70% franked.

² Final dividend declared on 17 August 2015 and payable on 30 September 2015 in respect of the half year ended 30 June 2015. The final dividend is 100% franked.

The Company has historically targeted a combined dividend and buy-back payout ratio of approximately 50% of normalised profit after tax over the medium term.

With the increase in forecast dividend franking levels, in August 2014 the Board increased the targeted dividend payout ratio to a range of 45% to 50% of normalised net profit after tax. The dividend payout ratio for the year ended 30 June 2015 was 49.0%.

The Company also seeks to frank its dividend to the maximum extent possible and expects future dividends to be fully franked. However, the actual dividend payout ratio and franking will depend on prevailing market conditions and capital allocation priorities at the time.

With the return to full dividend franking, the Board has resolved to establish a Dividend Reinvestment Plan (DRP). The DRP will commence for the final 2015 dividend, which will be paid on 30 September 2015. For this dividend, the Board has determined that new shares will be issued to fulfil DRP requirements. However, the new shares will not be issued at a discount to the prevailing Challenger share price.

No shares were bought back during the year.

6 Likely developments and expected results

The Group intends to continue with its current strategy of providing Australians with financial security for retirement. To continue to achieve this vision, the Group is 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 savings pool allocation to secure and lifetime income products; and
- 3 within the Funds Management business, to provide clients with relevant strategies exhibiting consistently superior risk/return outcomes.

Life segment outlook

The Australian retirement incomes market is expected to grow strongly over the next 20 years as Australia's baby boomers (born 1946 to 1964) move from retirement 'saving' to retirement 'spending'. Over this period, the number of Australians over 65, which is Life's target demographic, is expected to increase by 75%.

Challenger Life is well positioned to benefit from changes in retiree risk preferences, including increased focus on longevity risk by retirees. Annuities address many of the financial concerns retirees face in retirement. Demand for annuity products is being amplified through Challenger's market-leading distribution, product innovation and strong retirement incomes brand recognition.

Challenger is also investing in technology to allow annuities to easily integrate with account-based pensions, as there is a growing acceptance that annuities are part of an optimal retirement income strategy. Integrating annuities with account-based pensions supports income layering and enables guaranteed incomes to be combined with other products to build more comprehensive retirement income solutions.

During the year, Challenger formed a strategic partnership with Colonial First State (CFS), making Challenger annuities available from August 2015 to half of the Australian financial adviser market via CFS platforms. In the industry fund sector, Challenger-backed term and lifetime annuities have been integrated with VicSuper account-based pensions to create more comprehensive retirement income solutions for its clients.

Challenger has also announced a strategic alliance with the Link Group/AAS (Australian Administration Services) that will see Challenger's annuities available to their industry fund clients, who service the needs of 10 million super fund members.

The Australian Federal Government commissioned the Financial System Inquiry (FSI) to provide a 'blueprint' for Australia's financial system over the next decade.

The final FSI report (released December 2014) recommended the retirement phase of superannuation would benefit greatly from pre-selected retirement products for members that provide regular and stable income streams with longevity protection. Annuities were recognised by the FSI as providing stable incomes and providing longevity protection and could be part of pre-selected retirement products offered by superannuation funds.

The FSI also recommended that the impediments to longevity product development be removed. This would clear the way for Challenger to develop and issue Deferred Lifetime Annuities, which would expand Life's product offering. Deferred Lifetime Annuities are expected to be popular, as they provide protection against the risk of running out of money late in life.

The Federal Government is expected to respond to the FSI recommendations during the calendar year 2015. It is widely expected that the Government will support the FSI recommendations for comprehensive retirement income products and to remove the impediments to longevity product development.

The Australian retirement income market is undergoing significant change as retirees move from public to private pensions. The focus is starting to shift to the retirement phase of superannuation and there is considerable media and public policy discussion on the need for more private provision of longevity risk protection and longevity product innovation. With this focus on the retirement phase, retirement income models adopting income layering are emerging, superannuation funds are partnering with life companies to build more comprehensive retirement solutions, and product innovation is accelerating. The retirement incomes market is moving ahead of the retirement income regulation recommended by the FSI.

As Australia's leading retirement income specialist, Challenger is uniquely positioned to benefit from this focus on retirement incomes. Challenger is locking in distribution platforms across both the retail and industry segments of superannuation and, when coupled with the relationships Accurium maintains in the SMSF sector, Challenger has relationships that provide access to one third of Australia's superannuation industry.

Funds Management segment outlook

The Australian funds management market remains an attractive market underpinned by mandated superannuation contribution flows. Superannuation contributions increased to 9.5% of gross salaries on 1 July 2014 and are scheduled to increase to 12.0% by 2025. The mandated nature of Australia's superannuation system is expected to significantly increase the size of Australia's superannuation assets

6 Likely developments and expected results (continued)

Funds Management segment outlook (continued)

from \$2 trillion¹ at March 2015 to in excess of \$7 trillion² over the next 20 years.

Fidante Partners continues to identify new investment manager talent. The platform has a variety of managers across Australian equities, international equities, fixed income and infrastructure. Fidante Partners is adding capacity to existing managers and has significant capacity to increase FUM, which is expected to underwrite future earnings growth.

The acquisition of Dexion Capital substantially expands Fidante Partners' presence in Europe, where it already holds interests in two alternative boutique investment managers. This represents a significant step-up in Challenger's European presence and an important part of Fidante Partners' international distribution and product expansion. Dexion Capital's funds management operations provide a scalable platform to realise the ambition of replicating Fidante Partners' successful multi-boutique model in the European market, while opening up global distribution opportunities for the existing boutique managers.

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

Challenger's Funds Management business is well positioned to benefit from growth in Australia's superannuation system. The Funds Management platform has multiple brands and strategies with significant manager capacity. Coupled with Challenger's distribution capability, institutional-strength administration platform and strong boutique investment manager performance, the Funds Management business is well positioned to continue to increase shareholder returns.

Risks

The above outlook for the Life and Funds Management segments is subject to the following business risks:

- regulatory and political changes impacting financial services participants;
- demand for and competition with Challenger products, including annuities and managed funds;
- market volatility; and
- general uncertainty around the global economy and its impact on markets in which Challenger operates and invests.

¹ APRA Superannuation statistics – March 2015.

² Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2013–2033 – September 2013.

Guidance for the 2016 financial year

Life cash operating earnings

Life COE guidance for 2016 is a range of \$585 million to \$595 million and reflects a lower normalised growth assumption for equities. Commencing in the 2016 financial year, the assumed equities normalised growth assumption has been reduced from 6.0% per annum to 4.5% per annum to reflect lower expected returns on Life's equity portfolio as a result of the lower growth environment and mix of Life's equity portfolio. The lower equities normalised assumption has the impact of reducing Life's 2016 COE guidance by approximately \$13 million.

Retail annuity net book growth

Challenger has traditionally provided retail annuity net book growth guidance. However, under the revised ASX disclosure regime, providing guidance is becoming increasingly difficult. Further to this, in early fiscal year 2016, a number of new distribution initiatives commenced, including the Colonial First State and VicSuper annuities on platform initiatives. With these new distribution initiatives commencing, it is difficult to predict the exact level of net book growth expected in 2016. As a result, Challenger will not provide 2016 retail annuity net book growth guidance, but will continue to provide quarterly updates throughout the year.

Challenger Group

Challenger continues to target an overall return on equity of 18% (pre-tax) and expects to achieve a fully franked dividend payout ratio of 45% to 50% of normalised profit, subject to prevailing market conditions and capital allocation priorities.

7 Significant events after the balance date

On 2 July 2015, Challenger announced the sale of its 25% equity interest in Australian-based global fixed income fund manager, Kapstream Capital Pty Limited to Janus Capital Group Inc, a US-based global investment business, for \$45 million.

Challenger will recognise a \$40 million profit on sale in the 2016 financial year.

On 15 July 2015, Challenger announced it had agreed to acquire 100% of Dexion Capital Holdings Limited, a European alternative investments group comprising interests in three specialist fund managers, as well as an investments distribution business based in London.

Challenger will make agreed fixed payments of £19.6 million (A\$41 million) to Dexion's shareholders. The final acquisition price is dependent on profitability over a period of up to six years, under earn-out arrangements with key Dexion executives.

At the date of this 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 financial years which has not already been reflected in this report.

8 Indemnification and insurance of Directors and Officers

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

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. 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 paid.

Indemnification is provided by the Company.

9 Indemnification of auditor

To the extent permitted by law, the Company has agreed to indemnify its auditor, Ernst & Young, as part of the terms of its audit engagement agreement against claims by third parties arising from the audit (for an unspecified amount). No payment has been made to indemnify Ernst & Young during or since the financial year.

10 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.

11 Remuneration report

Letter from the Chair

Dear fellow shareholders,

On behalf of your Board, I am pleased to present Challenger's 2015 Remuneration Report.

Our business performance during 2015 continued to go from strength to strength, with all key financial and growth objectives achieved. Our strong business performance is translating into higher dividends, with dividends more than doubling over the past five years.

Challenger has continued to deliver for our shareholders over an extended period, and has achieved a very strong total shareholder return of 120% over five years, compared with an average ASX100 return of 62%.

To further strengthen the alignment between executive remuneration and shareholder outcomes, we have over the years made a number of changes to our remuneration policies and practices. These have included lengthening the vesting period of share based awards, increasing the minimum shareholding requirement for both the CEO and Non-Executive Directors and using a funding range to set the total Short and Long-Term Incentive pool.

Following these changes, your Board remains satisfied that our current approach drives appropriate alignment between shareholders and employees. As a result, we are making no changes to our remuneration approach in 2015.

Your Board considers ongoing engagement with shareholders and external stakeholders a critical element of confirming our remuneration strategy. In 2015, this engagement process continued, and I met with a range of institutional shareholders, proxy advisory firms and retail shareholder representatives. Feedback from these meetings endorsed Challenger's remuneration strategy and practices and encouraged a period of stability.

To further increase the transparency of Key Management Personnel remuneration outcomes during 2015, this report has been enhanced to provide more fulsome disclosure of share based awards by tranche, together with the corresponding total shareholder return (TSR) and vesting outcome.

Your Board is confident that Challenger's remuneration strategy and practices 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 outcomes 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 2015 Remuneration Report.

Yours sincerely



Peter Polson
Chair

11 Remuneration report (continued)

11.1 Remuneration strategy and structure

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

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

Market-competitive	Performance-based and equitable	Aligned with shareholders and takes account of risk
<ul style="list-style-type: none"> Designed to attract and retain Key Management Personnel (KMP) and employees with required capabilities and experience. Remuneration structure and quantum benchmarked to the external market via relevant remuneration surveys and publicly disclosed data as appropriate. Remuneration benchmarking data independently reviewed for KMP by Challenger's remuneration adviser (KPMG). A balance achieved between fixed, short-term and long-term remuneration appropriate to individual roles. 	<ul style="list-style-type: none"> Designed to motivate KMP to pursue Challenger's long-term growth. Appropriate remuneration provided for superior individual contribution to business unit and Challenger performance, aligning performance and remuneration outcomes. Behaviour consistent with the Challenger Principles rewarded, including behavioural assessment in the performance management process and linking to remuneration outcomes. Rigorous peer review undertaken through an annual calibration process to ensure internal equity and fairness across a range of employee segments, including gender. 	<ul style="list-style-type: none"> Significant portion of Short-term Incentive (STI) subject to deferral and linked to Challenger's future share price performance. Long-term share based awards vesting subject to satisfying a shareholder return performance measure, as well as time-based vesting conditions. All deferred share based awards subject to clawback and forfeiture provisions. Remuneration processes and governance in place to ensure that remuneration arrangements discourage excessive risk-taking.

11 Remuneration report (continued)

11.1 Remuneration strategy and structure (continued)

Remuneration components

Key components of Challenger's remuneration structure for KMP remain unchanged for 2015. Remuneration components comprise fixed and variable remuneration 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 market competitive level, reflecting size and complexity of role, responsibilities, experience and skills.
Variable	Cash STI	Annual 'at risk' remuneration, rewarding Challenger, business unit and individual performance.	Clearly links remuneration outcomes with performance and contribution against annual KPIs.
Variable	Share awards deferred for one and two years	At least 50% of STI awards are deferred into Deferred Performance Share Rights (DPSRs) with vesting in equal tranches over two years. Subject to forfeiture and clawback provisions under the Challenger Performance Plan (CPP).	Balances risk management and governance considerations by deferring a significant portion of STI to support shareholder alignment.
Variable	Share awards deferred for three years	As in 2014, and in recognition of initiatives undertaken in 2015 focused on long term value, the Board determined that a portion of 2015 DPSRs for all KMP would be deferred for three years. Subject to forfeiture and clawback provisions under the Challenger Performance Plan (CPP).	Balances risk management and governance considerations and rewards KMP for pursuing Challenger's long-term growth and success, supporting shareholder alignment.
Variable	Hurdled share awards deferred up to five years	Long-term 'at risk' remuneration. Awarded as Hurdled Performance Share Rights (HPSRs) vesting in up to five years. 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 lapse at the end of the fifth anniversary following grant. Subject to forfeiture and clawback provisions under the CPP.	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.

11 Remuneration report (continued)

11.2 Remuneration strategy and structure (continued)

Fixed remuneration

When determining fixed remuneration for KMP, the Board considers the size and complexity of the role, responsibilities, experience and skills. Fixed remuneration increases for KMP have been minimal for a series of years, reflecting our focus on performance-based variable remuneration.

Short-Term Incentive

KMP STI awards are primarily based on annual performance assessments and market pay benchmarks. The Board uses a balanced scorecard with specific objectives for each KMP. The annual contribution is then assessed against these objectives together with the behaviours that support the Challenger Principles.

For 2015, objectives were set and agreed with KMP in July 2014. In July 2015, the Board assessed the performance of each KMP against these objectives, which determined individual STI awards for KMP as outlined in Section 11.4 Key Management Personnel remuneration arrangements.

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

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 as DPSRs. The Board considers that STI deferral provides a retention mechanism and links deferred STI awards with shareholder returns.

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.

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 2015, 25% of aggregate variable reward for KMP was delivered as cash, 25% as share awards deferred for up to two years and 50% as share awards deferred for three years or more. Refer to Section 11.4 Key Management Personnel remuneration arrangements for further information.

Hurdled Performance Share Rights (HPSRs)

HPSRs 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 incentive arrangements may lead to unintended outcomes. Therefore, individual target and maximum award limits are not supported at Challenger. Instead, an aggregate variable reward pool is set each year with reference to annual normalised profit. Consideration is given to Challenger performance and the proportion of total remuneration that should be deferred over a longer period to ensure alignment with shareholders.

Individual LTI awards are determined based on a range of factors including individual performance and criticality, retention risk and relevant market benchmarks. The Board determines LTI awards for KMP. The Board retains discretion to amend or withdraw the LTI at any point.

HPSRs represent the right to receive a fully-paid ordinary Challenger share for nil consideration subject to continued employment and Challenger satisfying the absolute TSR performance target.

Fair value

Board-determined HPSR awards for KMP are allocated based on the fair value.

Like share options, the future value of HPSRs is uncertain and depends on share price movements. Whereas DPSRs deliver the face value of a share at vesting (subject to continued employment), HPSRs deliver no value at vesting if absolute TSR is below the performance threshold of 8% compounded annually. HPSRs deliver the face value of the share at vesting if absolute TSR is at or above 12% compounded annually. The Board believes it is appropriate to value HPSRs differently from DPSRs in recognition of the range of potential future values, including a nil value if the HPSRs do not meet the minimum performance threshold. HPSR fair values are independently calculated based on a market accepted calculation methodology, which values the expected payoff of an HPSR under a given set of assumptions. See Note 30 Employee entitlements for details.

In making the HPSR awards, the Board considers the range of potential future vesting outcomes, including the future face value delivered should the maximum performance target of 12% compounded annually be achieved.

11 Remuneration report (continued)

11.1 Remuneration strategy and structure (continued)

Performance measurement

The Board considers that TSR is an effective way to incentivise and measure shareholder value creation. 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 a 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 are 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 that 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 above average market returns over the long term, HPSR vesting will be directly linked to the superior returns delivered to shareholders.

Reflecting current market practice, 50% of HPSR awards vest at threshold performance of 8% absolute TSR compounded annually, 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 awards to vest.

Absolute TSR compounded annually	% of HPSRs that vest
Less than 8% p.a.	0%
8% and above up to 12% p.a.	Straight-line vesting between 50% and 100%
12% p.a. and above	100%

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 relevant performance start or end date. A 90-day VWAP reduces the risk of unexpected volatility or price manipulation that could benefit or disadvantage employees.

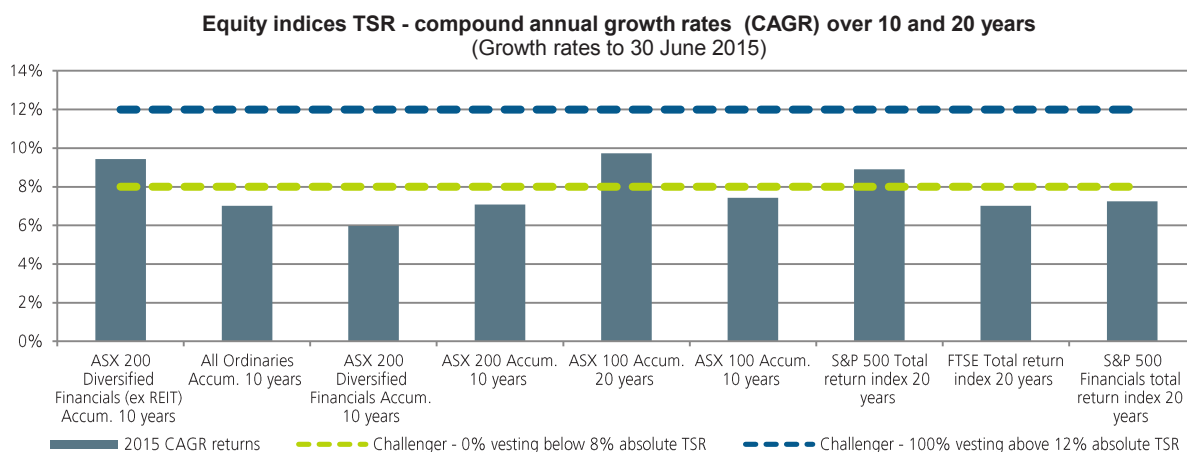
The absolute TSR performance targets were set following significant research and consideration, including:

- 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 HPSR performance targets are shown in the chart below relative to a range of indices:



11 Remuneration report (continued)

11.1 Remuneration strategy and structure (continued)

As an example, a share worth \$7.00 today and paying a 30 cents per share dividend reinvested each year would need to produce a total return (i.e. share price appreciation and accumulated reinvested dividends) of \$4.63 per share (a 66% return) over four years to achieve a 12% per annum compound return and for HPSR awards to vest in full.

During 2015, the Board again determined that the absolute TSR performance target of 8% to 12% compounded annually is challenging, particularly given the low interest rate environment, and continues to be the most appropriate way to incentivise and measure the creation of shareholder value.

Vesting periods

HPSR 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 award will be eligible to commence vesting on the third anniversary and the final third on the fourth anniversary following grant.

Where the absolute TSR performance targets are not satisfied for a particular tranche of an award, unvested HPSRs have the opportunity to vest at the end of the following tranche's vesting period, subject to an increased absolute TSR performance outcome which reflects another year of compound growth. Any unvested awards lapse at the end of the fifth anniversary following grant. Compared to market, where three-year cliff vesting is a common practice, this approach creates a longer-term focus and ensures that KMP and employees are motivated to deliver superior outcomes over an extended period of up to five years.

Challenger Performance Plan (CPP) Trust

The CPP Trust is an employee share trust established to satisfy Challenger's employee equity obligations arising from DPSRs and HPSRs.

Since the Trust commenced operation in December 2006, no shares have been issued to the Trust. 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. In order to facilitate capital efficiency and the appropriate distribution of dividends, DPSRs are predominantly hedged by way of physical shares and HPSRs via forward share purchase agreements. 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.

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 on the basis that the incentive is already earned and vesting is not subject to the achievement of a performance hurdle. 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 award vesting.

Any income distributed to KMP and employees from the CPP Trust is taken into account by the Remuneration Committee and the Board when considering remuneration recommendations. CPP Trust distributions to KMP are disclosed within the remuneration tables in Section 11.4 Key Management Personnel remuneration arrangements.

Tax Exempt Share Plan

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

The Tax Exempt Share Plan provides permanent employees a means to acquire Challenger shares at no cost, and to 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.

11 Remuneration report (continued)

11.2 Remuneration governance and risk management

Challenger's remuneration governance structures, outlined in the table below, provide strong oversight of remuneration practices and policies.

Detailed information concerning the scope of the Board and the Remuneration Committee's responsibilities can be found under the corporate governance section of Challenger's website.

Board	<ul style="list-style-type: none"> The Board is responsible for ensuring effective remuneration governance and related risk management practices. The Board approves remuneration principles and structures, ensures that they are competitive and equitable and that they support the long-term interests of Challenger. The Board receives recommendations from the Remuneration Committee and approves these remuneration recommendations where appropriate.
Remuneration Committee	<ul style="list-style-type: none"> The Board convenes a Remuneration Committee comprising at least three independent Directors to assist the in Board discharging 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 2015, five 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 & CEO and KMP remuneration, incentives, superannuation and life insurance arrangements and the Directors' remuneration framework.
Independent remuneration advisers	<ul style="list-style-type: none"> The Board, independent of management, appoints an adviser to the Remuneration Committee. During 2015, 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 2015, KPMG attended four of the five Board Remuneration Committee meetings and provided advice with respect to KMP remuneration arrangements. Fees paid or payable to KPMG in respect of these activities were \$68,733 (inclusive of GST). KPMG provided internal audit, tax, accounting, actuarial and transaction services and general remuneration factual information in 2015. Fees paid or payable to KPMG in respect of these activities were \$1,169,857 (inclusive of GST). Mercer was retained in 2015 to independently value DPSRs and HPSRs and test HPSR 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 & 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. Challenger's risk profile 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 Audit Committee provides reports to the Remuneration Committee and the Board summarising any breaches of the Risk Management Framework or other compliance policies. The Remuneration Committee and the 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 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, breaches are considered when determining cash STI and share based 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 cash STI and share based awards.

11 Remuneration report (continued)

11.2 Remuneration governance and risk management (continued)

Remuneration benchmarking

Challenger's 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 and in 2015 approved the following peer groups:

1 Financial Industry Remuneration Group survey:

The primary source of remuneration benchmark data at Challenger. 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:

Used as a secondary source of remuneration benchmark data comprised of publicly disclosed KMP remuneration data for select financial services companies. This peer group supports consideration of roles with comparable capital markets skills to Challenger's KMP, albeit that significant variation in company size and complexity exists between companies included in this peer group.

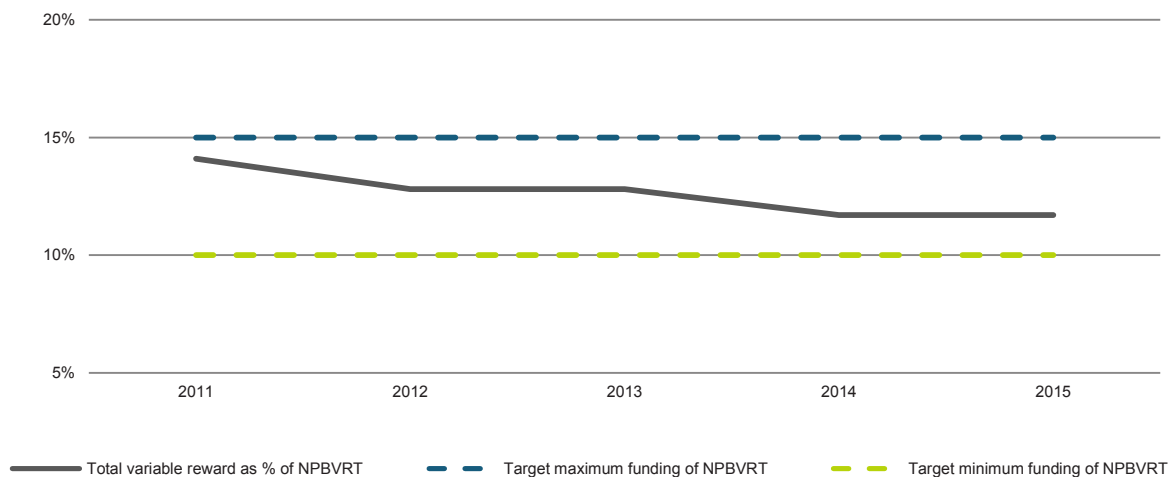
3 General industry publicly disclosed data:

Used as a secondary source of remuneration benchmark data comprised of 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, but does not account for industry-specific pay practices and levels.

In August 2015, the Board considered remuneration benchmark data as a key input when determining 2015 remuneration outcomes for KMP and is confident that awarded 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.

Variable remuneration governance

The Board determines a pool for total variable remuneration (cash STI and share based) annually, and targets a funding range of between 10% and 15% of normalised net profit before variable reward and tax (NPBVRT). Combined cash STI and share based awards from 2011 through 2015 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.

11 Remuneration report (continued)

11.2 Remuneration governance and risk management (continued)

For 2015, the Board approved a variable remuneration pool of 11.7% of NPBVRT (11.7% in 2014). The Board considers that the 2015 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. The Board retains discretion to determine the proportion of the variable remuneration pool which is allocated as cash and deferred share awards. In 2015, 51% (51% in 2014) of the pool was awarded as cash, 20% (22% in 2014) was awarded as equity deferred up to two years and 29% (27% in 2014) was awarded as equity deferred for three years or more.

Variable reward forfeiture and clawback provisions

Under the terms of the CPP, both DPSRs and HPSRs may be reduced or forfeited should the Board determine that 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).

CPP Trust governance arrangements

Computershare is the appointed independent trustee of the CPP Trust. The hedging position of the CPP Trust is continually monitored and reported to the Board. For further information see Note 15 Contributed equity. The Board retains discretion regarding the treatment of unvested equity in the event of a change of control.

Minimum shareholding guidelines

In July 2014, Challenger revised KMP and Non-Executive Director minimum shareholding guidelines in order to ensure alignment with shareholders. Minimum shareholding requirements are detailed in the table which follows:

Group	Requirement	Implied value ¹
Non-Executive Directors (NEDs)	One times base fees	Chair - \$385,000 NEDs - \$165,000
Managing Director & CEO	Two times fixed remuneration	\$2,500,000
Other KMP	One times fixed remuneration	\$650,000 to \$850,000

¹ Based on fees and remuneration at 30 June 2015.

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. Where fees are paid to the employer of the Non-Executive Director, the minimum shareholding guidelines do not apply.

The shareholdings of Non-Executive Directors and KMP at 30 June 2015 are set out in Sections 11.4 Key Management Personnel remuneration arrangements and 11.6 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, as this would not be consistent with Challenger's remuneration strategy or appropriate governance outcomes and be contrary to the intention of equity-based remuneration arrangements. Should a KMP or employee be found to have breached this requirement, it would 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 2015.

Employee share ownership

Employee share ownership levels by way of unvested equity are formally reviewed by the Board on a regular basis. As at 30 June 2015, 83% of permanent employees hold unvested Challenger equity (79% in 2014), which constitutes 4% employee ownership of Challenger (6% in 2014).

11 Remuneration report (continued)

11.3 Performance and remuneration snapshot

Since 2011, Challenger has increased both normalised net profit after tax (NPAT) by 35% and normalised earnings per share (EPS) by 18%, with this sustained strong business performance translating into increased dividends to shareholders by 82% over the period.

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

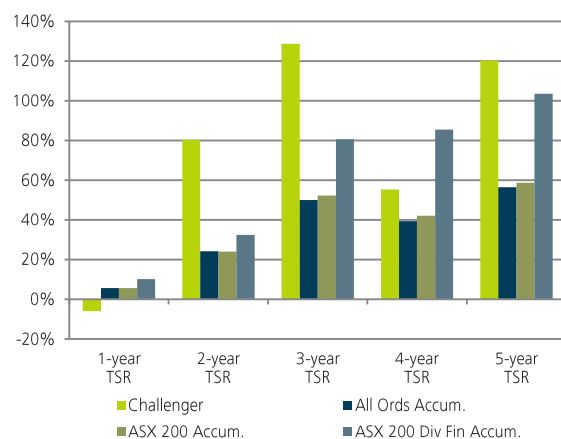
For the year ended

	30 June 2011	30 June 2012	30 June 2013	30 June 2014	30 June 2015
Normalised NPAT (\$M)	248.0	296.8	308.5	328.7	334.0
Normalised EPS (cents)	51.7	57.5	58.6	64.0	61.2
Closing share price (\$)	4.89	3.25	4.01	7.44	6.72
Dividends per share (cents)	16.5	18.0	20.0	26.0	30.0

Total shareholder return (TSR)

Source: IRESS and Bloomberg

Challenger's TSR has increased by 120% since 2010 and delivered significant long-term outperformance.



Challenger share price performance versus other Australian financial companies

Source: Bloomberg and Company data

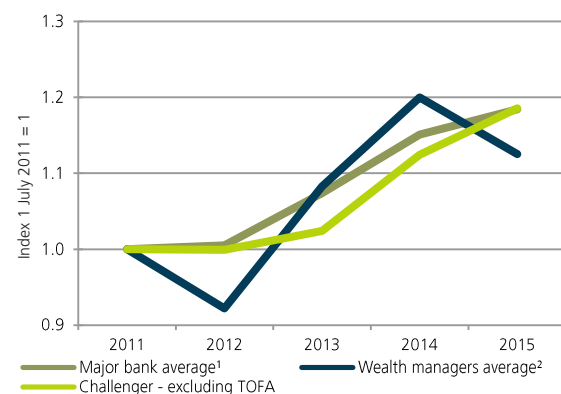
Challenger's share price has outperformed many Australian financial companies over the past five years.



Normalised EPS (excluding TOFA) versus other Australian financial companies

Source: Bloomberg and Company data

Challenger's normalised EPS has increased by 18% since 2011.



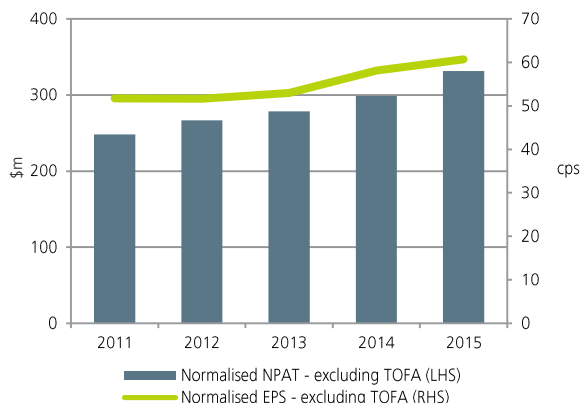
¹ Major bank average – (ANZ, CBA, NAB, WBC)

² Wealth managers average – (AMP, IOOF, PPT)

Normalised NPAT and Normalised EPS (excluding TOFA)

Source: Company data

Normalised NPAT and EPS have increased by 35% and 18% respectively since 2011.



11 Remuneration report (continued)

11.3 Performance and remuneration snapshot (continued)

Life – retail annuity sales

Source: Company data

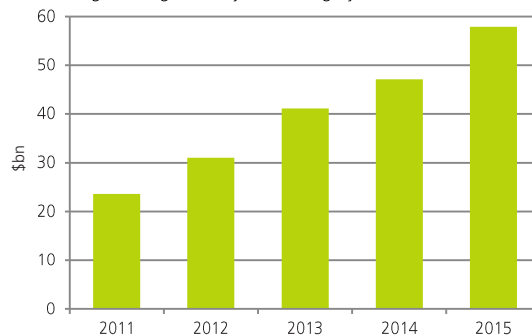
Retail annuity sales have increased by 45% since 2011.



Funds Management – funds under management (FUM)

Source: Company data

FM FUM has grown significantly, increasing by 145% since 2011.



2015 balanced scorecard outcomes

For 2015, 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. The performance measures, weighting range and outcomes are detailed below:

Objective	Performance measure	Outcome achieved	Weighting range
Financial	Normalised NPAT	\$334.0 million – exceeded target.	25%-35%
	Normalised EPS	61.2 cents per share – exceeded target.	
	Normalised RoE	18.0% – met target.	
Growth and customer	Retail annuity net book growth	Retail annuity net book growth of 9.4% (below target)	20%-40%
	Funds Management expansion	Funds under management of \$57.9 billion (up 23%) Two new boutiques, Arete and Tempo, were added to Challenger's boutique Funds Management business, Fidante Partners. The acquisition of Dexion Capital, a European alternative investments group based in London, materially expanded Fidante's alternative assets capability and presence in Europe.	
	Service delivery	The 2015 Wealth Insights Service Level Report ranked Challenger as follows: <ul style="list-style-type: none"> • Business Development Manager support – First • Online capability – Second • Technical and adviser support – Second • Overall adviser satisfaction – Third. 	

11 Remuneration report (continued)

11.3 Performance and remuneration snapshot (continued)

Objective	Performance measure	Outcome achieved	Weighting range
Growth and customer (continued)	Product and service growth	<p>The following initiatives in 2015 provide a platform for growth, enabling Challenger to secure the financial future of more Australians in retirement:</p> <ul style="list-style-type: none"> • VicSuper integrating Challenger annuities into its product offering; • Colonial First State (CFS) making Challenger annuities available on the CFS First Choice and CFS FirstWrap platforms; • agreement with Australian Administration Services (AAS), one of Australia's leading superannuation and pension administration specialists, to make annuities accessible to members of AAS's superannuation fund clients; • the rebranding and relaunching of Bendzulla Actuarial, acquired by Challenger in 2014, as Accurium, a broad based self-managed super fund (SMSF) retirement specialist. 	
	Brand effectiveness	<p>Recognition of Challenger's brand amongst both financial advisers and consumers continued to improve during 2015:</p> <ul style="list-style-type: none"> • 97% of advisers surveyed recognised Challenger as a leader in retirement income, up from 64% in 2010. • Consumer brand awareness increased from 62% to 66%. • Brand attribution increased by 3 percentage points to 59%. • Advertising awareness increased by 11 percentage points. • Challenger's consumer brand campaign was the financial services Gold Winner in the 2014 Effie Awards, and the Bronze Winner in the animation category of the 2014 Clio Awards. 	
	Retirement income thought leadership and education	<p>Challenger continued to make significant contributions to retirement income awareness and education.</p> <ul style="list-style-type: none"> • The University of New South Wales (UNSW) Retirement Planning Course was finalised, and 70 advisers are due to complete the course by the end of calendar year 2015. • Challenger's Technical Services team delivered presentations to over 6,000 advisers. • In partnership with Thomson Reuters, Challenger authored the Retirement Planning and Aged Care Planning chapters of the Australian Financial Planning Handbook. • Accurium launched a personalised automated retirement health check assessment to educate SMSF trustees about the risks of investing in retirement. 	

11 Remuneration report (continued)

11.3 Performance and remuneration snapshot (continued)

Objective	Performance measure	Outcome achieved	Weighting range
Risk and compliance	Control exposures from growth related activities through the risk framework and maintain compliance with the Risk Appetite Statement	<p>Compliance with Board Risk Appetite Statement for 2015 included:</p> <ul style="list-style-type: none"> • 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. <p>Challenger's normalised profit framework assumes negative 35 basis points (-0.35%), representing an allowance for credit defaults. Credit defaults in 2015 were lower than this assumed rate.</p>	15%-30%
People, community and sustainability	Sustainability outcomes	<p>Challenger's Sustainability Report provides further information on people, community and sustainability.</p> <p>Challenger's progress in climate disclosure was recognised at the 2014 Carbon Disclosure Project Climate Leadership Awards with the award for Best Year-on-Year Improvement in Climate Disclosure.</p> <p>In 2015, Challenger reviewed and strengthened its approach to sustainability, including:</p> <ul style="list-style-type: none"> • becoming carbon neutral for our business operations effective 30 June 2015; • implementing a responsible investment policy; • adopting the Global Reporting Initiative for sustainability reporting. 	15%-20%
	Employee engagement	Challenger was positioned ahead of the Australian and New Zealand Financial Services benchmark in the employee engagement survey conducted in March 2015, and recorded improved scores in each of the priority areas identified from the prior survey.	
	Gender equity	<p>In support of our gender diversity objectives, a number of initiatives were implemented, including:</p> <ul style="list-style-type: none"> • Gender diversity targets being developed. • A Scholarship Program for women introduced to support the professional development of high potential women with four scholarships awarded. • Unconscious bias training provided to all managers. • CEO, Brian Benari, becoming a Workplace Gender Equality Agency Equal Pay Ambassador. 	
	Leadership development and succession management	<p>Perceptions of the Leadership Team increased by eight points in the 2015 employee engagement survey, positioning Challenger ahead of both the Australian and New Zealand Financial Services and the best performing company norms for leadership.</p> <p>The Leadership Team conducted a further review of future leadership needs and new roles required to successfully deliver Challenger's business strategy.</p>	

11 Remuneration report (continued)

11.4 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*.

Challenger's KMP for 2015 are detailed in the table below:

Name	Role	Term as KMP in 2015
Brian Benari	Managing Director & CEO	Full year
Richard Howes	Chief Executive, Life	Full year
Paul Rogan	Chief Executive, Distribution Product & Marketing	Full year
Ian Saines	Chief Executive, Funds Management	From 2 March 2015
Andrew Tobin	Chief Financial Officer	Full year
Robert Woods	Chief Executive, Funds Management	Until 2 March 2015

Statutory remuneration

Statutory remuneration represents the accounting expense of remuneration in the financial year. It includes fixed remuneration, cash STI awards, the amortisation expense of deferred share awards granted in prior years and distributions from the CPP Trust.

Short-term employee benefits

KMP	Year	Salary ¹ \$	Super- annuation \$	Cash STI \$	Share- based payments ² \$	Other ³ \$	Total \$
B Benari	2015	1,235,947	18,783	900,000	3,001,935	212,826	5,369,491
	2014	1,237,003	17,775	900,000	2,726,883	199,255	5,080,916
R Howes	2015	632,387	18,783	700,000	1,995,380	133,263	3,479,813
	2014	633,392	17,775	625,000	1,973,757	143,939	3,393,863
P Rogan	2015	640,579	18,783	512,500	1,852,369	136,759	3,160,990
	2014	641,688	17,775	575,000	1,780,931	126,380	3,141,774
I Saines ⁴	2015	277,927	6,261	170,000	88,460	6,910	549,558
	2014	-	-	-	-	-	-
A Tobin	2015	632,470	18,783	425,000	1,126,036	87,359	2,289,648
	2014	582,225	17,775	400,000	961,392	65,198	2,026,590
R Woods ⁵	2015	426,181	12,608	369,178	1,241,981	81,879	2,131,827
	2014	636,074	17,775	600,000	1,746,331	128,417	3,128,597
Total	2015	3,845,491	94,001	3,076,678	9,306,161	658,996	16,981,327
	2014	3,730,382	88,875	3,100,000	9,189,294	663,189	16,771,740

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

² Calculated on the basis outlined in Note 30 Employee entitlements 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 HPSRs included in 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 a result, the value of the share-based payments included in the table may not necessarily have vested during the financial year.

³ 2015 values represent distributions from the CPP Trust and long service leave accruals, 2014 values represent distributions from the CPP Trust.

⁴ Mr Saines commenced with Challenger on 2 March 2015

⁵ Mr Woods transferred to a non-KMP role on 2 March 2015.

11 Remuneration report (continued)

11.4 Key Management Personnel remuneration arrangements (continued)

Split of statutory remuneration components

The splits of KMP statutory remuneration are set out below:

KMP	Year	Fixed remuneration	Cash STI	Share-based payments	Other	Total
B Benari	2015	23%	17%	56%	4%	100%
	2014	25%	18%	53%	4%	100%
R Howes	2015	19%	20%	57%	4%	100%
	2014	19%	19%	58%	4%	100%
P Rogan	2015	21%	16%	59%	4%	100%
	2014	21%	18%	57%	4%	100%
I Saines ¹	2015	52%	31%	16%	1%	100%
	2014	-	-	-	-	-
A Tobin	2015	28%	19%	49%	4%	100%
	2014	30%	20%	47%	3%	100%
R Woods ²	2015	21%	17%	58%	4%	100%
	2014	21%	19%	56%	4%	100%

¹ Mr Saines became a KMP on 2 March 2015.

² Mr Woods transferred to a non-KMP role on 2 March 2015.

Awarded remuneration

Awarded remuneration represents the value of remuneration that has been awarded for the financial year as determined by the Board. It includes fixed remuneration, cash STI and deferred share awards.

KMP	Year	Short-term employee benefits			Share-based payments				Total
		Salary ¹ \$	Super-annuation \$	Cash STI \$	1&2 year DPSR ² \$	3 year DPSR ³ \$	HPSR ⁴ \$	Other ⁵ \$	
B Benari	2015	1,235,947	18,783	900,000	900,000	550,000	1,650,000	190,683	5,445,413
	2014	1,237,003	17,775	900,000	900,000	500,000	1,350,000	199,255	5,104,033
R Howes	2015	632,387	18,783	700,000	700,000	287,500	862,500	122,133	3,323,303
	2014	633,392	17,775	625,000	625,000	400,000	725,000	143,939	3,170,106
P Rogan	2015	640,579	18,783	512,500	512,500	262,500	787,500	113,584	2,847,946
	2014	641,688	17,775	575,000	575,000	400,000	675,000	126,380	3,010,843
I Saines ⁶	2015	277,927	6,261	170,000	170,000	287,500	862,500	5,078	1,779,266
	2014	-	-	-	-	-	-	-	-
A Tobin	2015	632,470	18,783	425,000	425,000	200,000	600,000	68,060	2,369,313
	2014	582,225	17,775	400,000	400,000	225,000	475,000	65,198	2,165,198

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

² DPSRs will be formally granted in September 2015 and vest 50% one year after grant and 50% two years after grant.

³ DPSRs will be formally granted in September 2015 and vest three years after grant.

⁴ HPSRs will be formally granted in September 2015 with reference to the fair value at the time of grant.

⁵ Values represent distributions from the CPP Trust.

⁶ Mr Saines commenced with Challenger on 2 March 2015. HPSRs were awarded to attract, retain and drive alignment with long term shareholder interests.

11 Remuneration report (continued)

11.4 Key Management Personnel remuneration arrangements (continued)

Deferred Performance Share Rights granted

DPSRs granted to KMP during the year ended 30 June 2015 are detailed below:

KMP	Deferral from 2014 \$	Allocation price \$	Total number of DPSRs granted	Date of grant	Tranche 1		Tranche 2		Tranche 3	
					1 September 2015	Fair value \$	1 September 2016	Fair value \$	1 September 2017	Fair value \$
					Number		Number		Number	
B Benari	1,400,000	7.6978	206,090	16/9/14	63,559	7.08	66,079	6.81	76,452	6.54
R Howes	1,025,000	7.6978	151,188	16/9/14	44,138	7.08	45,888	6.81	61,162	6.54
P Rogan	975,000	7.6978	143,986	16/9/14	40,607	7.08	42,217	6.81	61,162	6.54
A Tobin	625,000	7.6978	92,019	16/9/14	28,248	7.08	29,368	6.81	34,403	6.54
R Woods ¹	1,000,000	7.6978	147,586	16/9/14	42,372	7.08	44,052	6.81	61,162	6.54

¹ Mr Woods transferred to a non-KMP role on 2 March 2015.

Deferred Performance Share Rights vested

DPSRs which vested to KMP during the year ended 30 June 2015 are detailed below:

KMP	Date of grant	Number	Fair value at grant \$	Vesting date
B Benari	12/9/12	130,529	394,198	1/9/14
	17/9/13	110,134	546,265	1/9/14
R Howes	12/9/12	97,897	295,649	1/9/14
	17/9/13	78,012	386,940	1/9/14
P Rogan	12/9/12	88,832	268,273	1/9/14
	17/9/13	79,541	394,523	1/9/14
A Tobin	12/9/12	36,258	109,499	1/9/14
	17/9/13	50,478	250,371	1/9/14
R Woods ¹	12/9/12	90,645	273,748	1/9/14
	17/9/13	42,830	212,437	1/9/14

¹ Mr Woods transferred to a non-KMP role on 2 March 2015.

Hurdled Performance Share Rights granted

HPSRs granted to KMP during the year ended 30 June 2015 are detailed below:

KMP	Grant date	TSR start price \$	Total number of HPSRs granted	Vesting		Fair value at grant \$	Fair value at grant \$
				Tranche 1	Tranche 2		
				1 September 2017	1 September 2018		
				Number vesting	Number vesting		
B Benari	16/9/14	7.6978	419,089	279,392	139,697	3.37	2.96
R Howes	16/9/14	7.6978	225,066	150,044	75,022	3.37	2.96
P Rogan	16/9/14	7.6978	209,544	139,696	69,848	3.37	2.96
I Saines	4/3/15	6.4394	204,383	129,533	74,850	3.86	3.34
A Tobin	16/9/14	7.6978	147,457	98,304	49,153	3.37	2.96
R Woods ¹	16/9/14	7.6978	209,544	139,696	69,848	3.37	2.96

¹ Mr Woods transferred to a non-KMP role on 2 March 2015.

11 Remuneration report (continued)

11.4 Key Management Personnel remuneration arrangements (continued)

Hurdled Performance Share Rights vested

HPSR grants considered by shareholders in prior periods and which vested to KMP during the year ended 30 June 2015 are detailed below, providing increased transparency of grants by tranche, together with TSR performance and vesting outcome. Total shareholder return outcomes for all HPSRs vesting during the year range between 20% and 52%, and are significantly above external market performance. The Board considers these outcomes reflect an appropriate alignment between shareholders and executives, in line with the guiding principles of Challenger's remuneration strategy.

Grant details				Vesting details				
KMP	Date	Number	Fair value ¹ \$	Date	Number	TSR outcome	Number vested or lapsed in prior years	Number yet to vest or lapse
B Benari	8/9/10	350,000	707,000	15/9/14	268,334	23%	81,666	-
	12/9/11	600,000	1,086,000	1/9/14	400,000	21%	-	200,000
	16/3/12	1,250,000	1,450,000	16/2/15	416,666	20%	416,666	416,668
R Howes	8/9/10	350,000	707,000	15/9/14	268,334	23%	81,666	-
	12/9/11	600,000	1,086,000	1/9/14	400,000	21%	-	200,000
	12/9/12	850,000	1,207,000	1/9/14	283,333	52%	-	566,667
P Rogan	8/9/10	200,000	404,000	15/9/14	153,334	23%	46,666	-
	12/9/11	500,000	905,000	1/9/14	333,332	21%	-	166,668
	12/9/12	700,000	994,000	1/9/14	233,333	52%	-	466,667
A Tobin	8/9/10	94,500	190,890	15/9/14	72,450	23%	22,050	-
	12/9/11	140,000	253,400	1/9/14	93,332	21%	-	46,668
	12/9/12	400,000	568,000	1/9/14	133,333	52%	-	266,667
R Woods ²	8/9/10	350,000	707,000	15/9/14	268,334	23%	81,666	-
	12/9/11	600,000	1,086,000	1/9/14	400,000	21%	-	200,000
	12/9/12	850,000	1,207,000	1/9/14	283,333	52%	-	566,667

¹ The fair value of an award is independently calculated and has been determined by the Board as the best estimate of the financial value of the underlying award.

² Mr Woods transferred to a non-KMP role on 2 March 2015.

Performance Share Rights held

Details of KMP DPSRs and HPSRs held as at 30 June 2015 are set out below:

KMP	Instrument	Number held at 1 July 2014	Number granted as remuneration	Number vested	Number held at 30 June 2015
B Benari	DPSRs	473,170	206,090	(240,663)	438,597
	HPSRs	2,551,668	419,089	(1,085,000)	1,885,757
R Howes	DPSRs	253,921	151,188	(175,909)	229,200
	HPSRs	2,243,334	225,066	(951,667)	1,516,733
P Rogan	DPSRs	247,915	143,986	(168,373)	223,528
	HPSRs	1,853,334	209,544	(719,999)	1,342,879
I Saines ¹	DPSRs	-	-	-	-
	HPSRs	-	204,383	-	204,383
A Tobin	DPSRs	137,214	92,019	(86,736)	142,497
	HPSRs	912,450	147,457	(299,155)	760,792

¹ Mr Saines commenced with Challenger on 2 March 2015.

11 Remuneration report (continued)

11.4 Key Management Personnel remuneration arrangements (continued)

Key Management Personnel and their affiliates' shareholdings in Challenger Limited

Details of KMP and their affiliates' shareholdings in Challenger Limited as at 30 June 2015 are detailed below:

KMP	Year	Opening balance	Number of vested DPSRs and HPSRs	Number of shares sold	Closing balance	Shareholding as a multiple of fixed remuneration for the year ¹
B Benari	2015	1,000,000	1,325,663	(1,325,663)	1,000,000	5.4
	2014	1,944,019	721,023	(1,665,042)	1,000,000	6.0
R Howes	2015	179,693	1,127,576	(1,127,576)	179,693	1.9
	2014	838,026	258,559	(916,892)	179,693	2.1
P Rogan	2015	150,000	888,372	(938,372)	100,000	1.0
	2014	100,000	193,428	(143,428)	150,000	1.7
I Saines ²	2015	-	-	-	-	-
	2014	-	-	-	-	-
A Tobin	2015	100,000	385,851	(290,000)	195,851	2.0
	2014	214,361	72,791	(187,152)	100,000	1.2
R Woods ³	2015	300,000	1,085,142	(1,085,142)	-	-
	2014	1,544,334	246,040	(1,490,374)	300,000	3.1
Total	2015	1,729,693	4,812,604	(4,766,753)	1,475,544	
	2014	4,640,740	1,491,841	(4,402,888)	1,729,693	

¹ Shareholding multiple based on 30 June 2015 closing share price of \$6.72.

² Mr Saines became a KMP on 2 March 2015.

³ Mr Woods transferred to a non-KMP role on 2 March 2015. The number of shares sold reflects shares sold whilst a KMP. Post 2 March 2015, Mr Woods holding disclosure is not required.

11 Remuneration report (continued)

11.5 Contractual arrangements

Brian Benari – Managing Director & CEO

Mr Benari was appointed Managing Director & CEO effective 17 February 2012. The terms of his appointment and termination arrangements were approved at an extraordinary general meeting on 28 February 2012. All equity awards for the

Managing Director & CEO are satisfied by the purchase of shares on market. 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 HPSRs
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	1 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 & CEO) employment agreements and notice periods

KMP do not have fixed terms of employment. The notice period for 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.

11.6 Non-Executive Director disclosures

Composition

Challenger's Non-Executive Directors for 2015 are detailed in the table below:

Name	Term as Non-Executive Director in 2015
Peter Polson (Chair)	Full year
Graham Cubbin	Full year
Steven Gregg	Full year
Jonathan Grunzweig	Full year
Russell Hooper	Retired on 27 February 2015
Brenda Shanahan	Full year
JoAnne Stephenson	Full year
Leon Zwier	Full year

11 Remuneration report (continued)

11.6 Non-Executive Director disclosures (continued)

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 2016.

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 added 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, inclusive of services provided at a subsidiary board level, for the year ended 30 June 2015:

Board/Committee	Chair fee \$	Member fee \$
Board ¹	385,000	165,000
Group Risk ²	22,500	11,500
Group Audit ²	22,500	11,500
Remuneration	34,000	18,000

¹ Board fees include Nomination Committee fees.

² The Group Risk and Audit Committee was separated effective 1 January 2015.

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

Non-Executive Director fees for the year ended 30 June 2015

The following table summarises Non-Executive Director fees for the year ended 30 June 2015:

Non-Executive Director	Year	Director fees \$	Superannuation \$	Total \$
P Polson ¹	2015	407,217	18,783	426,000
	2014	408,225	17,775	426,000
G Cubbin ²	2015	222,000	-	222,000
	2014	222,000	-	222,000
S Gregg	2015	167,123	15,877	183,000
	2014	167,506	15,494	183,000
J Grunzweig ³	2015	165,000	-	165,000
	2014	82,500	-	82,500
R Hooper ^{2, 4}	2015	110,000	-	110,000
	2014	165,000	-	165,000
B Shanahan	2015	188,128	17,872	206,000
	2014	188,558	17,442	206,000
J Stephenson	2015	191,217	18,783	210,000
	2014	192,225	17,775	210,000
L Zwier ²	2015	165,000	-	165,000
	2014	165,000	-	165,000
Total	2015	1,615,685	71,315	1,687,000
	2014	1,591,014	68,486	1,659,500

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

⁴ Mr Hooper retired from the Board on 27 February 2015.

11 Remuneration report (continued)

11.6 Non-Executive Director disclosures (continued)

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 at 30 June

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

Non-Executive Director	Year	Shares held at the beginning of the year	Movements	Shares held at the end of the year
P Polson	2015	122,000	-	122,000
	2014	122,000	-	122,000
G Cubbin	2015	97,702	-	97,702
	2014	177,702	(80,000)	97,702
S Gregg	2015	10,000	-	10,000
	2014	10,000	-	10,000
J Grunzweig	2015	250	-	250
	2014	250	-	250
R Hooper ¹	2015	160,000	(160,000)	-
	2014	160,000	-	160,000
B Shanahan	2015	250,000	2,112	252,112
	2014	250,000	-	250,000
J Stephenson	2015	2,000	5,000	7,000
	2014	-	2,000	2,000
L Zwier	2015	2,360	-	2,360
	2014	2,360	-	2,360
Total	2015	644,312	(152,888)	491,424
	2014	722,312	(78,000)	644,312

¹ Mr Hooper retired from the Board on 27 February 2015, so his holding disclosure is removed under 'Movements'.

Total Remuneration of Key Management Personnel and Non-Executive Directors

KMP and Non-Executive Directors	Short-term benefits \$	Post-employment benefits \$	Share-based payments \$	Other long-term benefits \$	Termination benefits \$	Total \$
Non-Executive Directors						
2015	1,615,685	71,315	-	-	-	1,687,000
2014	1,591,014	68,486	-	-	-	1,659,500
KMP						
2015	6,922,169	94,001	9,306,161	658,996	-	16,981,327
2014	6,830,382	88,875	9,189,294	663,189	-	16,771,740
All KMP and Non-Executive Directors						
2015	8,537,854	165,316	9,306,161	658,996	-	18,668,327
2014	8,421,396	157,361	9,189,294	663,189	-	18,431,240

11 Remuneration report (continued)

11.7 Summary of key terms and abbreviations used in the remuneration report

Key term	Description
Awarded remuneration	Represents the value of remuneration that has been awarded for the financial year. This includes fixed remuneration, Cash STI and deferred share awards.
Board	The Board of Directors of Challenger Limited and the main body responsible for the implementation of effective remuneration governance and related risk management practices at Challenger.
CPP	<i>Challenger Performance Plan</i> . Deferred equity awards are issued under the CPP.
CPP Trust	<i>Challenger Performance Plan Trust</i> . 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	<i>Deferred Performance Share Right</i> . 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; however, employees with unvested DPSRs may receive a distribution of income from the Challenger Performance Plan Trust.
Fair value	The number of HPSRs awarded to KMP and employees is calculated by reference to the fair value. The fair value for HPSRs is calculated on the basis outlined in Note 30 Employee entitlements and reflects the fair value of the benefit derived at the date at which they were granted. An independent third party determines the fair value using an option pricing model and discounted cash flow methodology, as appropriate.
HPSR	<i>Hurdled Performance Share Right</i> . HPSR awards are delivered under the CPP and are linked to the long-term performance of Challenger. 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. HPSR awards are provided to KMP and employees whose responsibilities provide them with the opportunity to materially influence long-term performance, strategy and shareholder value. Awards are determined based on a range of factors, and the Board has discretion to amend or withdraw at any point.
KMP	<i>Key Management Personnel</i> . 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 <i>Related party disclosures</i> .
Normalised NPAT	<i>Normalised net profit after tax</i> . Excludes asset or liability valuation movements that are above or below expected long-term trends and significant items that may positively or negatively impact financial results. Refer to the Review of operations section for further information.
Normalised RoE (pre-tax)	<i>Normalised return on equity (pre-tax)</i> . Normalised profit before tax divided by average net assets.
Normalised NPBVRT	<i>Normalised net profit before variable reward and tax</i> . 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 STI expense, employee share award expense and tax.
Remuneration Committee	The Board convenes a Remuneration Committee comprising independent Non-Executive Directors and which is a delegated sub-committee of the Board 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, the amortisation expense of share based awards granted in prior years and distributions from the CPP Trust.
STI	<i>Short-term Incentive</i> . 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	<i>Total shareholder return</i> . TSR represents the change in share price plus dividends received over a given timeframe. Challenger uses absolute TSR as the measure of performance for HPSRs.
Variable remuneration	Consists of Cash STI and share based awards (DPSRs and HPSRs).
VWAP	<i>Volume weighted average price</i> . 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).

12 Rounding

The amounts contained in this report and the financial report have been rounded to the nearest \$100,000 unless otherwise stated, 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.

13 Non-audit services

The Audit Committee has reviewed details of the amounts paid or payable for non-audit services provided to Challenger during the year ended 30 June 2015 by the company's auditor, EY.

The Directors are satisfied that the provision of those non-audit services by the auditor is compatible with the general standard of independence for auditors imposed by the Corporations Act and did not compromise the auditor independence requirements of the Corporations Act for the following reasons:

- all non-audit services were approved in accordance with the approval process outlined in the Auditor Independence Policy that outlines the approval process that must occur for all non-audit services and which involves the Challenger CEO, CFO or delegate, depending on size and circumstances;
- no non-audit services were carried out which were specifically excluded by the Auditor Independence policy and;
- for details of fees for non-audit services paid to the auditors, refer to Note 31 of the financial report.

14 Auditor's independence declaration

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



Ernst & Young
680 George Street
Sydney NSW 2000 Australia
GPO Box 2646 Sydney NSW 2001

Tel: +61 2 9248 5555
Fax: +61 2 9248 5959
ey.com/au

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 2015, 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

Sydney
17 August 2015

Liability limited by a scheme approved under Professional Standards Legislation.

15 Authorisation

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

P L Polson
Chair
Sydney
17 August 2015

B R Benari
Managing Director & Chief Executive Officer
Sydney
17 August 2015

Sustainability

Sustainability is critical for Challenger to build long-term value for customers, shareholders, employees and the wider community.

As part of our vision of providing Australians with financial security for retirement, we believe in having a retirement system that encourages long-term savings and the conversion of those savings into a retirement income that lasts a lifetime.

We also believe in the delivery of sustainable business practices through robust governance, strong risk management culture and practices, appropriate people and workplace programs and the responsible investment of customer and shareholder money. Finally, we strive to contribute to the sustainability of our environment and the communities in which we operate.

Our commitment to sustainable retirement incomes

Challenger is playing a critical role as Australia's superannuation system evolves and the focus shifts to converting retirement savings into long-term sustainable retirement incomes.

As a leader in Australian retirement incomes, we are a key contributor to industry and political debate, and through our thought leadership and innovation, we are leading the development of sustainable retirement incomes practices.

We are:

- introducing new longevity products to enhance the sustainability of our customers' retirement savings;
- using technology to increase access to retirement income products that provide guaranteed incomes;
- actively contributing to Australia's retirement incomes political debate; we believe Australia's retirement system should support the efficient conversion of superannuation assets into retirement incomes, with retirees protected from the risk of running out of money; and
- educating financial advisers and consumers on the importance of guaranteed retirement incomes and the need to protect against risks in retirement. In conjunction with the University of New South Wales, Challenger has launched Australia's first dedicated retirement income course for advisers.

Challenger has recently become a signatory to the United Nations Principles of Responsible Investment (UNPRI); this furthers our progress with our investment governance framework.

Our commitment to sustainable business practices

We are committed to:

- a strong governance and risk culture;
- responsible investment; and
- best practice people and workplace programs.

Our people are critical to our success. We foster and promote a working environment where diversity is embraced and our people are motivated to perform at their best.

We use Aon Hewitt to measure how engaged our people are. Our most recent engagement score of 61% placed us ahead of the Australian and New Zealand Financial Services benchmark.

We continue to invest in our people and have:

- implemented sponsorship and scholarship programs for high potential women to increase gender equality;
- recognised the rise of mental health issues in the broader community and implemented a wellbeing initiative to proactively manage and support our people impacted by mental health issues. Following our focus, utilisation of our Employee Assistance Program for mental health issues increased; and
- enhanced our commitment to diversity through the establishment of a Diversity Committee to ensure ongoing focus on and the promotion of workplace diversity. Five year gender composition targets have been developed by the Board.

Our employment brand

Challenger's employment brand, as developed with our employees, is built on the principles of Challenge, Collaborate, Grow and Achieve.

Our employment brand communicates the employment experience offered to current and potential employees.

Our most recent brand employee engagement survey showed a 10-point improvement in delivering on our promises to employees.

Our Commitment to the environment

We believe in doing the right thing by the environment and are committed to reducing the impact we have on it. We achieve this by raising awareness amongst our people, utilising technologies to minimise the resources we use and applying sustainable business practices.

Sustainability (continued)

In 2013, we partnered with Climate Friendly and introduced a program to offset greenhouse gas emissions for electricity consumption from our Sydney office.

In 2014, we extended our commitment to reducing greenhouse gas emissions by including waste (Sydney office), taxi trips, paper used and 20% of air travel.

In 2015, we became carbon neutral and offset greenhouse gas emissions across our entire business operation. We have invested in wind farms and native forest production in order to achieve this.

Our full commitment to sustainability is outlined in our Sustainability Report and can be viewed at:

 challenger.com.au/sustainabilityreport

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

Statement of comprehensive income

For the year ended 30 June

	Note	2015 \$M	2014 \$M
Revenue	1	1,689.0	1,615.8
Expenses	2	(1,051.1)	(945.8)
Finance costs	18	(246.8)	(262.3)
Share of profits of associates	25	15.3	15.9
Profit before income tax		406.4	423.6
Income tax expense	4	(78.5)	(53.9)
Profit for the year		327.9	369.7
Profit attributable to shareholders of Challenger Limited		299.0	340.6
Profit attributable to non-controlling interests	26	28.9	29.1
Profit for the year		327.9	369.7
Other comprehensive income			
Items that may be reclassified to profit and loss, net of tax			
Translation of foreign entities	17	20.7	(17.2)
Hedge of net investment in foreign operations	17	(23.5)	15.2
Cash flow hedges – SPV ¹	17	1.8	(4.0)
Other comprehensive expense for the year		(1.0)	(6.0)
Total comprehensive income for the year		326.9	363.7
Comprehensive income attributable to shareholders of Challenger Limited		298.0	334.6
Comprehensive income attributable to non-controlling interests		28.9	29.1
Total comprehensive income for the year		326.9	363.7
Earnings per share attributable to ordinary shareholders of Challenger Limited		cents	cents
Basic	20	54.8	66.3
Diluted	20	51.4	62.8

¹ 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	2015 \$M	2014 \$M
Assets			
Cash and cash equivalents	13	409.7	391.4
Cash and cash equivalents – SPV	7	183.9	216.6
Receivables	8	245.3	148.5
Mortgage assets – SPV	7	2,231.3	2,978.9
Derivative assets	12	584.7	318.0
Financial assets – fair value through profit and loss	5	10,926.4	10,027.3
Investment property held for sale	6	286.7	222.7
Investment and development property	6	2,826.4	2,222.1
Finance leases		40.4	39.4
Property, plant and equipment		138.8	138.1
Investment in associates	25	43.4	39.4
Other assets		65.2	35.1
Goodwill	28	531.0	531.0
Other intangible assets	28	18.4	14.8
Total assets of shareholders of Challenger Limited, policyholders, external unit holders and non-controlling interests		18,531.6	17,323.3
Liabilities			
Payables	11	258.9	443.3
Derivative liabilities	12	698.9	222.5
Interest bearing financial liabilities	16	2,925.6	2,370.0
Interest bearing financial liabilities – SPV	7	2,192.8	2,931.4
External unit holders' liabilities	10	944.7	1,072.4
Provisions		23.8	26.5
Current tax liability	4	23.6	34.4
Deferred tax liabilities	4	131.7	122.4
Life contract liabilities	9	8,693.0	7,824.3
Total liabilities of shareholders of Challenger Limited, policyholders, external unit holders and non-controlling interests		15,893.0	15,047.2
Net assets of shareholders of Challenger Limited policyholders, external unit holders and non-controlling interests		2,638.6	2,276.1
Equity			
Contributed equity	15	1,527.2	1,237.5
Reserves	17	23.7	69.8
Retained earnings	17	992.3	846.0
Total equity of shareholders of Challenger Limited		2,543.2	2,153.3
Non-controlling interests	26	95.4	122.8
Total equity of shareholders of Challenger Limited and non-controlling interests		2,638.6	2,276.1

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

Statement of changes in equity

Attributable to shareholders of Challenger Limited										
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
Balance at 1 July 2013		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	17/26	-	-	-	-	-	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	15	(43.2)	-	-	-	-	-	(43.2)	-	(43.2)
Vested shares released from the CPP Trust	15	17.2	-	-	-	-	-	17.2	-	17.2
CPP deferred share purchases	15	(8.4)	-	-	-	-	-	(8.4)	-	(8.4)
Share-based payment expense less releases	17	-	24.9	-	-	-	-	24.9	-	24.9
Dividends paid	19	-	-	-	-	-	(120.3)	(120.3)	-	(120.3)
Other movements	17	-	-	-	-	1.1	-	1.1	(253.1)	(252.0)
Balance at 30 June 2014 and 1 July 2014	26	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 2015										
Profit for the year	17/26	-	-	-	-	-	299.0	299.0	28.9	327.9
Other comprehensive income for the year		-	-	1.8	(2.8)	-	-	(1.0)	-	(1.0)
Total comprehensive income for the year		-	-	1.8	(2.8)	-	299.0	298.0	28.9	326.9
Other equity movements										
Shares purchased in the CPP Trust	15	(60.9)	-	-	-	-	-	(60.9)	-	(60.9)
Vested shares released from the CPP Trust	15	78.4	-	-	-	-	-	78.4	-	78.4
CPP deferred share purchases	15	(15.0)	-	-	-	-	-	(15.0)	-	(15.0)
Net proceeds from share placement	15	287.2	-	-	-	-	-	287.2	-	287.2
Share-based payment expense less releases	17	-	(44.9)	-	-	-	-	(44.9)	-	(44.9)
Dividends paid	19	-	-	-	-	-	(152.7)	(152.7)	-	(152.7)
Other movements	17	-	-	-	0.2	(0.4)	-	(0.2)	(56.3)	(56.5)
Balance at 30 June 2015	26	1,527.2	10.0	1.4	(6.6)	18.9	992.3	2,543.2	95.4	2,638.6

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	2015 \$M	2014 \$M
Operating activities			
Receipts from customers		631.7	651.1
Annuity and premium receipts	9	2,764.2	2,806.2
Annuity and claim payments	9	(2,361.3)	(2,526.0)
Payments to reinsurer	9	(4.6)	(4.0)
Receipts from external unit holders		944.0	581.6
Payments to external unit holders		(1,130.7)	(1,326.7)
Payments to vendors and employees		(539.7)	(566.2)
Dividends received		77.1	61.2
Interest received		588.0	552.8
Interest paid		(84.6)	(72.3)
Income tax paid		(68.2)	(10.3)
Net cash inflows from operating activities	14	815.9	147.4
Investing activities			
Payments on net purchases of investments		(1,392.5)	(908.4)
Payments for purchases of controlled entities		-	(294.6)
Net mortgage loan repayments		749.0	1,048.0
Net payments for purchase of associate		-	(0.5)
Payments for net purchases of property, plant and equipment		(5.1)	(7.4)
Net cash outflows from investing activities		(648.6)	(162.9)
Financing activities			
Proceeds from issue of Challenger Capital Notes		345.0	-
Proceeds from issue of ordinary shares		290.2	-
Costs associated with issue of Challenger Capital Notes and ordinary shares		(13.6)	-
Proceeds from borrowings – interest bearing financial liabilities		306.0	571.1
Repayment of borrowings – interest bearing financial liabilities		(880.7)	(1,075.7)
Payments for Treasury shares		(74.8)	(43.2)
Dividends paid		(152.7)	(120.3)
Distributions paid to non-controlling interests		(1.1)	(17.7)
Net cash outflows from financing activities		(181.7)	(685.8)
Net decrease in cash and cash equivalents		(14.4)	(701.3)
Cash and cash equivalents at the beginning of the year		608.0	1,309.3
Cash and cash equivalents at the end of the year		593.6	608.0
Cash and cash equivalents	13	409.7	391.4
Cash and cash equivalents – SPV	7	183.9	216.6
Cash and cash equivalents at the end of the year		593.6	608.0

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

Section 1: Basis of preparation and overarching 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 2015 was authorised for issue in accordance with a resolution of the Directors of the Company on 17 August 2015.

(i) Basis of preparation and statement of compliance

This is a general purpose financial report that has been prepared in accordance, and complies with the requirements of the *Corporations Act 2001*, Australian Accounting Standards and other authoritative pronouncements of the Australian Accounting Standards Board (AASB) and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. Challenger Limited is a for-profit entity for the purposes of preparing financial statements.

Unless otherwise stated, amounts in this financial report are presented in Australian dollars and have been prepared on an historical cost basis. 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. In the disclosure notes the current/non-current split is between items expected to be settled within 12 months (current) and those expected to be settled in greater than 12 months (non-current).

(ii) 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 2012-3 Amendments to Australian Accounting Standards – Offsetting Financial Assets and Financial Liabilities

The amendments and 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. The amendments were effective for annual periods beginning on or after 1 January 2014 and did not result in any material changes.

AASB 2013-3 Amendments to AASB 136 – Recoverable Amount Disclosures for Non-Financial Assets

The amendments include 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 amendments were effective for annual periods beginning on or after 1 January 2014 and did not result in any material changes.

AASB 2013-5 Amendments to Australian Accounting Standards – Investment Entities

The amendments define an investment entity and provide, under limited circumstances, an exception to the AASB 10 *Consolidated financial statements* consolidation requirements and application of AASB 3 *Business combinations*. An investment entity is required to measure unconsolidated subsidiaries at fair value through profit and loss. The amendments were effective for annual periods beginning on or after 1 January 2014 and did not result in any material changes.

Accounting standards and interpretations issued but not yet effective

AASB 9 Financial Instruments

The standard is effective for annual periods beginning on or after 1 January 2018; 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 but does not expect any material impact as a result of complying with the new requirements. Early adoption is not currently anticipated. 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 15 Revenue from Contracts with Customers

The new revenue standard establishes a single, comprehensive framework for revenue recognition effective for annual periods beginning on or after 1 January 2017 and replaces the previous revenue standards IAS 18 *Revenue* and IAS 11 *Construction contracts*. The standard does not apply to leases, financial instruments and insurance contracts. An Exposure Draft has been issued by the AASB to defer the effective date of this standard to 1 January 2018.

The Group is currently assessing the impact of this new standard but does not expect any material impact as a result of complying with the new requirements.

AASB 2015-2 Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 101

The amendments are intended to further encourage companies to apply professional judgement in determining what information to disclose and in what order in the financial statements. The Group has considered the new standard and has implemented format changes in relation to the order of material in the financial report and removal of immaterial disclosures.

In addition to those described above, there are a number of amendments to Australian Accounting Standards, 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.

(iii) Principles of consolidation

The financial statements consolidate the financial information of controlled entities. An entity is controlled when the Company is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. 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.

(iv) Comparatives

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

(v) Rounding of amounts

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

(vi) 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's 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 12 Derivative financial instruments.

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.

(vii) Goods and services tax (GST)

Revenue, 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.

(viii) 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 disclosed individually within each of the relevant notes to the financial statements.

(ix) 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 (CGU) exceeds its recoverable amount, the asset or CGU is considered impaired and is written down to its recoverable amount. Impairment losses are recognised in the statement of comprehensive income, 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 statement of comprehensive income as impairment losses.

Impairment losses recognised in respect of a CGU are allocated first to reduce the carrying amount of any goodwill allocated to that CGU, 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 statement of comprehensive income unless the asset is carried at the revalued amount, in which case it is treated as a revaluation increase. Impairment losses recognised for goodwill are not subsequently reversed.

(x) Restrictions on assets

Financial assets held in Challenger Life Company Limited (CLC) can only be used within the restrictions imposed under the *Life Insurance Act 1995* (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. Refer to Note 9 Life contract liabilities.

Section 2: Key numbers

This section presents the results and performance of the Group for the year and provides additional information about those line items on the statement of comprehensive income that the Directors consider most relevant in the context of understanding the financial components of the Group's operations.

Note 1 Revenue

	30 June 2015 \$M	30 June 2014 \$M
Investment revenue		
Fixed income securities and cash		
Interest revenue	796.2	785.8
Net realised and unrealised gains on fixed income securities ¹	134.6	240.3
Investment property and property securities		
Property rental revenue	266.2	239.9
Dividend revenue	22.2	25.3
Net realised and unrealised gains on investment property and property securities	98.2	10.3
Revenue from sale of development properties	25.6	17.3
Equity and infrastructure investments		
Dividend revenue	39.8	24.4
Net realised and unrealised gains on equity investments	25.9	38.1
Net realised and unrealised gains on infrastructure investments	39.5	47.0
Other		
Net realised and unrealised gains on foreign exchange translation and hedges	48.5	47.1
Net realised and unrealised losses on interest rate derivatives	(99.3)	(57.7)
Net realised and unrealised gains on equity swap derivatives	28.8	0.8
Management fee revenue	158.9	131.8
Other revenue		
Life insurance contract premiums and related revenue	490.8	620.5
Change in life insurance contract liabilities	(332.6)	(549.7)
Change in life investment contract liabilities	(56.1)	(5.9)
Change in reinsurance contract liabilities	1.8	0.5
Total revenue	1,689.0	1,615.8

¹ Includes fair value movements in subordinated debt (Note 22 Fair values of financial assets and liabilities).

Recognition and measurement

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

- Interest revenue is recognised as it accrues using an effective interest rate method, taking into account the effective yield of the financial asset.
- Interest revenue on finance leases is recognised on a basis that reflects a constant periodic return on the net investment in the finance lease.
- 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 statement of comprehensive income when the change in value is recognised in the statement of financial position.

Note 1 Revenue (continued)

Recognition and measurement (continued)

- Property rental revenue 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 recognised on a straight line basis over the life of the contract.
- Dividend revenue from listed equity shares and listed property securities is recognised as income on the date the share is quoted ex-dividend. Dividend revenue from unlisted equity shares and unlisted property securities is recognised when the dividend is declared.
- Management fee revenue is derived from the provision of investment management services to the Group's managed investment products and residential mortgage-backed assets. Management fee revenue is recognised when the services are provided. Life insurance contract premiums are recognised as revenue when received.
- 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 2 Expenses. Refer to Note 9 Life contract liabilities for more detail on the recognition and measurement of life contract liabilities.

Note 2 Expenses

	30 June 2015 \$M	30 June 2014 \$M
Life insurance contract claims and expenses	210.5	109.0
Cost of life insurance contract liabilities	124.1	93.4
Cost of life investment contract liabilities	238.1	285.5
Reinsurance contracts	1.6	2.3
Investment property related expenses ¹	68.4	70.2
Development properties cost of sales	23.9	15.6
Management fee expense	87.7	81.4
Distribution expenses	41.8	50.2
Employee expenses	127.0	118.4
Employee share-based payments	26.3	25.3
Superannuation	6.7	6.0
Occupancy expense – operating lease	4.2	6.1
Depreciation and amortisation expense	18.6	20.0
Technology and communications	23.9	21.2
Professional fees	19.1	16.5
Other expenses	29.2	24.7
Total expenses	1,051.1	945.8

¹ Investment property related expenses relate to rental income generating investment properties.

Recognition and measurement

Expenses are 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.

Note 2 Expenses (continued)

Recognition and measurement (continued)

- Life insurance contract claims and expenses are recognised when the liability to the policyholder under the contract has been established.
- Cost of life insurance and life investment 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 1 Revenue. Refer to Note 9 Life contract liabilities for more detail on the recognition and measurement of life contract liabilities.

Note 3 Segment information

The reporting segments¹ of the Group have been identified as follows:

For the year ended 30 June

	Life		Funds Management		Total reporting segments		Corporate and other ²		Total	
	2015 \$M	2014 \$M	2015 \$M	2014 \$M	2015 \$M	2014 \$M	2015 \$M	2014 \$M	2015 \$M	2014 \$M
Net income	543.8	481.3	117.5	110.2	661.3	591.5	1.3	1.8	662.6	593.3
Operating expenses	(87.1)	(77.1)	(73.4)	(66.9)	(160.5)	(144.0)	(63.7)	(61.4)	(224.2)	(205.4)
Normalised EBIT	456.7	404.2	44.1	43.3	500.8	447.5	(62.4)	(59.6)	438.4	387.9
Interest and borrowing costs							(3.8)	(4.1)	(3.8)	(4.1)
Normalised net profit/(loss) before tax	456.7	404.2	44.1	43.3	500.8	447.5	(66.2)	(63.7)	434.6	383.8
Tax on normalised profit									(100.6)	(55.1)
Normalised net profit after tax									334.0	328.7
Investment experience after tax									(35.0)	11.9
Profit attributable to the shareholders of Challenger Ltd									299.0	340.6
Other statutory segment information										
Revenue from external customers	760.6	715.8	128.1	113.8	888.7	829.6	4.1	0.4	892.8	830.0
Interest revenue	758.9	738.5	-	-	758.9	738.5	37.3	47.3	796.2	785.8
Interest expense	(230.0)	(257.2)	-	-	(230.0)	(257.2)	(16.8)	(5.1)	(246.8)	(262.3)
Intersegment revenue	(40.1)	(25.1)	40.1	25.1	-	-	-	-	-	-
Depreciation and amortisation	(11.1)	(12.4)	(0.1)	-	(11.2)	(12.4)	(7.4)	(7.6)	(18.6)	(20.0)
As at 30 June										
Segment assets	13,437.4	11,746.5	161.1	153.9	13,598.5	11,900.4	4,837.7	5,300.1	18,436.2	17,200.5
Segment liabilities	(11,028.4)	(9,567.4)	(32.9)	(20.3)	(11,061.3)	(9,587.7)	(4,831.7)	(5,459.5)	(15,893.0)	(15,047.2)
Net assets attributable to shareholders	2,409.0	2,179.1	128.2	133.6	2,537.2	2,312.7	6.0	(159.4)	2,543.2	2,153.3

¹ Refer to next page for definitions of the terms used in the management view of segments.

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

Note 3 Segment information (continued)

Definitions

Operating segments

The following segments are identified on the basis of internal reporting to key management personnel, including the Chief Executive Officer (the chief operating decision maker) of the Group, and comprise component parts of the Group that are regularly reviewed by senior management in order to allocate resources and assess performance:

Life

The Life segment principally includes the annuity and life insurance business carried out by CLC and Accurium Actuarial Pty Limited (provision of self-managed superannuation fund actuarial certificates). CLC offers fixed rate retirement and superannuation products that are designed for investors who are seeking a low-risk, fixed term or lifetime investment and seek capital protection. CLC invests in assets providing long-term income streams for customers.

Funds Management

Funds Management earns fees from its Fidante Partners and Challenger Investment Partners 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 the Fidante Partners boutique fund managers and, through the Challenger Investment Partners business, offers a range of managed investments across fixed income and property.

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

Normalised vs. statutory results

Net income and operating expenses differ from revenue and expenses as disclosed in the statement of comprehensive income as certain direct costs (including distribution expenses, property expenses and management fees) included in expenses are netted off against revenues in deriving the management view of net income above. Net income consists of the following sub-categories of management views of revenue:

- Normalised cash operating earnings (Life segment).
- Net income (Funds Management segment).
- Other income (Corporate and other segment).

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 which are excluded from the management view as they form part of investment experience (refer below).

Normalised cash operating earnings

This 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, distribution expenses and fees.

Normalised EBIT

Normalised earnings before interest and tax (EBIT) comprises net income less operating expenses, as defined above. It excludes investment experience, corporate interest and borrowing costs and tax.

Interest and borrowing costs differ from finance costs as disclosed in the statement of comprehensive income 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 statement of comprehensive income, 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 isolate the volatility arising from asset and liability valuation within 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 (refer below) plus annuity valuation changes. Investment experience after tax is investment experience net of tax at the prevailing income tax rate.

Normalised capital growth

This 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.

Note 3 Segment information (continued)

Definitions (continued)

Normalised capital growth (continued)

The normalised growth rates for the year are +6.0% for equity, +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.

Annuity valuation 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 the corresponding interest rate, foreign exchange and inflation 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; hence, no geographical split is provided to the chief operating decision maker.

	30 June 2015 \$M	30 June 2014 \$M
Reconciliation of management to statutory view of after-tax profit		
Operating segments normalised net profit before tax	500.8	447.5
Corporate and other normalised net loss before tax	(66.2)	(63.7)
Normalised net profit before tax (management view of pre-tax profit)	434.6	383.8
Tax on normalised profit	(100.6)	(55.1)
Normalised net profit after tax	334.0	328.7
Investment experience after tax	(35.0)	11.9
Profit attributable to the shareholders of Challenger Limited	299.0	340.6
Profit attributable to non-controlling interests excluded from management view	28.9	29.1
Statutory view of profit after tax	327.9	369.7
Reconciliation of management view of revenue to statutory revenue		
Operating segments	661.3	591.5
Corporate and other	1.3	1.8
Net income (management view of revenue)	662.6	593.3
Expenses and finance costs offset against revenue		
SPV expenses and finance costs offset against SPV income	81.7	114.4
Distribution expenses offset against related income	41.8	50.2
Change in life contract liabilities and reinsurance contracts recognised in expenses	574.4	490.2
Property related expenses offset against property income	68.4	70.2
Interest and loan amortisation costs	148.2	144.4
Management fees	87.7	81.4
Adjustment for non-controlling interests and other items	74.2	53.5
Difference between management view of investment experience and statutory recognition		
Actual capital growth	40.5	96.9
Normalised capital growth	(80.4)	(55.6)
Annuity valuation experience	(10.1)	(23.1)
Statutory revenue (refer Note 1 Revenue)	1,689.0	1,615.8

Note 4 Income tax

	30 June 2015 \$M	30 June 2014 \$M
Analysis of income tax expense		
Current income tax expense for the year	(76.1)	(89.6)
Current income tax (expense)/benefit prior year adjustment	(1.0)	1.0
Deferred income tax (expense)/benefit	(1.4)	34.7
Income tax expense	(78.5)	(53.9)
Income tax (expense)/benefit on translation of foreign entities	(9.2)	4.9
Income tax benefit/(expense) on hedge of net investment in foreign operations	10.0	(2.4)
Income tax benefit from other comprehensive income	0.8	2.5
Reconciliation of income tax expense		
Profit before income tax	406.4	423.6
Prima facie income tax based on the Australian company tax rate of 30%	(121.9)	(127.1)
Tax effect of amounts not assessable/deductible in calculating taxable income:		
– non-assessable and non-deductible items ¹	14.2	57.0
– rate differential on offshore income	14.9	1.9
– tax adjustment in respect of non-controlling interests	8.7	8.7
– other items	5.6	5.6
Income tax expense	(78.5)	(53.9)
Underlying effective tax rate²	20.8%	21.3%

¹ The comparative amounts at 30 June 2014 include a reduction in tax expense of \$30.0 million in respect of the application of the Taxation of Financial Arrangements (TOFA) law for which an ATO private binding ruling was received in February 2012. The 2014 financial year was the final period for this tax deduction.

² The calculation of the underlying effective tax rate excludes the non-controlling interests' profits of \$28.9 million (30 June 2014: \$29.1 million). It also excludes the reduction in income tax expense in respect of the TOFA transition application of \$nil (30 June 2014: \$30.0 million).

	Statement of financial position		Statement of comprehensive income	
	30 June 2015 \$M	30 June 2014 \$M	30 June 2015 \$M	30 June 2014 \$M
Analysis of deferred tax				
Deferred tax assets				
Accruals and provisions	30.8	33.6	(2.7)	3.1
Employee entitlements	3.3	3.0	0.3	0.4
Losses	21.8	24.2	1.1	14.3
Other	14.1	20.9	(3.1)	(4.1)
Total deferred tax assets	70.0	81.7	(4.4)	13.7
Deferred tax liabilities				
Deferred acquisition and origination costs	(1.4)	(1.8)	0.5	0.5
Fixed asset temporary differences	-	-	-	(1.2)
Unrealised foreign exchange movements	(17.3)	(8.7)	(8.5)	(34.4)
Unrealised gains on investments	(116.4)	(135.8)	19.4	55.7
Other	(66.6)	(57.8)	(8.4)	0.4
Total deferred tax liabilities	(201.7)	(204.1)	3.0	21.0
Net deferred tax liability (statement of financial position)	(131.7)	(122.4)		
Deferred income tax (expense)/benefit (statement of comprehensive income)			(1.4)	34.7

Note 4 Income tax (continued)

	30 June 2015 \$M	30 June 2014 \$M
Analysis of current tax liability		
Opening balance	34.4	2.3
Current year income tax expense	76.1	89.6
Current tax prior year adjustment	1.0	(1.0)
Tax in equity	(12.5)	0.1
Tax losses utilised	(6.7)	(41.1)
Income tax paid	(68.2)	(10.3)
Other	(0.5)	(5.2)
Closing balance	23.6	34.4

Income tax paid in 2015 was \$68.2 million (2014: \$10.3 million) and was lower than the current year income tax expense for the period due to the utilisation of carried forward tax losses, tax movements through equity and a PAYG instalment rate based on prior year tax payable. These items are predominantly timing differences and it is generally expected that the tax expense and tax paid will align with time.

Recognition and measurement

Income tax expense for the year comprises current and deferred tax. Income tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly 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, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss in the statement of comprehensive income; 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 by the parent 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 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 statement of comprehensive income; 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.

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 statement of comprehensive income. 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.

Note 4 Income tax (continued)

Recognition and measurement (continued)

Tax effect accounting by members of the tax group

Members of the tax consolidated group have applied tax funding principles under which Challenger Limited and each of the members of the tax consolidated group agree to pay 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.

Unused revenue losses

Substantially all revenue losses of the Challenger tax consolidated group have been fully utilised in the year to 30 June 2015. A deferred tax asset in relation to \$20.0 million of revenue losses (net) has been recognised in respect of non-tax consolidated group entities. A further deferred tax asset of \$24.1 million 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.

Unused capital losses

Unused gross capital losses have increased from \$141.0 million at 30 June 2014 to \$299.0 million at 30 June 2015 due mostly to capital losses that arose on termination of the Howard Mortgage Fund during the year. No deferred tax asset has been recognised in respect of these capital losses.

Section 3: Operating assets and liabilities

This section discloses information relating to the assets and liabilities underlying the Group's financial performance and the key sources of funding for those assets. It further presents the derivative financial instruments employed to hedge the Group's financial risk exposures, and consolidated information relating to the cash flows and holdings of cash and cash equivalents of the Group.

Note 5 Financial assets – fair value through profit and loss

	30 June 2015 \$M	30 June 2014 \$M
Domestic sovereign bonds and semi-government bonds	1,347.8	1,625.8
Floating rate notes and corporate bonds	5,779.7	4,545.6
Residential mortgage and asset-backed securities	2,243.8	2,199.4
Non-SPV mortgage assets	318.3	153.2
Fixed income securities	9,689.6	8,524.0
Shares in listed and unlisted corporations	43.9	73.9
Unit trusts, managed funds and other	299.4	307.9
Equity securities	343.3	381.8
Units in listed and unlisted infrastructure trusts	290.1	360.7
Other infrastructure investments	306.0	291.5
Infrastructure investments	596.1	652.2
Indirect property investments in listed and unlisted trusts	297.4	469.3
Property securities	297.4	469.3
Total financial assets – fair value through profit and loss	10,926.4	10,027.3
Current	5,476.9	5,001.1
Non-current	5,449.5	5,026.2
	10,926.4	10,027.3

Note 5 Financial assets – fair value through profit and loss (continued)

Recognition and measurement

The Group categorises its financial assets into either financial assets – fair value through profit and loss (being initially designated as such) or available-for-sale (which includes transaction costs at initial recognition). The classification depends on the definition and the purpose for which the investments were acquired. Assets designated as fair value through profit and loss consist of fixed income, equity, infrastructure, and property securities. They are carried at fair value with unrealised gains and losses being recognised through the statement of comprehensive income. There are currently no available-for-sale financial assets.

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 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.

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.

Key estimates and assumptions

Unlisted investment valuations

Investments held at fair value through profit and loss for which there is no active market or external valuation available are valued making as much use of available and supportable market data as possible and keeping judgemental inputs to a minimum, either by:

- reference to the current market value of another instrument that is substantially the same;
- using recent arm's length market transactions;
- options pricing models refined to reflect the issuer's specific circumstances;
- discounted cash flow analysis; or
- other methods consistent with market best practice.

Refer Note 21 Financial risk management for further disclosure.

Note 6 Investment and development property

	30 June 2015 \$M	30 June 2014 \$M
Investment property held for sale ^{1,2}	286.7	222.7
Investment property in use	2,736.6	2,125.5
Investment property under development	19.2	18.8
Total investment property	3,042.5	2,367.0
Development property held for resale	70.6	77.8
Total investment and development property²	3,113.1	2,444.8

¹ Held for sale properties: The Forum, Cisco, Innaloo Cinema and Jam Factory (30 June 2014: Taylors Institute, CSIRO, Osada Nagasaki).

² Investment property held for sale and development property are considered current. All other investment property is considered non-current.

Note 6 Investment and development property (continued)

	Investment property in use		Investment property under development		Development property held for resale	
	30 June 2015	30 June 2014	30 June 2015	30 June 2014	30 June 2015	30 June 2014
	\$M	\$M	\$M	\$M	\$M	\$M
Reconciliation of carrying amounts						
Balance at the beginning of the year	2,125.5	2,333.6	18.8	18.6	77.8	79.2
Movements for the year						
– acquisitions ¹	886.8	176.2	-	-	-	-
– disposals	-	(131.1)	-	-	(23.9)	(15.6)
– transfers to investment property held for sale	(286.7)	(222.7)	-	-	-	-
– capital expenditure	7.7	12.3	0.5	1.6	16.7	14.2
– net revaluation gain/(loss)	(3.9)	(16.3)	(0.1)	(1.4)	-	-
– foreign exchange gain/(loss)	7.2	(26.5)	-	-	-	-
Balance at the end of the year	2,736.6	2,125.5	19.2	18.8	70.6	77.8

¹ Investment property acquisitions: Golden Grove \$138.7 million (July 2014), The Barracks \$153.0 million (October 2014), 53 Albert St \$222.3 million (December 2014), Next Hotel \$142.0 million, Clarence Street \$144.9 million and Bourke Street \$85.9 million (January 2015).

Recognition and measurement

Investment and development property is initially recognised at cost, including transaction costs. Subsequent to initial recognition, investment and development property is recognised at fair value.

Independent valuations for all investment properties are conducted at least annually by suitably qualified valuers, and the Directors make reference to these independent valuations when determining fair value.

Each independent valuer is appointed in line with the valuation policy which requires that valuers are authorised to practise under the law of the relevant jurisdiction where the valuation takes place and have at least five years of continuous experience in the valuation of property of a similar type to the property being valued.

The valuer must have no pecuniary interest that could conflict with the valuation of the property, must be suitably indemnified, and must comply 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 market capitalisation approach and the discounted cash flow approach (using market-determined risk-adjusted discount rates). 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. The values of investment property do not reflect anticipated enhancement from future capital expenditure.

Investment property is classified as held for sale if its carrying value will be recovered principally through a sale transaction rather than through continuing use. This condition is met only when management is committed to the sale and the sale is highly probable. Investment property held is carried at fair value, being the latest valuation available or agreed sale price.

Gains or losses arising from changes in the fair values of investment properties are included in the statement of comprehensive income 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 statement of comprehensive income in the year of retirement or disposal.

Where properties are debt financed, that finance is provided either by secured mortgages or by funding that 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).

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.

Note 6 Investment and development property (continued)

Recognition and measurement (continued)

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 (fair value) in the ordinary course of business on completion, 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.

Analysis of investment property as at 30 June	Acquisition date ¹	Total cost ² \$M	Carrying value 2015 \$M	Cap rate 2015 ³ %	Last external valuation date	Carrying value 2014 \$M	Cap rate 2014 ³ %
Investment property in use							
Australia							
Century City Walk, VIC	16-Oct-06	30.0	39.1	7.50	30-Jun-15	34.5	8.00
Innaloo Cinema, WA	17-Dec-01	32.1	45.1	7.25	30-Jun-15	44.4	7.50
Jam Factory, VIC	04-Jul-00	124.9	129.8	7.25	31-Dec-14	126.0	7.25
Lennox, NSW	27-Jul-13	27.0	29.7	7.00	30-Jun-15	26.6	7.50
Karratha, WA	28-Jun-13	52.5	57.4	7.00	30-Jun-15	53.7	7.75
Bunbury Forum, WA	03-Oct-13	151.5	147.0	6.75	30-Jun-15	145.2	6.75
Kings Langley, NSW	29-Jul-01	15.9	19.5	7.25	30-Jun-15	19.2	7.50
31 Queen Street, VIC	31-Mar-11	93.4	102.1	7.50	31-Dec-14	97.5	7.75
The Barracks, QLD	31-Oct-14	153.0	147.0	7.50	30-Jun-15	-	-
Next Hotel, QLD	25-Mar-15	142.0	141.8	7.38	30-Jun-15	-	-
Golden Grove Shopping Centre, SA	31-Jul-14	138.9	132.9	6.75	30-Jun-15	-	-
County Court, VIC	30-Jun-00	210.2	281.5	7.43	31-Dec-14	281.5	7.50
ABS Building, ACT	01-Jan-00	119.9	126.5	7.75	30-Jun-15	132.5	8.00
DIAC Building, ACT	01-Dec-01	103.2	119.0	8.75	30-Jun-15	120.5	8.25
Discovery House, ACT	28-Apr-98	87.4	101.5	7.75	31-Dec-14	100.0	8.00
Elders House, SA	21-Jun-02	47.7	27.0	9.25	30-Jun-15	37.0	9.00
Executive Building, Hobart, TAS	30-Mar-01	30.2	33.2	8.50	30-Jun-15	32.9	8.50
Makerston, QLD	14-Dec-00	66.9	66.7	8.75	31-Dec-14	72.5	9.00
35 Clarence Street, NSW	15-Jan-15	144.9	144.9	7.00	-	-	-
565 Bourke Street, VIC	28-Jan-15	85.9	85.6	7.25	-	-	-
53 Albert Street, QLD	12-Dec-14	222.3	210.5	6.75	-	-	-
The Forum, Cisco, NSW	05-Jan-01	106.8	111.7	8.25	31-Dec-14	110.6	8.25
The Forum, Verizon, NSW	05-Jan-01	69.1	71.7	8.50	31-Dec-14	68.9	8.75
6 Foray St, Fairfield, NSW	31-Dec-08	17.9	11.9	9.00	31-Dec-14	13.1	10.50
Cosgrove Industrial Park, Enfield, NSW	31-Dec-08	56.9	65.0	7.00	30-Jun-15	56.9	7.75
Spotlight, Laverton North, VIC	31-Dec-08	16.2	19.5	7.50	31-Dec-14	18.5	8.00
12-30 Toll Drive, Altona North, VIC	31-Dec-08	13.9	14.0	7.75	30-Jun-15	13.8	8.50
2-10 Toll Drive, Altona North, VIC	31-Dec-08	6.3	6.6	7.75	31-Dec-14	5.9	8.50
1-9 Toll Drive, Altona North, VIC	31-Dec-08	3.3	4.0	8.00	30-Jun-15	3.9	8.25
CSIRO, NSW	27-Jun-01	-	-	-	-	170.0	8.38
Taylor Institute, Waterloo, NSW	16-May-01	-	-	-	-	42.6	9.25
Total Australia		2,370.2	2,492.2			1,828.2	

¹ Acquisition date represents the date of CLC's initial acquisition or consolidation of the investment vehicle holding the asset.

² Total cost represents the original acquisition cost plus additions less full and partial disposals since acquisition date.

³ The capitalisation ('cap') rate is derived by dividing the net property income over the carrying value of an investment property.

Note 6 Investment and development property (continued)

Analysis of investment property as at 30 June (continued)	Acquisition date	Total cost \$M	Carrying value 2015 \$M	Cap rate 2015 %	Last external valuation date	Carrying value 2014 \$M	Cap rate 2014 %
Europe							
Rozalia Park	12-Apr-07	80.6	17.3	10.19	30-Jun-15	13.9	10.71
Rue Charles Nicolle, Villeneuve les Beziers	31-Dec-08	18.3	10.7	8.75	30-Jun-15	11.9	8.50
Avenue de Savigny, Aulnay sous Bois	31-Dec-08	20.3	14.4	6.75	30-Jun-15	15.4	6.95
105 Route d'Orleans, Sully sur Loire	31-Dec-08	27.1	10.2	9.75	30-Jun-15	11.6	9.75
140 Rue Marcel Paul, Gennevilliers	31-Dec-08	14.0	10.1	9.50	30-Jun-15	10.7	7.25
ZAC Papillon, Parcay-Meslay	31-Dec-08	10.1	6.9	9.25	30-Jun-15	7.1	8.65
Japan							
Carino Chitosedai	31-Jan-10	118.3	102.0	5.00	31-Dec-14	97.7	5.10
Carino Tokiwadai	31-Jan-10	77.0	67.5	4.90	30-Jun-15	64.5	5.20
Izumiya Hakubaicho	31-Jan-10	68.7	59.2	5.30	31-Dec-14	56.2	5.50
Valor Toda	31-Jan-10	42.5	36.3	5.80	30-Jun-15	34.3	6.00
Life Higashinakano	31-Jan-10	32.8	29.7	4.90	31-Dec-14	28.4	5.00
Life Asakusa	31-Jan-10	27.8	26.2	4.90	30-Jun-15	24.3	5.20
Yaoko Sakato Chiyoda	31-Jan-10	18.2	14.8	5.40	31-Dec-14	13.8	5.50
Kansai Super Saigo	31-Jan-10	13.1	11.3	5.60	30-Jun-15	10.9	6.10
Kojima Nishiarai	31-Jan-10	10.8	9.2	5.00	30-Jun-15	8.1	6.00
DeoDeo Kure	31-Jan-10	31.4	25.9	5.90	30-Jun-15	24.8	6.10
Seiyu Miyagino	31-Jan-10	9.7	8.7	5.80	30-Jun-15	8.2	6.10
Aeon Kushiro	31-Jan-10	27.8	26.6	5.60	30-Jun-15	25.1	5.90
Life Nagata	31-Jan-10	25.2	22.8	5.10	30-Jun-15	21.5	5.50
Valor Takinomizu	31-Jan-10	26.8	21.3	6.10	31-Dec-14	21.5	5.80
Osada Nagasaki	31-Jan-10	-	-	-	-	10.1	-
Total overseas		700.5	531.1			520.0	
Total investment property in use¹		3,070.7	3,023.3			2,348.2	
Investment property under development							
TRE Data Centre	14-Apr-10	12.4	12.4	-	n/a	12.0	-
Enfield	31-Dec-08	20.5	6.8	-	30-Jun-15	6.8	-
Total investment property under development		32.9	19.2			18.8	
Development property							
Maitland	6-Dec-06	70.6	70.6	-	-	77.8	-
Total development property		70.6	70.6	-	-	77.8	-

¹ At 30 June 2015, the investment property portfolio occupancy rate for Australia was 98.0% (30 June 2014: 97.0%) with a weighted average lease expiry of 4.4 years (30 June 2014: 5.1 years), Europe 87.9% (30 June 2014: 82.1%) with a weighted average lease expiry of 1.7 years (30 June 2014: 2.0 years) and Japan 100% (30 June 2014: 95.3%) with a weighted average lease expiry of 9.1 years (30 June 2014: 8.7 years).

Note 7 Special Purpose Vehicles

	30 June 2015 \$M	30 June 2014 \$M
Consolidated		
Cash and cash equivalents	183.9	216.6
Mortgage assets ¹	2,231.3	2,978.9
Derivative assets	2.2	1.3
Other assets	1.0	0.3
Total assets	2,418.4	3,197.1
Payables ²	223.4	264.3
Derivative liabilities	0.8	1.8
Interest bearing financial liabilities ¹	2,192.8	2,931.4
Total liabilities	2,417.0	3,197.5
Net assets	1.4	(0.4)
Cash flow hedge reserve	1.4	(0.4)
Total equity attributable to residual income unit holders	1.4	(0.4)

¹ \$518.2 million (30 June 2014: \$662.8 million) of the Mortgage assets balance is considered current, and \$509.3 million (30 June 2014: \$652.2 million) of the Interest bearing financial liabilities balance is considered current.

² Payables differ from the Payables in Note 11 Payables by the value of the cumulative eliminations between the SPV and other members of the Group.

Recognition and measurement

The Group manages and services Special Purpose Vehicle (SPV) trusts that hold residential mortgage-backed assets and issue securitised financial liabilities. The trusts are entities that fund pools of residential mortgage-backed loans via the issuance of residential mortgage-backed securities (RMBS). All borrowings of these SPVs are limited in recourse to the assets of the SPV.

As the Group retains the beneficial interest to the residual income of these trusts, it is deemed to control them and, as a result, they are consolidated. However, the significant risks and rewards (most notably credit risk) lie with the RMBS holders.

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.

SPV 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 and carried at amortised cost.

SPV mortgage assets are non-derivative financial loan assets with fixed or determinable payments that are not quoted in an active market. They are recognised at their amortised cost less impairment losses.

The Group uses derivative financial instruments to hedge the risks associated with SPV interest rate and foreign currency fluctuations. All these 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 statement of comprehensive income.

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

SPV interest bearing financial liabilities are initially recognised at fair value calculated net of directly attributable transaction costs, and subsequently measured at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in the statement of comprehensive income over the period of the contract using the effective interest rate method.

Note 7 Special Purpose Vehicles (continued)

Key estimates and assumptions

The SPV mortgage asset values are reviewed at each statement of financial position date to determine whether there is any indication of impairment. If any such indication exists, each mortgage asset's recoverable amounts are estimated and the value is stated net of impairment provisions which are

measured as any shortfall between the carrying amount of each loan and the present value of expected future cash flows, discounted at the loan's original effective interest rate and adjusted for lenders' mortgage insurance coverage.

	30 June 2015 \$M	30 June 2014 \$M
Analysis of SPV mortgage assets impairment provision		
Balance at the beginning of the year	62.7	60.6
Additional provisions and adjustments to estimates	(0.7)	8.1
Utilisation of provision against incurred losses	(21.2)	(6.0)
Balance at the end of the year	40.8	62.7

Note 8 Receivables

	30 June 2015 \$M	30 June 2014 \$M
Interest receivable	95.7	70.2
Trade debtors	56.6	33.3
Derivative credit support	39.5	-
Amounts recoverable from managed trusts	11.3	7.5
Dividends and distributions receivable	10.3	10.0
Other receivables	31.9	27.5
Total receivables	245.3	148.5
Current	239.6	146.0
Non-current	5.7	2.5
	245.3	148.5

Recognition and measurement

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

Key estimates and assumptions

Carrying values

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.

Note 9 Life contract liabilities

	30 June 2015 \$M		30 June 2014 \$M	
Fair value of life contract liabilities				
Life investment contract liabilities – at fair value	6,626.9		6,210.1	
Life insurance contract liabilities – at margin on services value	2,013.3		1,556.6	
Reinsurance contract liabilities – at margin on services value	52.8		57.6	
Total life contract liabilities	8,693.0		7,824.3	
	Life investment contract liabilities		Life insurance contract liabilities	
	Reinsurance contract liabilities		Total life contract liabilities	
	30 June 2015 \$M	30 June 2014 \$M	30 June 2015 \$M	30 June 2014 \$M
Movement in life contract liabilities				
Balance at the beginning of the year	6,210.1	6,150.0	1,556.6	913.5
Deposits and premium receipts	2,273.4	2,185.7	490.8	620.5
Payments and withdrawals	(2,150.8)	(2,417.0)	(210.5)	(109.0)
Revenue per Note 1	56.1	5.9	(158.2)	(70.8)
Expense per Note 2	238.1	285.5	334.6	202.4
Balance at the end of the year	6,626.9	6,210.1	2,013.3	1,556.6
	30 June 2015 \$M		30 June 2014 \$M	
Analysis of life insurance and reinsurance contract liability and expenses				
Best estimate liability				
Value of future life insurance contract benefits	2,009.7		1,554.1	
Value of future expenses	79.0		67.1	
Value of future premiums	(203.7)		(112.2)	
Total best estimate liability	1,885.0		1,509.0	
Value of future profit margins	181.1		105.2	
Net life insurance and reinsurance contract liability	2,066.1		1,614.2	
Life insurance and reinsurance contract operating expenses				
Maintenance expenses	7.8		6.3	
Total life insurance and reinsurance contract operating expenses	7.8		6.3	
Analysis of life contract profit				
Profit margin release on life insurance contracts	9.4		6.5	
Loss recognition in respect of life insurance contracts ¹	(86.0)		(72.9)	
Loss recognition in respect of life investment contracts	(94.4)		(111.6)	
Difference in actual and assumed experience in respect of life insurance contracts	78.4		77.4	
Difference in actual and assumed experience in respect of life investment contracts	251.0		297.6	
Profit arising from difference between actual and assumed experience	158.4		197.0	
Investment earnings on assets in excess of life contract liabilities	145.1		154.1	
Life contract profit after tax	303.5		351.1	

¹ Under margin on services (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.

Note 9 Life contract liabilities (continued)

Recognition and measurement

The operations of the Group include the selling and administration of life contracts through Challenger Life Company Limited (CLC). These contracts are governed under the *Life Insurance Act 1995* (the Life Act) and are classified as either life insurance contracts or life investment contracts. Life insurance and life investment contract liabilities are collectively referred to as life contract liabilities or policy liabilities.

Life investment contract liabilities

Life investment contracts are contracts regulated under the Life Act but which do not meet the definition of life insurance contracts under AASB 1038 *Life Insurance Contracts* and similar contracts issued by entities operating outside of Australia.

For fixed term policies, the liability is based on the fair value of the income payments and associated expenses, being the net present value of the payments and expenses 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 statement of comprehensive income 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.

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.

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 meet 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 reinsurance.

Valuation

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, longevity reinsurance, wholesale mortality and wholesale morbidity. 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, wholesale morbidity and longevity reinsurance.

Key assumptions applied in the valuation of life contract liabilities

Discount rates

Under APRA Prudential Standards and AASB 1038 *Life Insurance Contracts*, life insurance contract liabilities are calculated by discounting expected future cash flows at a risk-free rate, set at the Commonwealth Government Bond curve plus an illiquidity premium where applicable 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 2.5-4.0% (30 June 2014: 3.0-4.7%) per annum.

Expenses

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

Note 9 Life contract liabilities (continued)

Valuation (continued)

Key assumptions applied in the valuation of life contract liabilities (continued)

Expenses (continued)

next year are allocated between acquisition, maintenance and investment based on the nature of the expense. Forecasted maintenance expenses then are converted to a per-contract unit cost or percentage of account balance, again depending on the nature of the expense.

Inflation

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 1.4% for short-term inflation and 2.6% for long-term (30 June 2014: 1.7% short-term, 2.7% long-term) per annum.

Surrenders

No surrenders or voluntary discontinuances are assumed for life investment contracts. Where policyholders 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 tables, adjusted for Challenger's own recent experience. 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. 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% (30 June 2014: 1.0–4.0%) per annum.

Base mortality rates for wholesale mortality and longevity reinsurance are determined as a multiple of pensioner mortality rates (based on the self-administered pension schemes or SAPS2 tables mortality investigation developed by the Institute and Faculty of Actuaries (UK) using United Kingdom data collected between 2004–2012) or population rates as appropriate. Rates are adjusted for expected future mortality improvements based on observed and expected improvements. Rates of future mortality improvement applied are between 0.0–4.0% (30 June 2014: 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 statement of comprehensive income 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 statement of comprehensive income 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 life contract operations of CLC are conducted within three separate statutory funds as required by the Life Act. Both the shareholders' and policyholders' interests in these statutory funds are reported in aggregate in the financial report of the Group. Fund 1 is a non-investment-linked fund and Fund 3 is investment-linked. Both of these are closed to new business. Fund 2 is the principal operating fund of the Group and contains non-investment-linked contracts, including the Group's term annuity business, lifetime annuity policies and the related reinsurance, plus the wholesale mortality, wholesale morbidity and longevity reinsurance. Life contract liabilities for Funds 1, 2 and 3 are \$3.9 million, \$8,685.6 million and \$3.5 million respectively (2014: \$4.8 million, \$7,815.6 million, \$3.9 million).

Current/non-current split for total life contracts

There is a fixed settlement date for the majority of life contract liabilities. Approximately \$2,071.6 million (2014: \$1,483.3 million) of life contract liabilities have a contractual maturity within 12 months of the reporting date. Based on assumptions applied for the 30 June 2015 valuation of life contract liabilities, \$2,248.3 million of principal payments on fixed term and lifetime business are expected in the year to 30 June 2016 (30 June 2015: \$1,683.6 million).

Life insurance risk

The Group is exposed to longevity risk on its individual lifetime annuities and wholesale longevity reinsurance. Longevity risk is the risk that policyholders may live longer than expectations. The Group is exposed to mortality risk on the wholesale mortality reinsurance. This is the risk that death rates in the reference portfolios exceed expectations. The Group is also exposed to morbidity risk on the wholesale morbidity reinsurance. That is the risk that morbidity rates in the reference portfolios exceed expectation. The Group manages the longevity risk by regular reviews of the portfolio to confirm continued survivorship of policyholders receiving income plus regular review of

Note 9 Life contract liabilities (continued)

Life insurance risk (continued)

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 and morbidity risk by the regular reviews of the portfolio to

ensure that mortality and morbidity 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 2015 \$M	30 June 2014 \$M	30 June 2015 \$M	30 June 2014 \$M	30 June 2015 \$M	30 June 2014 \$M	30 June 2015 \$M	30 June 2014 \$M
Insurance risk sensitivity analysis								
50% increase in the rate of mortality improvement	104.7	71.3	53.9	36.6	(73.3)	(49.9)	(37.7)	(25.6)
10% increase in maintenance expenses	6.6	4.2	6.6	4.2	(4.6)	(2.9)	(4.6)	(2.9)

Liquidity risk for insurance contracts

The following table summarises the undiscounted maturity profile of the Group's life insurance contracts. The analysis is based on undiscounted estimated cash outflows, including interest and

principal payments. The undiscounted maturity profile of life investment contracts is disclosed in Note 21 Financial risk management:

Undiscounted life insurance contract liabilities	1 year or less \$M	1-3 years \$M	3-5 years \$M	>5 years \$M	Total \$M
2015	206.1	348.4	287.9	2,086.3	2,928.7
2014	204.1	307.1	236.0	1,610.9	2,358.1

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.

Note 10 External unit holders' liabilities

	30 June 2015 \$M	30 June 2014 \$M
Current	590.0	1,072.4
Non-current	354.7	-
Total liabilities to external unit holders	944.7	1,072.4

Recognition and measurement

The Group controls a number of guaranteed index return trusts that contain contributed funds in respect of 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.

Note 11 Payables

	30 June 2015 \$M	30 June 2014 \$M
Trade creditors and accruals	146.7	139.2
Unsettled trades payable	72.9	230.8
Derivative credit support ¹	-	24.5
Payables – SPV	6.0	9.7
Distributions payable	-	6.8
Other creditors	33.3	32.3
Total payables	258.9	443.3
Current	248.9	428.3
Non-current	10.0	15.0
	258.9	443.3

¹ For 2015 the derivative credit support has transitioned to a receivable position, refer Note 8 Receivables.

Recognition and measurement

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.

Incentives received on entering into operating leases are recognised as liabilities and are amortised over the life of the lease. Other operating lease payments are charged to the statement of comprehensive income in the periods in which they are incurred.

Note 12 Derivative financial instruments

Analysis of derivative financial instruments	30 June 2015			30 June 2014		
	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
Non-SPV						
Interest rate swaps						
Less than one year	6,974.6	16.0	(3.5)	2,210.4	9.7	(0.5)
One to three years	6,740.6	88.3	(31.1)	2,950.9	61.2	(8.7)
Three to five years	2,713.7	65.4	(31.3)	1,610.9	51.6	(9.0)
Greater than five years	12,803.9	338.7	(246.0)	5,405.4	152.5	(106.4)
Total interest rate swaps	29,232.8	508.4	(311.9)	12,177.6	275.0	(124.6)
Inflation-linked swaps						
Less than one year	315.0	-	(6.8)	253.0	-	-
Greater than five years	19.4	-	-	15.4	4.6	(4.6)
Total inflation-linked swaps	334.4	-	(6.8)	268.4	4.6	(4.6)
Futures contracts						
Less than one year	3,351.2	-	(0.1)	4,789.6	-	(0.2)
One to three years	-	-	-	150.0	-	-
Total futures contracts	3,351.2	-	(0.1)	4,939.6	-	(0.2)
Forward currency contracts						
Less than one year	2,273.2	20.8	(24.5)	2,275.2	15.9	(4.1)
One to three years	12.5	0.1	-	-	-	-
Total forward currency contracts	2,285.7	20.9	(24.5)	2,275.2	15.9	(4.1)
Cross-currency swaps						
Less than one year	669.7	2.7	(81.4)	368.1	17.2	(22.3)
One to three years	693.0	15.5	(105.1)	245.6	1.7	(25.6)
Three to five years	649.0	23.8	(86.5)	96.4	-	(16.2)
Greater than five years	193.4	-	(55.2)	211.1	0.1	(22.1)
Total cross-currency swaps	2,205.1	42.0	(328.2)	921.2	19.0	(86.2)
Equity swaps						
Less than one year	771.5	5.3	(18.7)	-	0.1	-
One to three years	415.7	4.0	(4.9)	-	-	-
Total equity swaps	1,187.2	9.3	(23.6)	-	0.1	-
Credit default swaps						
Less than one year	32.5	-	(0.1)	37.1	0.1	-
One to three years	222.5	1.9	(1.8)	116.5	1.9	(0.1)
Three to five years	49.0	-	(0.8)	107.0	0.1	(0.9)
Greater than five years	9.1	-	(0.3)	-	-	-
Total credit default swaps	313.1	1.9	(3.0)	260.6	2.1	(1.0)
Options						
Less than one year	0.4	-	-	-	-	-
One to three years	0.5	-	-	0.4	-	-
Three to five years	-	-	-	0.5	-	-
Total options	0.9	-	-	0.9	-	-
Total non-SPV	38,910.4	582.5	(698.1)	20,843.5	316.7	(220.7)

Note 12 Derivative financial instruments (continued)

Analysis of derivative financial instruments (continued)	30 June 2015			30 June 2014		
	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
SPV						
Interest rate swaps – SPV						
Less than one year	17.8	-	(0.1)	17.6	-	(0.1)
One to three years	17.0	-	(0.3)	24.6	-	(0.3)
Three to five years	2.9	-	(0.1)	1.7	-	(0.1)
Total interest rate swaps – SPV	37.7	-	(0.5)	43.9	-	(0.5)
Cross-currency swaps – SPV						
Greater than five years	999.8	2.2	(0.3)	1,350.6	1.3	(1.3)
Total cross-currency swaps – SPV	999.8	2.2	(0.3)	1,350.6	1.3	(1.3)
Total – SPV	1,037.5	2.2	(0.8)	1,394.5	1.3	(1.8)
Total derivative financial instruments¹		584.7	(698.9)		318.0	(222.5)

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, allowing for net settlement as a single arrangement of multiple instruments with a counterparty in the event of default or other specified circumstances. If applied to the derivative portfolio, the derivative assets would reduce by \$327.5 million (30 June 2014: \$99.6 million) and the derivative liabilities would reduce by \$327.5 million (30 June 2014: \$99.6 million).

Recognition and measurement

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 market risk. 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 statement of comprehensive income.

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 entities 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, 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 statement of comprehensive income. 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 statement of comprehensive income.

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.

Note 12 Derivative financial instruments (continued)

Recognition and measurement (continued)

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, that could affect the statement of comprehensive income. 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 statement of comprehensive income.

Amounts recognised in equity are transferred to the statement of comprehensive income 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 statement of comprehensive income. 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 statement of comprehensive income. The cumulative gain or loss previously recognised in equity is recognised in other comprehensive income on disposal or partial disposal of the foreign operation.

Derivatives designated as hedges of net investment in foreign currency operations

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 2015, a post-tax loss of \$23.5 million (30 June 2014: post-tax gain of \$15.2 million) was recognised in equity for the hedging of exposure to the net investment in foreign currency operations.

Derivatives designated as cash flow hedges

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 21 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 rates. 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 2015, a post-tax gain of \$1.8 million (30 June 2014: post-tax loss \$4.0 million) was recognised in equity for cash flow hedges with no statement of comprehensive income impact of any ineffective portions during either the current or prior comparative periods.

Note 13 Cash and cash equivalents

	30 June 2015 \$M	30 June 2014 \$M
Cash at bank and on hand	371.5	335.4
Deposits at call	-	30.7
Other cash equivalents	38.2	25.3
Total cash and cash equivalents¹	409.7	391.4

¹ All cash and cash equivalents are considered current.

Recognition and measurement

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 and carried at amortised cost. For the purposes of the statement of cash flows, cash and cash equivalents are stated net of bank overdrafts.

Note 14 Reconciliation of profit to operating cash flow

	30 June 2015 \$M	30 June 2014 \$M
Profit for the year	327.9	369.7
Adjusted for		
Net realised gain on disposal of investment assets	(252.0)	(80.2)
Net unrealised gain on revaluation of investment assets	(24.2)	(239.2)
Share of associates' net profit	(15.3)	(15.9)
Change in life contract liabilities	470.4	424.8
Depreciation and amortisation expense	18.6	20.0
Share-based payments	26.3	25.3
Dividends from associates	15.6	16.1
Change in operating assets and liabilities		
Decrease in receivables	1.4	15.1
(Increase)/decrease in other assets	(30.1)	10.3
Increase/(decrease) in payables	10.9	(13.9)
Decrease in provisions	(2.7)	(0.5)
Increase in life contract liabilities	398.3	276.2
Decrease in external unit holders' liabilities	(127.7)	(679.0)
(Decrease)/increase in net tax liabilities	(1.5)	18.6
Net cash flows from operating activities	815.9	147.4

Section 4: Capital structure and financing costs

This section outlines how the Group manages its capital structure and related financing costs, as well as capital adequacy and reserves. It also provides details on the dividends and earnings per share of the Company.

Note 15 Contributed equity

	30 June 2015		30 June 2014	
	No. of shares	Value of shares	No. of shares	Value of shares
	M	\$M	M	\$M
Analysis of contributed equity				
Ordinary shares issued	569.7	1,622.7	530.9	1,335.5
CPP Trust shares treated as Treasury shares	(8.7)	(48.7)	(12.5)	(66.2)
CPP deferred share purchases treated as Treasury shares	(7.6)	(46.8)	(7.8)	(31.8)
Total contributed equity	553.4	1,527.2	510.6	1,237.5
Movements in contributed equity				
Ordinary shares				
Balance at the beginning of the year	530.9	1,335.5	530.9	1,335.5
Issued under share placement	38.8	287.2	-	-
Balance at the end of the year	569.7	1,622.7	530.9	1,335.5
CPP Trust				
Balance at the beginning of the year	12.5	66.2	8.7	40.2
Shares purchased (including settled forwards)	10.3	60.9	7.6	43.2
Vested shares released to employees	(14.1)	(78.4)	(3.8)	(17.2)
Balance at the end of the year	8.7	48.7	12.5	66.2
CPP deferred share purchases				
Balance at the beginning of the year	7.8	31.8	6.6	23.4
CPP deferred share purchases	4.6	33.8	3.0	14.0
Settled forward purchases	(4.8)	(18.8)	(1.8)	(5.6)
Balance at the end of the year	7.6	46.8	7.8	31.8

Recognition and measurement

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 Challenger Performance Plan (CPP) Trust or under CPP deferred share purchase agreements in respect of equity incentive plan awards to employees. Refer to Note 30 Employee entitlements for further details.

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 (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.

Note 15 Contributed equity (continued)

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 via an Internal Capital Adequacy Assessment Process (ICAAP) at both the Group and the prudentially-regulated Challenger Life Company Limited (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 for the Group and CLC 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. The Group 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 operational 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.

Credit ratings

Standard & Poor's long-term credit ratings for the Company and CLC at the statement of financial position date 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 the Group's strong business profile, earnings and capital position.

Equity placement and share purchase plan

In August 2014, the Company conducted an underwritten institutional ordinary share placement, raising \$250.0 million with 33.2 million ordinary shares issued. The Company also conducted a share purchase

plan (SPP) for retail investors which raised \$40.2 million (with 5.6 million new ordinary shares issued) in October 2014. Total issue costs (net of tax) were \$3.0 million, resulting in net proceeds of \$287.2 million. The majority of the proceeds from the institutional share placement and SPP were injected into CLC as Common Equity Tier 1 (CET1) capital.

Dividends and share buy-back

The Group 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 Group Board regularly reviews the mix between dividends and share buy-back as part of the Group's ICAAP. With the forecast increase in dividend franking levels, in August 2014 the Challenger Limited Board increased the targeted dividend payout ratio to a range of 45% to 50% of normalised net profit after tax. However, the actual dividend payout ratio will depend on prevailing market conditions and capital allocation priorities. No share buy-backs were undertaken in 2015 and none are anticipated in 2016.

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. Under these standards a life company must have in place an ICAAP, documented in an ICAAP Summary Statement. CLC complied with these requirements at all times during the period.

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 Life and General Insurance Capital (LAGIC) regulatory standards issued by APRA.

CLC's excess capital above the PCA at 30 June 2015 was \$1,009.4 million, up \$106.8 million for the year.

The introduction of the LAGIC standards increased CLC's regulatory capital requirement by \$322.8 million on 1 January 2013. APRA provided a three year transition period to meet these new requirements.

Therefore CLC's 30 June 2015 excess capital position includes a LAGIC transition balance of \$107.6 million (30 June 2014 includes \$215.2 million). The final \$107.6 million of the LAGIC transition balance will amortise on 1 January 2016.

Note 15 Contributed equity (continued)

Capital management (continued)

Prescribed capital amount (PCA) (continued)

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 within this range of 1.4 to 1.6 times, and CLC's capital position contemplates the amortisation of the LAGIC transition balance over the next six months.

The PCA ratio at 30 June 2015 was 1.59 times, down from 1.66 times at 30 June 2014, reflecting amortisation of the second LAGIC transition balance (\$107.6 million on 1 January 2015), changes in asset allocation, net AUM growth, capital issuances and retained earnings. Excluding the full LAGIC transition balance (\$107.6 million), CLC's PCA ratio at 30 June 2015 was 1.49 times (30 June 2014: 1.44 times).

Subordinated debt

CLC's total regulatory capital base includes \$474.0 million (30 June 2014: \$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 the ensuing four years. For tranches already past their call date at 1 January 2013, under LAGIC the first coupon date after 1 January 2013 is considered the first call date.

CLC's subordinated debt includes \$158.9 million which had a call date prior to 1 January 2013 and a first coupon date thereafter of 7 June 2013. As a result, under APRA's transition arrangements, only \$63.6 million (i.e. 40% of the total amount) is eligible as Tier 2 regulatory capital on 30 June 2015.

Tier 1 and Tier 2 regulatory capital

Under APRA's transition arrangements, CLC's statutory funds have three years to transition to the minimum requirement of Tier 1 capital representing 80% of the PCA. At a CLC consolidated level, APRA 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 Tier 1 ratio was 1.31 times the PCA at 30 June 2015 (30 June 2014: 1.31 times).

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.

Details of the CLC capital adequacy multiple are below:

CLC Capital	30 June 2015 \$M	30 June 2014 \$M
CLC's excess capital under LAGIC		
Common Equity Tier 1 regulatory capital	1,907.6	1,783.1
Additional Tier 1 regulatory capital	345.0	-
Tier 2 regulatory capital – subordinated debt ¹	474.0	476.8
CLC total regulatory capital base	2,726.6	2,259.9
Prescribed capital amount		
Asset risk charge ²	1,773.6	1,530.5
Insurance risk charge	120.5	83.9
Operational risk charge	22.6	22.8
Aggregation benefit	(91.9)	(64.7)
Prescribed capital amount – excluding transition relief	1,824.8	1,572.5
LAGIC transition relief ³	(107.6)	(215.2)
CLC prescribed capital amount	1,717.2	1,357.3
CLC excess over prescribed capital amount	1,009.4	902.6
Capital adequacy ratio (times)	1.59	1.66

¹ Differs from \$567.0 million disclosed in Note 16 Interest bearing financial liabilities due to \$2.5 million (30 June 2014: \$2.7 million) of accrued interest and \$95.3 million (30 June 2014: \$51.7 million) of inadmissible Tier 2 regulatory capital.

² The asset risk charge includes the combined stress test scenarios and default stress adjustments.

³ LAGIC transition relief reduces by one third (\$107.6 million) on each of 1 January 2014, 1 January 2015 and 1 January 2016.

Note 16 Interest bearing financial liabilities

	30 June 2015		30 June 2014	
	Facility \$M	Outstanding \$M	Facility \$M	Outstanding \$M
Bank loans				
Corporate	350.0	-	350.0	-
Controlled property trusts ¹	769.8	535.8	809.0	646.0
Controlled infrastructure trusts	206.0	206.0	206.1	206.1
Repurchase agreements	1,267.4	1,267.3	978.3	978.3
Total bank loans	2,593.2	2,009.1	2,343.4	1,830.4
Non-bank loans				
Subordinated debt issuance	567.0	567.0	525.9	525.9
Challenger Capital Notes	336.8	336.8	-	-
Other finance	1.4	1.4	3.2	3.2
Controlled property trusts	11.3	11.3	10.5	10.5
Total non-bank loans	916.5	916.5	539.6	539.6
Total interest bearing financial liabilities	3,509.7	2,925.6	2,883.0	2,370.0
Current		1,379.4		1,043.1
Non-current		1,546.2		1,326.9
		2,925.6		2,370.0

¹ Total facility limit consists of redraw loan facilities limits totalling \$300.0 million and non-redraw loan facility limits totalling \$469.8 million.

Recognition and measurement

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 statement of comprehensive income 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 statement of comprehensive income 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 statement of comprehensive income.

Details of liabilities**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 applicable to each tranche 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 2015 balance includes \$236.3 million (30 June 2014: \$246.0 million) of Yen denominated loans in the Japanese property trusts. Other controlled property trusts loans total \$299.5 million (30 June 2014: \$400.0 million). A total of \$64.8 million (30 June 2014: \$64.8 million) of these liabilities are secured against properties available for sale and therefore have been classified as current.

Note 16 Interest bearing financial liabilities (continued)

Details of liabilities (continued)

Controlled infrastructure trusts

The facility has an expiry date of June 2022 and is secured by way of first-ranking mortgages over the corresponding infrastructure assets.

Repurchase agreements

CLC has entered into repurchase agreements with certain counterparties whereby fixed income securities are sold for cash whilst simultaneously agreeing to repurchase the fixed income security at a fixed price and fixed date in the future. These agreements finance bonds held for hedging purposes and are interest bearing, with interest factored into the price at which the bonds are repurchased and paid on repurchase. All agreements as at 30 June 2015 are current and all matured in July 2015. They will continue to be rolled into new agreements in the future.

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 and carries a floating rate of interest. The proceeds of both issuances were made available to Statutory Fund 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 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 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 first coupon date following the call date, where the tranche was already past its call date) after 1 January 2013, thereafter amortising over four years. At 30 June 2015, there was \$474.0 million (30 June 2014: \$476.8 million) of subordinated debt admissible as Tier 2 regulatory capital.

Challenger Capital Notes

On 9 October 2014, the Company completed the issue of the Challenger Capital Notes (Notes), raising \$345.0 million of new debt funding. The Notes may be redeemed or resold for cash or converted by the Company on 25 May 2020 (or at an earlier date in certain circumstances), subject to APRA's prior written approval. Otherwise, the Notes will mandatorily convert into ordinary equity shares on 25 May 2022 (subject to certain conditions being satisfied).

If the conditions to mandatory conversion are not met on 25 May 2022, conversion will be deferred to a later date when the conditions are retested. Costs associated with the transaction have been capitalised against the liability and will be expensed to the statement of comprehensive income over the life of the Notes. The Notes do not constitute regulatory capital of the Company. The proceeds from the Notes were used to fund a subscription of notes issued by CLC. The notes issued by CLC were approved by APRA and constitute Additional Tier 1 capital of CLC.

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 2015, 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.

Key estimates and assumptions

Subordinated debt valuation

Subordinated debt is recognised at fair value and is valued by reference to the trading margin on the Challenger Capital Notes, adjusted to allow for its higher ranking in the capital structure (using market comparable instruments) and illiquidity.

Note 17 Reserves and retained earnings

	30 June 2015 \$M	30 June 2014 \$M
Share-based payments reserve		
Balance at the beginning of the year	54.9	30.0
Share-based payments for the period	26.3	25.3
Releases from share-based payments reserve	(78.4)	(17.2)
Tax on equity	7.2	16.8
Balance at the end of the year	10.0	54.9
Cash flow hedge reserve – SPV¹		
Balance at the beginning of the year	(0.4)	3.6
Gain/(loss) on cash flow hedges	1.8	(4.0)
Balance at the end of the year	1.4	(0.4)
Foreign currency translation reserve¹		
Balance at the beginning of the year	(4.0)	(2.0)
Gain/(loss) on translation of foreign entities ²	20.7	(11.8)
(Loss)/gain on hedge of net investment in foreign entities ²	(23.5)	15.2
Recycled to the profit and loss	0.2	(5.4)
Balance at the end of the year	(6.6)	(4.0)
Adjusted controlling interests reserve¹		
Balance at the beginning of the year	19.3	18.2
Change in holdings in controlled entities	(0.4)	1.1
Balance at the end of the year	18.9	19.3
Total reserves	23.7	69.8
Retained earnings		
Balance at the beginning of the year	846.0	625.7
Profit attributable to equity holders	299.0	340.6
Dividends paid	(152.7)	(120.3)
Total retained earnings	992.3	846.0

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

² Net of tax.

Recognition and measurement**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

This 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

This reserve is 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

This 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.

Note 18 Finance costs

	30 June 2015 \$M	30 June 2014 \$M
Interest expense	125.1	117.2
Interest expense – SPV	81.7	112.8
Interest expense – property trusts	23.1	27.2
Other finance costs	16.9	5.1
Total finance costs	246.8	262.3

Recognition and measurement

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.

Note 19 Dividends paid and proposed

	30 June 2015 \$M	30 June 2014 \$M
Dividends declared and paid during the year		
Final 30 June 2014 40% franked dividend: 13.5 cents (30 June 2013: 10.5 cents unfranked)	71.4	55.0
Interim 30 June 2015 70% franked dividend: 14.5 cents (30 June 2014: 12.5 cents unfranked)	81.3	65.3
Total dividends paid	152.7	120.3
Dividend proposed (not recognised as a liability at 30 June)		
Final 30 June 2015 100% franked dividend: 15.5 cents (30 June 2014: 40% franked 13.5 cents)	87.0	68.9

Refer to Note 15 Contributed equity for details of the dividend policy and dividend payout ratios. A dividend reinvestment plan will be in operation for dividends commencing with the 30 June 2015 final dividend.

	30 June 2015 \$M	30 June 2014 \$M
Group franking credits account		
Franking account balance at the beginning of the year	25.3	8.0
Franking credits from the payment of income tax during the year	65.3	9.3
Franking credits from dividends received during the year	6.6	6.9
Franking credits applied to dividend payments to shareholders	(37.1)	-
Franking credits applied to Challenger Capital Notes	(3.0)	-
Other	-	1.1
Franking credits balance	57.1	25.3

Note 20 Earnings per share

	30 June 2015 cents	30 June 2014 cents
Basic earnings per share	54.8	66.3
Diluted earnings per share ¹	51.4	62.8
	\$M	\$M
Profit attributable to ordinary shareholders used in the calculation of earnings per share	299.0	340.6
	Number	Number
Weighted average ordinary shares for basic earnings per share	545,665,690	513,778,947
Weighted average effect of dilution	57,865,009	28,221,509
Weighted average ordinary shares for diluted earnings per share	603,530,699	542,000,456

¹ In order to calculate the diluted earnings per share, the profit attributable to ordinary shareholders is adjusted by \$11.3 million interest on Challenger Capital Notes (2014: nil).

Recognition and measurement

Basic earnings per share is calculated by dividing the total 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 is net of Treasury shares held by the Challenger Performance Plan (CPP) Trust or under CPP deferred share purchase agreements in respect of equity incentive plan awards to employees.

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 17,157,558 (2014: 17,083,638).

Diluted earnings per share is calculated by dividing the total 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 shares that may be converted under the terms of Challenger Capital Notes of 37.2 million shares (2014: nil) and shares granted under the Challenger Performance Plan of 20.7 million shares (2014: 28.2 million). Since the CPP Trust commenced operation in December 2006, no shares have been issued to the CPP Trust. Instead, shares are acquired by the CPP Trust to mitigate shareholder dilution.

Section 5: Risk management

This section outlines how financial risk is managed within the Group and provides additional information about how the overall risk management program seeks to minimise potentially adverse financial effects associated with key financial risks. This section also provides disclosures on the fair values of assets and liabilities of the Group, the valuation techniques used in determining the fair value of those assets and liabilities, and the sensitivities of assets categorised as Level 3 instruments to reasonable changes in valuation assumptions.

Note 21 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 Committee (GRC) and Group Audit Committee (GAC) to assist in the discharge of certain of its responsibilities. In particular, the committees assist the Board in 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 GRC, GAC 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 GRC and the Board.

The Group's principal financial instruments consist of cash and cash equivalents, receivables, available-for-sale assets, financial assets at fair value through profit and loss, payables, life insurance contract liabilities, life investment contract liabilities, derivatives 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 Section 1 Basis of preparation and overarching 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 and APRA. 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 entities, 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 entities 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.

Note 21 Financial risk management (continued)

Interest rate risk (continued)

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. 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 below, 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 entities, and vice versa:

	Change in variable	Profit/(loss) 30 June 2015 \$M	Change in equity 30 June 2015 \$M	Profit/(loss) 30 June 2014 \$M	Change in equity 30 June 2014 \$M
Non-SPV	+100bps	7.1	7.1	5.0	5.0
	-100bps	(7.1)	(7.1)	(5.0)	(5.0)
SPV	+100bps	(2.0)	(2.0)	(2.6)	(2.6)
	-100bps	2.0	2.0	2.6	2.6
Total	+100bps	5.1	5.1	2.4	2.4
	-100bps	(5.1)	(5.1)	(2.4)	(2.4)

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 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 statement of comprehensive income 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.

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 below, a 10% movement in equity prices would have a material impact on the consolidated Group's financial position. It is assumed that the relevant change occurs as at the statement of financial position date:

	Change in variable	Profit/(loss) 30 June 2015 \$M	Change in equity 30 June 2015 \$M	Profit/(loss) 30 June 2014 \$M	Change in equity 30 June 2014 \$M
Asset class					
Property securities	+10%	20.8	20.8	32.8	32.8
	-10%	(20.8)	(20.8)	(32.8)	(32.8)
Infrastructure investments	+10%	20.3	20.3	25.2	25.2
	-10%	(20.3)	(20.3)	(25.2)	(25.2)
Other assets	+10%	13.1	13.1	20.6	20.6
	-10%	(13.1)	(13.1)	(20.6)	(20.6)
Total assets	+10%	54.2	54.2	78.6	78.6
	-10%	(54.2)	(54.2)	(78.6)	(78.6)

Note 21 Financial risk management (continued)

Price risk (continued)

Credit spread risk sensitivity

The Group is exposed to price movements resulting from credit spread fluctuations through its fixed income securities net of subordinated debt. As at 30 June 2015, a 50 basis point increase/decrease in credit spreads would result in a post-tax (at 30%) unrealised loss/gain in the statement of comprehensive income and equity of \$80.5 million (30 June 2014: \$78.9 million).

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. 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 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 currency 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 statement of comprehensive income.

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 entities 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:

	GBP \$M	USD \$M	Euro \$M	JPY \$M	Other \$M
30 June 2015					
Financial assets	367.8	2,062.3	446.2	250.4	368.5
Financial liabilities	(44.9)	(197.8)	(31.4)	-	-
Foreign currency contracts and cross currency swaps	(318.5)	(1,837.5)	(420.6)	(246.1)	(371.0)
Net exposure in Australian dollars	4.4	27.0	(5.8)	4.3	(2.5)
30 June 2014					
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	10.2	(1.5)	(6.1)	(1.9)	24.8

The analysis in the currency risk table shows the impact on the statement of comprehensive income 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 applied as this reflects a reasonable measurement given the current level of exchange rates and the volatility observed on an historic basis. 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 in the table on the following page, a 10% movement in foreign currency exchange rates would have minimal impact on the Group's financial position:

Note 21 Financial risk management (continued)**Currency risk (continued)**

	Movement in variable against \$	Profit/(loss) 30 June 2015 \$M	Change in equity 30 June 2015 \$M	Profit/(loss) 30 June 2014 \$M	Change in equity 30 June 2014 \$M
British Pound (GBP)	+10%	0.3	0.3	0.7	0.7
	-10%	(0.3)	(0.3)	(0.7)	(0.7)
US Dollar (USD)	+10%	1.9	1.9	(0.1)	(0.1)
	-10%	(1.9)	(1.9)	0.1	0.1
Euro (EUR)	+10%	(0.3)	(0.3)	(0.4)	(0.4)
	-10%	0.3	0.3	0.4	0.4
Japanese Yen (JPY)	+10%	-	0.3	-	-
	-10%	-	(0.3)	-	-
Other	+10%	(0.2)	(0.2)	1.7	1.7
	-10%	0.2	0.2	(1.7)	(1.7)

Credit default risk

The Group makes use of external ratings agencies (Standard & Poor's, Fitch, Moody's or other reputable credit rating agency) to determine credit ratings. 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.

Credit exposure by credit rating

The table below 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 including 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 by Standard & Poor's at BBB- or above, with non-investment grade therefore being below BBB-:

	Investment grade				Non-inv. grade	Other	Total
	AAA \$M	AA \$M	A \$M	BBB \$M	\$M	\$M	\$M
30 June 2015							
Cash and cash equivalents	409.7	-	-	-	-	-	409.7
Cash and cash equivalents – SPV	183.9	-	-	-	-	-	183.9
Receivables	14.0	47.5	3.1	4.7	21.3	154.7	245.3
Mortgage assets – SPV	1,233.1	652.4	343.7	-	2.1	-	2,231.3
Fixed income securities	3,352.2	754.4	1,653.4	1,768.9	2,021.6	139.1	9,689.6
Derivative assets	-	609.7	0.5	(26.1)	-	0.6	584.7
Total assets with credit exposures	5,192.9	2,064.0	2,000.7	1,747.5	2,045.0	294.4	13,344.5
30 June 2014							
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

Note 21 Financial risk management (continued)

Credit default risk (continued)

Mortgage assets – SPV

Mortgage assets – SPV are funded via securitised residential mortgage-backed securities (RMBS). As a result, the Group is not exposed to significant credit risk on these assets as this is borne by the RMBS holder. The credit risk of the mortgage loans within an SPV is therefore taken as being equivalent to that of the residential mortgage-backed security.

Collateral held over assets

In the event of a default against any of the mortgages in any 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.

Ageing and impairment of amortised cost financial assets

The table below gives 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:

	Not past due/not impaired	Past due but not impaired			Past due and impaired	Total
		0-1 months	1-3 months	3-6 months		
Amortised cost financial assets	\$M	\$M	\$M	\$M	\$M	\$M
30 June 2015						
Receivables	239.6	2.2	3.5	-	-	245.3
Mortgage assets – SPV	2,052.3	95.3	64.0	8.1	11.6	2,231.3
Total receivables	2,291.9	97.5	67.5	8.1	11.6	2,476.6
30 June 2014						
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

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 a 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 statement of comprehensive income in respect of valuation changes (excluding foreign exchange) for the year ended 30 June 2015 was a loss of \$5.9 million (30 June 2014: \$19.1 million). The subordinated debt has been valued by reference to the trading margin on the Challenger Capital Notes, adjusted to allow for its higher ranking in the capital structure (using market comparable instruments) and illiquidity.

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 to target sufficient liquidity to meet all cash requirements of the Group over an ensuing twelve month period which ensures that the regulatory guidelines set out in ASIC Regulatory Guide 166 *Licensing: Financial requirements* for holders of an AFSL are met.

Note 21 Financial risk management (continued)

Liquidity risk (continued)

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.

Maturity profile of undiscounted financial 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:

Maturing profile of undiscounted financial liabilities	1 year or less \$M	1-3 years \$M	3-5 years \$M	>5 years \$M	Total \$M
30 June 2015					
Payables	242.9	10.0	-	-	252.9
Payables – SPV	6.0	-	-	-	6.0
Interest bearing financial liabilities	1,559.4	655.5	522.4	758.3	3,495.6
Interest bearing financial liabilities – SPV	607.5	828.5	496.6	683.2	2,615.8
External unit holders' liabilities	590.0	354.7	-	-	944.7
Life contract liabilities	2,510.8	2,739.3	1,027.2	891.5	7,168.8
Derivative liabilities	121.8	138.2	123.4	315.2	698.6
Total undiscounted financial liabilities	5,638.4	4,726.2	2,169.6	2,648.2	15,182.4
30 June 2014					
Payables	418.5	15.0	-	-	433.5
Payables – SPV	9.8	-	-	-	9.8
Interest bearing financial liabilities	1,066.6	1,029.4	171.7	1,064.3	3,332.0
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 financial liabilities	5,424.9	4,824.2	2,119.4	3,144.7	15,513.2

Note 22 Fair values of financial assets and liabilities

Fair value determination and classification

Fair value reflects the price that would be received on sale of 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).

Note 22 Fair values of financial assets and liabilities (continued)

Fair value determination and classification (continued)

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

Valuation techniques

The Group's listed and unlisted fixed income securities, government/semi-government securities and over-the-counter derivative financial instruments are all classified as 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. Internally-rated fixed income securities are 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, earnings-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 that is valued by reference to the trading margin on the Challenger Capital Notes, adjusted to allow for its higher ranking in the capital structure (using market comparable instruments) and illiquidity. 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 represent products or product options for which the liability is determined based on an 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 2015		30 June 2014	
	Carrying value \$M	Fair value \$M	Carrying value \$M	Fair value \$M
Difference between amortised cost and fair value				
Mortgage assets – SPV ¹	2,231.3	2,293.1	2,978.9	3,061.8
Interest bearing financial liabilities – SPV ²	2,192.8	2,118.1	2,931.4	2,832.0
Challenger Capital Notes ³	345.0	327.1	-	-

¹ Mortgage assets – SPV are predominantly classified as Level 3 in the fair value hierarchy.

² Interest bearing financial liabilities – SPV are predominantly classified as Level 2 in the fair value hierarchy.

³ Challenger Capital Notes are classified as Level 1 in the fair value hierarchy.

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 Valuation 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 table on the following page 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:

Note 22 Fair values of financial assets and liabilities (continued)**Valuation process (continued)**

	Level 1 \$M	Level 2 \$M	Level 3 \$M	Total \$M
30 June 2015				
Derivative assets	-	584.7	-	584.7
Fixed income securities ¹	-	7,807.2	1,882.4	9,689.6
Equity securities	10.0	100.7	232.6	343.3
Infrastructure investments ¹	128.0	-	468.1	596.1
Property securities ²	177.4	-	120.0	297.4
Investment property	-	111.7	3,001.4	3,113.1
Total assets	315.4	8,604.3	5,704.5	14,624.2
Derivative liabilities	0.1	698.6	0.2	698.9
Interest bearing financial liabilities	327.1	81.3	568.4	976.8
External unit holders' liabilities	-	944.7	-	944.7
Life investment contract liabilities	-	88.4	6,538.6	6,627.0
Total liabilities	327.2	1,813.0	7,107.2	9,247.4
30 June 2014				
Derivative assets	-	318.0	-	318.0
Fixed income securities	-	7,182.4	1,341.6	8,524.0
Equity securities	171.4	46.0	164.4	381.8
Infrastructure investments	109.2	-	543.0	652.2
Property securities	364.9	-	104.4	469.3
Investment property	-	222.7	2,144.3	2,367.0
Total 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	529.2	670.7
External unit holders' liabilities	-	1,072.4	-	1,072.4
Life investment contract liabilities	-	100.9	6,109.2	6,210.1
Total liabilities	0.2	1,537.0	6,638.6	8,175.7

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). For structured entities with asset-backed financing 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 2015 the carrying value of asset-backed financing assets was \$7.7 million (30 June 2014: \$70.8 million) with no undrawn commitments (30 June 2014: \$47.4 million) and securitisations was \$3,367.2 million (30 June 2014: \$3,007.6 million) plus \$184.4 million undrawn commitments (30 June 2014: \$34.4 million).

² Refer Note 6 Investment and development property for valuation techniques and key unobservable inputs.

Note 22 Fair values of financial assets and liabilities (continued)

Level 3 reconciliation

The following table shows a reconciliation of the movement in the fair value of financial instruments categorised within Level 3 of the fair value hierarchy during the year:

	30 June 2015		30 June 2014	
	Assets \$M	Liabilities \$M	Assets \$M	Liabilities \$M
Balance at the beginning of the year	2,153.4	6,638.6	2,654.0	6,642.2
Fair value gains/(losses)	153.3	336.7	(29.4)	223.9
Acquisitions	1,621.0	2,176.7	784.7	2,043.6
Maturities and disposals	(1,172.2)	(2,044.8)	(1,110.6)	(2,271.1)
Transfers to other categories ^{1,2}	(52.4)	-	(145.3)	-
Balance at the end of the year³	2,703.1	7,107.2	2,153.4	6,638.6
Unrealised losses included in the statement of comprehensive income for assets and liabilities held at the statement of financial position date	(144.5)	(331.1)	(48.3)	(223.9)

¹ The Group 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 sensitivities

The following table shows the sensitivity of Level 3 financial instruments to a reasonable change in alternative assumptions in respect of the non-observable inputs into the fair value calculation:

	Level 3 value ¹ \$M	Positive impact \$M	Negative impact \$M	Valuation technique	Reasonable change in non-observable input ^{2,3}
30 June 2015					
Fixed income securities	1,882.4	63.4	(21.7)	Discounted cash flow	Primarily credit spreads
Interest bearing financial liabilities	(568.4)	(10.4)	11.5	Discounted cash flow	Primarily credit spreads
Net fixed income	1,314.0	53.0	(10.2)		
Equity, infrastructure, property assets	820.7	46.9	(47.1)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Investment contract liabilities	(6,538.6)	3.8	(3.8)	Discounted cash flow	Primarily expense assumptions
Derivative liabilities	(0.2)	0.3	(0.3)	Discounted cash flow	Primarily credit spreads
Total Level 3	(4,404.1)	104.0	(61.4)		
30 June 2014					
Fixed income securities	1,341.6	66.2	(13.2)	Discounted cash flow	Primarily credit spreads
Interest bearing financial liabilities	(529.2)	(22.9)	24.2	Discounted cash flow	Primarily credit spreads
Net fixed income	812.4	43.3	11.0		
Equity, infrastructure, property assets	811.8	42.3	(41.9)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Investment contract liabilities	(6,109.2)	4.4	(4.4)	Discounted cash flow	Primarily expense assumptions
Derivative liabilities	(0.2)	0.1	(0.1)	Discounted cash flow	Primarily credit spreads
Total Level 3	(4,485.2)	90.1	(35.4)		

¹ The fair value of the asset or liability would increase/decrease if the credit spread, discount rate or expense assumptions decrease/increase or if the other inputs increase/decrease.

² Specific asset valuations will vary from asset to asset as each individual industry profile will determine appropriate valuation inputs to be utilised.

³ The effect of a change to reflect a reasonable possible alternative assumption was calculated by adjusting the credit spreads by 50bps, discount rates by between 50bps – 100bps, changing the valuation of the unlisted schemes by 5% and adjusting the expense assumption allocation splits by 10%.

Section 6: Group structure

This section provides details and disclosures relating to the parent entity of the Group, controlled entities, investments in associates, non-controlling (minority) interests and any acquisitions and/or disposals of businesses in the year. Disclosure on related parties is also provided in this section.

Note 23 Parent entity

	30 June 2015 \$M	30 June 2014 \$M
Company		
Statement of comprehensive income for the year ended		
Revenue	164.5	189.0
Finance costs	(12.6)	-
Profit before income tax	151.9	189.0
Income tax benefit	1.3	5.8
Profit and total comprehensive income for the year	153.2	194.8
Statement of financial position as at		
Assets		
Cash and cash equivalents	1.4	1.4
Receivables	980.5	939.2
Financial asset – fixed income security ¹	345.0	-
Deferred tax assets	1.7	9.7
Investment in controlled entities	1,504.1	1,211.8
Total assets	2,832.7	2,162.1
Liabilities		
Payables	308.4	201.8
Interest bearing financial liability	336.8	-
Current tax liability	23.4	30.2
Total liabilities	668.6	232.0
Net assets	2,164.1	1,930.1
Equity		
Contributed equity	1,622.6	1,335.4
Share-based payments reserve	(20.2)	31.9
Retained earnings	561.7	562.8
Total equity	2,164.1	1,930.1

¹ Financial asset – fixed income security relates to the subscription by the Company of notes issued by CLC that qualify as Additional Tier 1 capital of CLC.

Refer Note 29 Contingent liabilities, contingent assets and credit commitments for details of any contingent liabilities applicable to the parent entity.

Note 24 Controlled entities

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

Challenger Diversified Property Trust 1	Interstar Millennium Series 2004-1E Trust
Challenger DPG France II SAS	Interstar Millennium Series 2004-2G Trust
Challenger DPG France SAS	Interstar Millennium Series 2004-4E Trust
Challenger FM 2 Holdings Pty Ltd	Interstar Millennium Series 2004-5 Trust
Challenger Funds Management Holdings Pty Ltd	Interstar Millennium Series 2005-1G Trust
Challenger Group Holdings Ltd	Interstar Millennium Series 2005-2L Trust
Challenger Group Pty Ltd	Interstar Millennium Series 2005-3E Trust
Challenger Group Services (UK) Ltd	Interstar Millennium Series 2006-1 Trust
Challenger Group Services Pty Ltd	Interstar Millennium Series 2006-2G Trust
Challenger High Yield Fund	Interstar Millennium Series 2006-3L Trust
Challenger Life Company Ltd	Interstar Millennium Series 2006-4H Trust
Challenger Life Company Holdings Pty Ltd	Interstar NZ Millennium Series 2004-A Trust
Challenger Life Debt Investments (Europe) Ltd (UK)	
Challenger Life Fund Property Investments Pty Ltd	417 St Kilda Road Trust
Challenger Life Offshore Investments Ltd (Jersey)	417 St. Kilda Holding Trust A
Challenger Life Subsidiary Holdings Ltd	417 St. Kilda Holding Trust B
Challenger Luxembourg Holding No.1A SARL (Luxembourg)	Balloon Inflation Linked Bond Trust ¹
Challenger Luxembourg Holding No.2 SARL (Luxembourg)	Belconnen Property Trust
Challenger Management Services Ltd	Challenger Australia Listed Property Holding Trust
Challenger Mortgage Management Pty Ltd	Challenger Bunbury Trust
Challenger Non-Conforming Finance Pty Ltd	Challenger CKT Holding Trust
Challenger Property Asset Management Pty Ltd	Challenger European Property Holding Trust
CDPG Luxembourg II SARL (Luxembourg)	Challenger European Property Trust
Challenger SkyBridge Fund (LP) Jersey Ltd (Jersey)	Challenger Financial Services Group Trust
Challenger Strategic Property Partners 1	Challenger German Property Trust
CDPG Luxembourg Holdings SARL (Luxembourg)	Challenger Howard Property Trust for 417 St Kilda Road
Challenger Treasury Ltd	Challenger Intermediate Unit Trust
Challenger UK Tank Storage Ltd (UK)	Challenger Karratha Trust
Challenger UK Terminals Ltd (Jersey)	Challenger Kenedix Japan Trust
Challenger Welcome Break Ltd (Jersey)	Challenger Life IRP Trust
Challenger Wind Holdings Pty Ltd	Challenger Life MN Trust
Clashfern Investments (UK) Ltd (UK)	Challenger MEIF Holding Trust
CLS US Holdings, LLC (USA)	Challenger MEIF Trust
CDPG Luxembourg SARL (Luxembourg)	Challenger North of England Gas Holding Trust
CFSG Holdings No.2 (Victoria) Pty Ltd	Challenger Property Income Trust
Fidante Partners Ltd	Challenger Property Trust No.18
Fidante Partners Services Ltd	Challenger Property Trust No.19
Godo Kaisha Kenedix Master Tokumei Kumiai ¹ (Japan)	Challenger Property Trust No.27
Godo Kaisha Sub Tokumei Kumiai One ¹ (Japan)	Challenger Property Trust No.30
Godo Kaisha Sub Tokumei Kumiai Two ¹ (Japan)	Challenger Property Trust No.31
Howard Commercial Lending Ltd	Challenger Property Trust No.32
Kudu Investment Partners I, LP ²	Challenger Property Trust No.35
LANV Pty Ltd	Challenger Property Trust No.36
Oaklands Hill Pty Ltd	Challenger Seattle Trust
RRETRO Fund Ltd ¹ (Cayman Islands)	Challenger Towers Holding Trust
US LLC Holdings Pty Ltd	Challenger UK Tank Storage Holding Trust
Waterford County Pty Ltd	Challenger USPF II Trust
	Challenger Wind Trust
Challenger Millennium NPL Trust	CLC Commercial Mortgages Trust
Challenger Millennium Series 2007-1E Trust	CLC Leveraged Loan Trust
Challenger Millennium Series 2007-2L Trust	County Court Property Trust
Challenger Millennium Series 2013-1 Trust	Crown Domestic Sovereign Bond Trust ¹
Challenger Millennium Warehouse C Trust	Discovery House Trust
Challenger Millennium Warehouse F Trust	Harris Global Sovereign Bond Trust ¹
Interstar Millennium Series 2002-1G Trust	Hayes Park Property Trust
Interstar Millennium Series 2003-3G Trust	Hotels Investment Trust
	Rendezvous Hotels Flinders Street Trust
	Riverside Trust No.1

Note 24 Controlled entities (continued)

Riverside Trust No.2

Senator House Property Trust

TLG Holding Unit Trust

TLG Unit Trust

Village Property Trust

Unless otherwise stated, all material entities are incorporated in Australia and 100% owned.

¹ Percentage holding is less than 100%.² Consolidated in 2015.**Recognition and measurement**

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 statement of comprehensive income.

Note 25 Investment in associates

Name of company	Principal activity	Country of domicile	30 June 2015 %¹	30 June 2014 %¹	30 June 2015 \$M	30 June 2014 \$M
Alphinity Investment Management Pty Ltd	Funds Management	Australia	30	30	0.9	1.7
Ardea Investment Management Pty Ltd	Funds Management	Australia	30	30	3.1	3.6
Arete Investment Partners Pty Ltd	Funds Management	Australia	35	-	0.8	-
Bentham Asset Management Pty Ltd	Funds Management	Australia	49	49	0.6	0.6
Challenger MBK Fund Management Pte Ltd	Funds Management	Singapore	-	50	-	1.6
Greencape Capital Pty Ltd	Funds Management	Australia	35	35	14.9	13.5
Kapstream Capital Pty Ltd	Funds Management	Australia	25	25	6.7	6.3
Kinetic Investment Partners Pty Ltd	Funds Management	Australia	20	20	0.2	0.5
Metisq Capital Holdings Pty Ltd	Funds Management	Australia	49	49	6.8	6.5
Merlon Capital Partners Pty Ltd	Funds Management	Australia	30	30	0.8	0.8
Novaport Capital Pty Ltd	Funds Management	Australia	49	49	1.3	1.8
Tempo Asset Management Pty Ltd	Funds Management	Australia	40	40	0.8	0.4
Wavestone Capital Pty Ltd	Funds Management	Australia	33	33	2.2	2.1
Whitehelm Capital Pty Ltd	Funds Management	Australia	30	-	4.3	-
Total investment in associates²					43.4	39.4

¹ Represents ownership and voting rights percentages.² Investment in associates is all considered non-current, with the exception of Kapstream Capital Pty Ltd which was disposed of on 2 July 2015, refer to Note 32 Subsequent events.

Note 25 Investment in associates (continued)

	30 June 2015 \$M	30 June 2014 \$M
Movements in carrying amount of investment in associates		
Opening balance	39.4	40.0
Purchase of investment in associates	3.7	0.5
Share of associates' net profit	15.3	15.9
Dividend and capital (redemptions)/injections	(15.0)	(17.0)
Carrying amount at the end of the year	43.4	39.4
Share of associates' profit or loss		
Profit before tax	15.3	15.9
Profit after tax for the year	15.3	15.9
Share of the associates' statement of financial position		
Current assets	27.1	23.5
Non-current assets	5.9	5.9
Total assets	33.0	29.4
Current liabilities	17.6	12.8
Non-current liabilities	0.2	2.1
Total liabilities	17.8	14.9
Net assets	15.2	14.5

Recognition and measurement

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 statement of comprehensive income 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.

Note 26 Non-controlling interests

	30 June 2015	30 June 2014
Representing the following shares of equity in the applicable entities	\$M	\$M
Contributed equity	29.9	73.4
Reserves	18.9	19.0
Opening retained profits ¹	17.7	1.3
Profit for the year	28.9	29.1
Total non-controlling interests	95.4	122.8

¹ Includes pre-acquisition retained profits.

Recognition and measurement

Non-controlling interests reflect the share of the results and equity attributable to non-controlling interests for controlled entities where the Group owns

less than 100% of the issued capital or units. Each of the components is accounted for in accordance with the Group's accounting policies as stated elsewhere in the notes to the financial statements.

Note 27 Related parties

Directors and key executives

The Directors and key executives of Challenger Limited at any time during the reporting period were as follows:

Directors

Peter Polson	Independent Chair
Brian Benari	Managing Director and Chief Executive Officer
Graham Cubbin	Independent Non-Executive Director
Steven Gregg	Independent Non-Executive Director
Jonathan Grunzweig	Independent Non-Executive Director
JoAnne Stephenson	Independent Non-Executive Director
Brenda Shanahan	Independent Non-Executive Director
Leon Zwier	Independent Non-Executive Director
Russell Hooper (retired 27 February 2015)	Independent Non-Executive Director

Key executives

Richard Howes	Chief Executive, Life
Paul Rogan	Chief Executive, Distribution, Product & Marketing
Ian Saines (appointed 2 March 2015)	Chief Executive, Funds Management
Andrew Tobin	Chief Financial Officer
Robert Woods (transferred to a non-KMP role 2 March 2015)	Chief Executive, Funds Management

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 24 Controlled entities.

were also entered into between the Group and associated entities (refer to Note 25 Investment in associates) for the provision of distribution and administration services. The Group earned fee income during the year of \$33.5 million (2014: \$32.6 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.

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

Loans to Directors and key executives

There were no loans made to Directors or key executives as at 30 June 2015 (30 June 2014: nil).

Note 27 Related parties (continued)**Total Remuneration of Key Management Personnel and Non-Executive Directors**

KMP and Non-Executive Directors	Short-term benefits \$	Post- employment benefits \$	Share- based payments \$	Other long-term benefits \$	Termination benefits \$	Total \$
Non-Executive Directors						
2015	1,615,685	71,315	-	-	-	1,687,000
2014	1,591,014	68,486	-	-	-	1,659,500
KMP						
2015	6,922,169	94,001	9,306,161	658,996	-	16,981,327
2014	6,830,382	88,875	9,189,294	663,189	-	16,771,740
All KMP and Non-Executive Directors						
2015	8,537,854	165,316	9,306,161	658,996	-	18,668,327
2014	8,421,396	157,361	9,189,294	663,189	-	18,431,240

Section 7: Other items

This section provides information that is less significant in understanding the financial performance and position of the Group perhaps due to lack of movement in the amount or the overall size of the balance. Nevertheless, these items assist in understanding the Group or are required under Australian or International Accounting Standards, the *Corporations Act 2001* and/or the *Corporations Regulations*.

Note 28 Goodwill and other intangible assets

	30 June 2015 \$M	30 June 2014 \$M
Goodwill	531.0	531.0
Other intangible assets		
Software at cost	11.2	7.5
Less: accumulated amortisation	(6.3)	(5.4)
	4.9	2.1
Customer list at cost	0.2	0.2
Less: accumulated amortisation	-	-
	0.2	0.2
Operating lease intangible at cost	22.8	22.8
Less: accumulated amortisation	(7.2)	(6.4)
Less: foreign exchange losses	(2.3)	(3.9)
	13.3	12.5
Total other intangible assets	18.4	14.8

	Goodwill		Customer list		Software		Operating lease	
	30 June 2015 \$M	30 June 2014 \$M	30 June 2015 \$M	30 June 2014 \$M	30 June 2015 \$M	30 June 2014 \$M	30 June 2015 \$M	30 June 2014 \$M
Balance at the beginning of the year	531.0	506.8	0.2	-	2.1	2.2	12.5	12.1
Additions	-	24.2	-	0.2	3.7	0.6	-	-
Foreign exchange gain	-	-	-	-	-	-	1.6	1.9
Amortisation expense	-	-	-	-	(0.9)	(0.7)	(0.8)	(1.5)
Balance at the end of the year	531.0	531.0	0.2	0.2	4.9	2.1	13.3	12.5

Recognition and measurement

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 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

Note 28 Goodwill and other intangible assets (continued)

Recognition and measurement (continued)

Goodwill (continued)

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 and 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. Impairment losses recognised for goodwill are not subsequently reversed.

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.

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.

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 lives.

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 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 (in this case, 25 years).

Key estimates and assumptions

Goodwill recoverable amounts

The Group assesses whether goodwill is impaired at least annually in accordance with the accounting policy. These value in use calculations involve an estimation of the recoverable amount of the cash-generating units to which the goodwill is allocated using cash flow projections based on financial forecasts approved by senior management which cover an appropriate time horizon.

The discount rates are based on the Group's weighted average cost of capital. The relevant assumptions are as follows:

- budgeted gross margins, being 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, taken as the yield on a government bond at the beginning of the budgeted year; and
- growth rates, which are consistent with long-term trends in the industry segments in which the businesses operate.

The derived values in use for each cash-generating unit 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 cash-generating unit to fall short of the carrying amounts as at 30 June 2015. All goodwill is non-current.

Other intangible assets amortisation

Useful lives of intangible assets used in the calculation of the amortisation expense are examined on an annual basis and where applicable, adjustments are made on a prospective basis.

In the instance of customer list intangibles, the amortisation period is four years.

The amortisation period for internal and external costs directly incurred in acquiring and developing software is usually five years. Costs incurred on software maintenance are expensed as incurred.

Note 28 Goodwill and other intangible assets (continued)

Impairment testing of goodwill

The following CGUs represent the carrying amounts of goodwill:

CGU	30 June 2015 \$M	30 June 2014 \$M	30 June 2015 Discount rate %	30 June 2014 Discount rate %	Cash flow horizon (years)
Life	444.0	444.0	11.0	11.0	5
Funds Management	87.0	87.0	11.0	11.0	5
Total	531.0	531.0			

Note 29 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 assets, including real estate properties, warranties to purchasers on several agreements that are still outstanding at 30 June 2015. 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 warranties 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 2015 there are potential future commitments totalling \$303.0 million (30 June 2014: \$217.1 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 a 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.

Note 29 Contingent liabilities, contingent assets and credit commitments (continued)

	30 June 2015 \$M	30 June 2014 \$M
Analysis of credit commitments		
Non-cancellable operating leases – Group as lessee		
Amounts due in less than one year	18.0	24.3
Amounts due between one and two years	11.7	17.8
Amounts due between two and five years	35.5	15.9
Amounts due in greater than five years	153.5	83.4
Total operating leases – Group as lessee	218.7	141.4
Contracted capital expenditure		
Amounts due in less than one year	7.9	8.6
Amounts due between one and two years	5.1	4.0
Amounts due between two and five years	7.5	9.9
Amounts due in greater than five years	3.2	3.9
Total capital expenditure commitments	23.7	26.4
Non-cancellable operating leases – Group as lessor		
Amounts due in less than one year	(234.0)	(172.6)
Amounts due between one and two years	(197.3)	(157.9)
Amounts due between two and five years	(439.1)	(391.9)
Amounts due in greater than five years	(306.0)	(463.6)
Total operating leases – Group as lessor	(1,176.4)	(1,186.0)
Other contracted commitments		
Amounts due in less than one year	306.7	129.1
Total other contracted commitments	306.7	129.1
Net commitments	(627.3)	(889.1)

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 18 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. At 30 June 2015, the total of the gross future minimum payments expected to be received under non-cancellable subleases was \$6.8 million (30 June 2014: \$11.4 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 statement of financial position date but not recognised as liabilities. They primarily relate to the investment property portfolio.

Other contracted commitments

This represents amounts payable in relation to acquisitions of investment properties that have exchanged in June 2015 and will settle in the 2016 financial year.

Note 30 Employee entitlements

	30 June 2015 \$M	30 June 2014 \$M
Employee¹ entitlements provision	10.9	10.2

¹ The total number of employees of the Group at 30 June 2015 was 560 (30 June 2014: 539).

Recognition and measurement

Superannuation funds

Obligations for contributions to superannuation funds are recognised as an expense in the statement of comprehensive income as they are 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 statement of financial position date, are recognised in respect of employees' services up to the statement of financial position 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 statement of financial position date. The estimated future cash outflows are discounted using yields from Australian corporate bonds (2014: Government bond rate) 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.

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 statement of comprehensive income, 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 Treasury shares is recognised as a reduction in equity. On vesting of the award they are subsequently recognised as an increase in equity and a reduction in share-based payment reserve at an average acquisition purchase price.

The cumulative expense or investment recognised for equity-settled transactions at each statement of financial position 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 an award cancelled 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.

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 (CPP Trust).

Note 30 Employee entitlements (continued)

Recognition and measurement

Share-based payment transactions (continued)

Employee share acquisition plan (continued)

The CPP Trust is consolidated, as the substance of the relationship is that the trust is controlled by the Group.

Through contributions to the CPP 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 statement of comprehensive income over the duration of the contract.

Deferred performance share rights (DPSRs)

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 vesting period is typically between two and three years. DPSRs give a right to ordinary fully paid shares upon vesting.

The table below sets out the details of the DPSRs granted under the Challenger Performance Plan during 2015 and movements on previous issues.

Grant date	Latest date for vesting ¹	Reference price \$	Fair value at grant \$	Outstanding at 1 July 2014	Granted during the year	Vested during the year	Expired during the year	Outstanding at 30 June 2015
16 Sep 14	01 Sep 17	7.698	6.54	-	814,495	(3,058)	(9,174)	802,263
16 Sep 14	01 Sep 16	7.698	6.81	-	745,071	(3,190)	(11,946)	729,935
16 Sep 14	01 Sep 15	7.698	7.08	-	716,649	(3,068)	(11,491)	702,090
17 Sep 13	01 Sep 16	4.086	4.46	122,372	-	-	-	122,372
17 Sep 13	01 Sep 15	4.086	4.71	1,192,241	-	(9,956)	(25,071)	1,157,214
17 Sep 13	01 Sep 14	4.086	4.96	1,192,166	-	(1,192,166)	-	-
11 Jun 13	01 Sep 15	3.573	3.36	18,191	-	-	-	18,191
11 Jun 13	01 Sep 15	3.306	3.36	15,723	-	-	-	15,723
11 Jun 13	01 Mar 15	3.573	3.45	25,888	-	(25,888)	-	-
11 Jun 13	01 Sep 14	3.573	3.55	18,190	-	(18,190)	-	-
11 Jun 13	01 Sep 14	3.306	3.55	15,722	-	(15,722)	-	-
12 Sep 12	01 Sep 14	3.448	3.02	1,168,762	-	(1,168,762)	-	-
Total				3,769,255	2,276,215	(2,440,000)	(57,682)	3,547,788

¹ At the date of vesting, DPSRs are transferred to the individual and released from the CPP Trust.

Hurdled performance share rights (HPSRs)

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 total shareholder returns. The HPSRs 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 HPSRs 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 HPSR awards will not be eligible to vest until the third anniversary following grant.

Note 30 Employee entitlements (continued)

Recognition and measurement (continued)

Hurdled performance share rights (continued)

Subject to continued employment and meeting the absolute total shareholder return (TSR) performance target, two thirds of a HPSR 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. HPSRs are converted to ordinary fully paid shares upon vesting.

The table below sets out details of the HPSRs granted under the Challenger Performance Plan during 2015 and movements on previous issues:

Grant date	Expected date for vesting ¹	Reference price \$	Fair value at grant \$	Outstanding at 1 July 2014	Granted during the year	Vested during the year	Expired during the year	Outstanding at 30 June 2015
04 Mar 15	01 Sep 18	6.439	3.34	-	74,850	-	-	74,850
04 Mar 15	01 Sep 17	6.439	3.86	-	129,533	-	-	129,533
16 Sep 14	01 Sep 18	7.698	2.96	-	811,382	-	-	811,382
16 Sep 14	01 Sep 17	7.698	3.37	-	1,622,730	-	-	1,622,730
17 Sep 13	01 Sep 17	4.086	2.69	2,211,390	-	-	(22,334)	2,189,056
17 Sep 13	01 Sep 16	4.086	3.23	2,211,305	-	-	(22,333)	2,188,972
17 Sep 13	01 Sep 15	4.086	3.79	2,211,305	-	-	(22,333)	2,188,972
11 Jun 13	01 Jun 17	3.928	1.33	200,000	-	(66,666)	-	133,334
12 Sep 12	01 Sep 16	3.448	1.42	7,963,000	-	(2,654,310)	(126,669)	5,182,021
16 Mar 12	16 Feb 16	4.361	1.16	833,334	-	(416,666)	-	416,668
14 Dec 11	01 Sep 15	4.747	1.56	750,000	-	(500,000)	-	250,000
12 Sep 11	01 Sep 15	4.747	1.93	6,358,000	-	(4,238,634)	(58,336)	2,061,030
14 Dec 10	01 Dec 14	4.166	2.38	72,150	-	(72,150)	-	-
08 Sep 10	15 Sep 14	3.724	2.02	3,750,562	-	(3,750,562)	-	-
Total				26,561,046	2,638,495	(11,698,988)	(252,005)	17,248,548

¹ At the date of vesting, HPSRs are transferred to the individual and released from the CPP Trust.

Key estimates and assumptions

Share-based payments

The Group measures the cost of equity-settled transactions with employees granted during the year by reference to the fair value of the ordinary shares at the date at which they are granted. The fair values are determined by independent external valuers using a Black-Scholes model for DPSRs and a Monte Carlo simulation model for HPSRs which utilises the TSR share price hurdles. Key inputs into the valuation models for equity awards granted during the year are as follows:

Input	16 Sep 14 PSR ¹	16 Sep 14 HPSR ¹	04 Mar 15 HPSR ¹
Dividend yield (%)	4.00	4.00	4.00
Risk-free rate (%)	2.70–2.84	2.70–3.09	1.91–2.07
Volatility ² (%)	28	28	29
Valuation (\$)	6.54–7.08	2.96–3.37	3.34–3.86

¹ Staggered deferred vesting applies to these grants.

² Forecast volatility rate implied from historic trend.

Note 31 Remuneration of auditor

	30 June 2015	30 June 2014
Amounts received or due and receivable by Ernst & Young relating to	\$'000	\$'000
Full year audit and half year review of the Group financial report	1,274.0	1,364.0
Other audit services – audit and review of trusts and funds	560.5	1,015.3
Other services in relation to the Group		
– taxation services	327.3	489.6
– other assurance services	537.2	535.7
Total auditor remuneration¹	2,699.0	3,404.6

¹ Auditor's remuneration for the Group is paid by Challenger Group Services Limited, a wholly owned entity within the Group.

Note 32 Subsequent events**Sale of Kapstream Capital Pty Limited**

On 2 July 2015, Challenger announced the sale of its 25% equity interest in Australian-based global fixed income fund manager, Kapstream Capital Pty Limited, to Janus Capital Group Inc., a US-based global investment business, for \$45.0 million.

Challenger will recognise a \$40.0 million pre-tax profit from the sale of its 25% equity interest in Kapstream, with the profit on sale recognised in the 2016 financial year. Following the sale, Fidante Partners will no longer receive equity distributions from Kapstream; however, it will receive administration and distribution fees. As a result, over the medium term, Fidante Partners' normalised earnings are not expected to be negatively impacted.

Acquisition of Dexion Capital Holdings Limited

On 15 July 2015, Challenger announced it had agreed to acquire 100% of Dexion Capital Holdings Limited (Dexion Capital), a European alternative investments group comprising interests in three specialist fund managers, as well as an investments distribution business, based in London.

Dexion Capital's strategic relationships comprise interests in three boutique fund managers: renewable energy specialist Resonance Asset Management Limited; UK social housing investor Horizon Infrastructure Partnership Limited; and Agricultural Asset Management Limited, which is focused on agricultural investments in the US and UK. In addition, Dexion Capital manages London-listed alternative asset fund Dexion Absolute Limited.

Challenger will make an agreed fixed payment of £19.6 million (A\$41.0 million) to Dexion's shareholders. The final acquisition price is dependent on profitability over a period of up to six years, under earn-out arrangements with key Dexion executives. The acquisition is immediately earnings accretive and is expected to meet Challenger's 18% pre-tax return on equity target.

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

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 2015 and of its performance for the year ended on that date; and
 - ii. complying with Australian Accounting Standards and the *Corporations Regulations 2001*;
- b. the financial statements and notes of the Group also comply with International Financial Reporting Standards as disclosed in Section 1(i) Basis of preparation and 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 from the Chief Executive Officer and Chief Financial Officer in accordance with section 295A of the *Corporations Act 2001* for the financial year ended 30 June 2015.

On behalf of the Board



P L Polson
Chair

Sydney
17 August 2015



B R Benari
Managing Director and Chief Executive Officer

Sydney
17 August 2015



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Independent auditor's report

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 2015, 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 Section 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 judgement, 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:

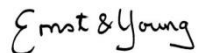
- a. the financial report of Challenger Limited is in accordance with the *Corporations Act 2001*, including:
 - i. giving a true and fair view of the consolidated entity's financial position as at 30 June 2015 and of its performance for the year ended on that date; and
 - ii. complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and
- b. the financial report also complies with International Financial Reporting Standards as disclosed in Section 1.

Report on the remuneration report

We have audited the remuneration report included in pages 16 to 37 of the directors' report for the year ended 30 June 2015. 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 2015 complies with section 300A of the *Corporations Act 2001*.



Ernst & Young



D N Jewell
Partner

Sydney
17 August 2015

Investor information

Substantial shareholders

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

Substantial shareholders as at 31 July 2015		Number of shares	% of issued capital
Caledonia (Private) Investments Pty Ltd		32,520,035	6.13
UBS Group AG		30,208,688	5.30
20 largest individual shareholders as at 31 July 2015			
1.	HSBC Custody Nominees (Australia) Limited	144,837,570	25.42
2.	J P Morgan Nominees (Australia) Limited	94,227,872	16.54
3.	National Nominees Limited	72,944,159	12.80
4.	Citicorp Nominees Pty Limited	52,886,062	9.28
5.	UBS Nominees Pty Ltd	14,020,937	2.46
6.	BNP Paribas Noms Pty Ltd <DRP>	10,538,854	1.85
7.	National Nominees Limited <DB A/C>	7,485,407	1.31
8.	AMP Life Limited	7,037,776	1.24
9.	CPU Share Plans Pty Ltd <CGF – PSR Unallocated A/C>	5,433,181	0.95
10.	UBS Wealth Management Australia Nominees Pty Ltd	4,478,321	0.79
11.	Argo Investments Limited	3,590,311	0.63
12.	CPU Share Plans Pty Ltd <CGF Performance Plan A/C>	3,253,469	0.57
13.	HSBC Custody Nominees (Australia) Limited – A/C 3	3,000,111	0.53
14.	SBN Nominees Pty Ltd <10004 Account>	2,426,000	0.43
15.	HSBC Custody Nominees (Australia) Limited – GSCO ECA	2,237,360	0.39
16.	Sandhurst Trustees Limited <DMP Asset Management A/C>	2,230,152	0.39
17.	HSBC Custody Nominees (Australia) Limited <NT – Comnwlth Super Corp A/c>	2,092,067	0.37
18.	Citicorp Nominees Pty Limited <Colonial First State INV A/C>	1,707,728	0.30
19.	HSBC Custody Nominees (Australia) Limited – A/C 2	1,249,214	0.22
20.	National Nominees Limited <N A/C>	1,186,477	0.21
Total 20 largest individual shareholders – issued capital		436,836,028	76.68
Total remaining shareholders balance		132,862,793	23.32

Distribution of shares (as at 31 July 2015)

Range	Number of shareholders	Number of shares	% of issued capital
1 – 1,000	11,313	5,783,664	1.02
1,001 – 5,000	13,698	34,052,043	5.98
5,001 – 10,000	3,221	23,562,382	4.14
10,001 – 100,000	1,892	41,027,619	7.20
100,001 and over	119	465,300,113	81.66
Total	30,243	569,725,821	100.00
Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum \$500.00 parcel at \$7.17 per unit	70	523	9,407

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.

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.

Investor information (continued)

Buyback

There is currently no market buyback.

On market acquisitions for employee incentive schemes during the financial year ended 30 June 2015

10.3 million Challenger Limited ordinary shares were purchased on market to satisfy entitlements under Challenger's employee incentive schemes at an average price per share of \$5.91.

Top 20 Noteholders of Challenger Capital Notes as at 31 July 2015

20 largest individual noteholders as at 31 July 2015		Number of notes	% of issued notes
1.	UBS Wealth Management Australia Nominees Pty Ltd	610,698	17.70
2.	National Nominees Limited	158,711	4.60
3.	HSBC Custody Nominees (Australia) Limited	149,729	4.34
4.	J P Morgan Nominees Australia Limited	126,495	3.67
5.	Australia Executor Trustees Limited <DDH Preferred Income Fund>	58,328	1.69
6.	Navigator Australia Ltd <MLC Investment Settlement A/C>	50,234	1.46
7.	Eastcote Pty Ltd <Van Lieshout Family A/C>	40,000	1.16
8.	Citicorp Nominees Pty Ltd	28,800	0.84
9.	GCF Investments Pty Ltd	23,700	0.69
10.	Willimbury Pty Ltd	22,000	0.64
11.	Catholic Church Insurance Limited	20,400	0.59
12.	Netwealth Investments Limited <Wrap Services A/C>	20,374	0.59
13.	GCF Investments Pty Ltd	20,000	0.58
14.	Nulis Nominees (Australia) Limited <Navigator Mast Plan Sett A/C>	19,447	0.56
15.	Shengli Investments Pty Ltd <Chang Family A/C>	19,000	0.55
16.	Sandhurst Trustees Ltd <DMP Asset Management A/C>	17,923	0.52
17.	270 King Street Pty Ltd	17,600	0.51
18.	Aust Executor Trustees Ltd <Charitable Foundation>	16,350	0.47
19.	RBC Investor Services Australia Nominees Pty Ltd <Piselect>	16,000	0.46
20.	BT Portfolio Services Limited <Kiddo Investments S/F A/C>	15,250	0.44
Total 20 largest individual noteholders – issued notes		1,451,039	42.06
Total remaining noteholders balance		1,998,961	57.94

Distribution of notes (as at 31 July 2015)

Range	Number of holders	Number of notes	% of notes
1 – 1,000	2,164	851,197	24.67
1,001 – 5,000	315	726,275	21.05
5,001 – 10,000	48	385,129	11.16
10,001 – 100,000	19	441,766	12.80
100,001 and over	4	1,045,633	30.32
Total	2,550	3,450,000	100.00
Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum \$500.00 parcel at \$97.80 per unit	6	-	-

ASX listing

Challenger Capital Notes are listed on the Australian Securities Exchange under the trade symbol CGFPA. Note price details can be accessed via the ASX website www.asx.com.au.

Voting rights

Challenger Capital Notes do not confer any voting rights in the Company but if they are exchanged or converted for ordinary shares in accordance with their terms of issue, then the voting rights of the ordinary shares will be the same as for ordinary shares.

Investor information (continued)

Shareholder queries

For any administrative matters in respect of your Challenger Limited shareholding or noteholding, please contact the Company's share registrar, Computershare:

Computershare Investor Services Pty Limited
Level 4, 60 Carrington Street, Sydney NSW 2000
Telephone: 1800 780 782
Website: 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.

Principal place of business and registered office
in Australia

Level 15

255 Pitt Street

Sydney NSW 2000

Telephone: 02 9994 7000

Investor services: 13 35 66

Facsimile: 02 9994 7777

Website: www.challenger.com.au

Directors

Peter Polson (Chair)

Brian Benari (Managing Director and Chief Executive
Officer)

Graham Cubbin

Steven Gregg

Jonathan Grunzweig

Brenda Shanahan

JoAnne Stephenson

Leon Zwier

Company secretaries

Michael Vardanega

Andrew Brown

Share register

Computershare Investor Services Pty Ltd

Level 4

60 Carrington Street

Sydney NSW 2000

Telephone: 1800 780 782

Website: www.computershare.com.au

Auditor

Ernst & Young

680 George Street

Sydney NSW 2000

