challenger

Challenger Limited ACN 106 842 371

Annual Report 2016

Challenger Limited – providing our customers with financial security for retirement.

CHALLENGER.COM.AU

Key Dates

28 September 2016
Final dividend payment date

27 October 2016
2016 Annual General Meeting

14 February 2017
Half year financial results
Interim dividend announcement

28 March 2017
Interim dividend payment date

15 August 2017
Full year financial results
Final dividend announcement

27 September 2017
Final dividend payment date

26 October 2017
2017 Annual General Meeting

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

challenger.com.au/share/keydates

2016 Annual General Meeting

Location:
Wesley Centre, 220 Pitt Street, Sydney

Date:
27 October 2016

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 2016.

Online Publications

ABOUT THIS REPORT

The Annual Report 2016, including the full financial report for the year ended 30 June 2016, can be downloaded from Challenger's online Shareholder Centre at:

challenger.com.au/share

ANNUAL REVIEW 2016

The Annual Review 2016 can be viewed online at:

challenger.com.au/annualreview2016

CORPORATE GOVERNANCE STATEMENT 2016

The Corporate Governance Statement 2016 can be viewed online at:

challenger.com.au/corporategovernance

SUSTAINABILITY REPORT 2016

The Sustainability Report 2016 can be viewed online at:

challenger.com.au/sustainabilityreport

Five-year history

	30 June 2016	30 June 2015	30 June 2014	30 June 2013	30 June 2012
Earnings ($M)					
Normalised cash operating earnings (COE)	592.4	543.8	481.3	452.2	435.7
Net fee income	127.7	117.5	110.2	99.4	83.0
Other income	1.0	1.3	1.8	4.9	8.8
Total net income	**721.1**	**662.6**	**593.3**	**556.5**	**527.5**
Personnel expenses	(172.8)	(154.8)	(144.4)	(130.3)	(128.9)
Other expenses	(76.8)	(69.4)	(61.0)	(61.4)	(60.3)
Total expenses	**(249.6)**	**(224.2)**	**(205.4)**	**(191.7)**	**(189.2)**
Normalised EBIT	**471.5**	**438.4**	**387.9**	**364.8**	**338.3**
Interest and borrowing costs	(4.1)	(3.8)	(4.1)	(4.6)	(3.3)
Normalised profit before tax	**467.4**	**434.6**	**383.8**	**360.2**	**335.0**
Normalised tax	(105.7)	(100.6)	(55.1)	(51.7)	(38.2)
Normalised profit after tax	**361.7**	**334.0**	**328.7**	**308.5**	**296.8**
Investment experience after tax	(56.1)	(35.0)	11.9	99.8	(148.3)
Significant items after tax	22.1	-	-	8.5	-
Profit attributable to equity holders	**327.7**	**299.0**	**340.6**	**416.8**	**148.5**
Normalised cost to income ratio (%)	34.6%	33.8%	34.6%	34.5%	35.9%
Normalised effective tax rate (%)	22.6%	23.1%	14.4%	14.4%	11.4%
Earnings per share (EPS) (cents)					
Basic EPS – normalised profit	64.6	61.2	64.0	58.6	57.5
Basic EPS – statutory profit	58.5	54.8	66.3	79.2	28.8
Diluted EPS – normalised profit	60.9	57.2	60.6	58.0	55.7
Diluted EPS – statutory profit	55.4	51.4	62.8	78.3	27.8
Capital management (%)					
Normalised return on equity (RoE) – pre-tax	17.8%	18.0%	18.8%	19.6%	21.2%
Normalised return on equity (RoE) – post-tax	13.7%	13.9%	16.1%	16.8%	18.8%
Statutory return on equity (RoE) – post-tax	12.5%	12.4%	16.7%	22.7%	9.4%
Statement of financial position ($M)					
Total assets	20,978.3	18,531.6	17,323.3	17,784.8	17,778.6
Total liabilities	18,294.3	15,893.0	15,047.2	15,490.6	15,734.1
Net assets[1]	2,684.0	2,638.6	2,276.1	2,294.2	2,044.5
Net assets[2]	2,680.9	2,543.2	2,153.3	1,947.4	1,692.2
Net assets[2] – average[3]	2,630.7	2,410.4	2,044.4	1,835.7	1,577.2
Net tangible assets	2,097.0	1,993.8	1,607.5	1,426.3	1,172.8
Net assets per basic share ($)	4.80	4.60	4.22	3.78	3.20
Net tangible assets per basic share ($)	3.75	3.60	3.15	2.77	2.22

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

	30 June 2016	30 June 2015	30 June 2014	30 June 2013	30 June 2012
Underlying operating cash flow ($M)	**297.1**	**287.9**	**321.0**	**321.5**	**282.3**
Dividends per share (cents)					
Dividend – interim[1]	16.0	14.5	12.5	9.5	7.5
Dividend – final[1]	16.5	15.5	13.5	10.5	10.5
Total dividend[1]	**32.5**	**30.0**	**26.0**	**20.0**	**18.0**
Dividend payout ratio – normalised profit (%)	50.3%	49.0%	40.6%	34.1%	31.3%
Dividend payout ratio – statutory profit (%)	55.6%	54.7%	39.2%	25.2%	62.5%
Sales and annuity book net flows ($M)					
Annuity sales	3,351.2	2,753.1	2,798.8	2,179.2	1,954.3
Other Life sales	998.5	944.0	581.6	951.8	703.5
Total Life sales	**4,349.7**	**3,697.1**	**3,380.4**	**3,131.0**	**2,657.8**
Life annuity net flows[2]	740.4	738.2	887.1	598.1	582.9
Life annuity book	9,558.5	8,692.6	7,824.4	7,123.3	6,553.0
Life annuity net book growth[2] (%)	8.5%	9.4%	12.5%	9.1%	10.4%
Funds Management – net flows[3]	(2,517.2)	7,738.9	2,147.4	6,978.6	4,226.0
Assets under management ($M)					
Life	14,112	12,795	11,087	10,787	9,773
Funds Management	56,662	57,902	47,126	41,103	31,017
Elimination of cross-holdings[4]	(10,723)	(10,908)	(7,488)	(7,120)	(7,346)
Total assets under management	**60,051**	**59,789**	**50,725**	**44,770**	**33,444**
Other					
Headcount – closing full time employees	635	560	539	487	479
Weighted average number of ASX-listed basic shares on issue (M)	560.2	545.7	513.8	526.1	516.4
Number of shares on issue – closing (M)	571.2	569.7	530.9	530.9	544.7
Share price – closing ($)	8.63	6.72	7.44	4.01	3.25
Market capitalisation at 30 June ($M)[5]	4,928.6	3,828.4	3,949.9	2,128.9	1,770.3

[1] 2016 final dividend franked at 100% (2016 interim: 100%; 2015 final: 100%; 2015 interim: 70%; 2014 final: 40%, previous periods: unfranked). Total 2016 franking at 100% (2015: 86%).

[2] Annuity net flows and net book growth exclude the High Yield Fund maturity in 2014 ($284 million outflow).

[3] Includes the derecognition of $5.4 billion of funds under management as a result of the sale of Kapstream to Janus Capital in July 2015.

[4] Life assets managed by Funds Management.

[5] 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 2016.

1 Directors

The names and details of the Directors of the Company holding office during the financial year ended 30 June 2016 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 IDP Education Limited (listed 26 November 2015) (appointed 21 March 2007).

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.

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), WPP AUNZ Ltd (formerly 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 (appointed 18 July 2012) and Caltex Australia Limited (appointed 9 October 2015). Mr Gregg was 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 and Global Head – Special Situations 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 international economies and equity markets and 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 member of the Australian Institute of Company Directors.

Ms Stephenson has extensive experience in financial services both in Australia and the United Kingdom. Ms Stephenson 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) and Japara Healthcare Ltd (appointed 1 September 2015).

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.

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 2015 to 30 June 2016 are set out below.

Directors' meetings

Director	Board		Group Risk Committee		Group Audit Committee		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	7	7	4	4	4	4	5	5	2	2
B Benari[1]	7	7	-	-	-	-	-	-	-	-
G Cubbin	7	7	4	4	4	4	5	5	2	2
S Gregg	7	7	-	-	-	-	5	5	2	2
J Grunzweig	7	6	-	-	-	-	-	-	2	2
B Shanahan	7	7	4	4	4	4	5	5	2	2
J Stephenson	7	7	4	4	4	4	-	-	2	2
L Zwier	7	6	-	-	-	-	-	-	2	2

[1] B Benari is an invitee and attends the GAC and GRC meetings.

2 Company Secretary

Michael Vardanega (Bachelor of Commerce and Bachelor of Laws) is the General Counsel and Executive General Manager, Corporate Affairs. He is a qualified solicitor and was appointed as Company Secretary on 1 March 2011. Mr Vardanega's responsibilities at Challenger encompass legal and regulatory affairs, corporate governance, company secretarial, corporate affairs, advocacy and corporate social responsibility. 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 About Challenger

Challenger Limited (Challenger, CGF, the Group or the Company) is an investment manager with offices in Australia and London. Challenger is listed on the Australian securities exchange and is regulated by the Australian Prudential Regulation Authority (APRA), the Australian banking, superannuation, general insurance and life insurance regulator. Challenger is regulated by APRA as the owner of Challenger Life Company Limited (CLC), an Australian life insurance company. Challenger's activities are also subject to supervision by other regulatory agencies both in Australia and in other markets in which it operates.

Founded in 1985, Challenger is one of Australia's largest fund managers and now employs 635 people managing assets of $60 billion with total equity of $2.7 billion as at 30 June 2016.

3.1 Operating segments and principal activities

For internal reporting and risk management purposes, Challenger's principal activities are divided into two operating segments, Life and Funds Management, which are serviced by one Distribution, Marketing and Research team who are responsible for ensuring the appropriate marketing and distribution of both operating segments' products. Both operating segments and the Distribution, Marketing and Research team are supported by centralised operations functions which are responsible for appropriate processes and systems and providing the necessary resources to meet regulatory, compliance, financial reporting, legal and risk management requirements.

Life – the Life segment comprises CLC, Australia's leading provider of annuities and guaranteed retirement income products and Accurium Pty Limited, Australia's leading provider of self-managed superannuation fund (SMSF) actuarial certificates.

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 both independent financial advisers and financial advisers that are part of the major hubs. Being an independent product manufacturer, Life has distribution representation on all major Australian hubs and platforms.

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 that each operate under their own brand. Fidante Partners provides administration and distribution services to the boutiques and shares in the profits of these businesses through equity ownership. In July 2015, Fidante Partners expanded its presence in Europe where it already held interests in UK-based alternative asset managers, by acquiring Dexion Capital.

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.

3.2 Challenger's vision and strategy

Challenger's vision is to provide its customers with financial security for retirement while at the same time delivering superior returns for its shareholders. Challenger seeks to:

- increase the Australian retirement savings pool allocation to secure and stable incomes;
- be recognised as the leader and partner of choice in retirement income solutions with a broad product offering; and
- provide clients with relevant investment strategies exhibiting consistently superior performance.

Challenger's approach to delivering this vision and strategy is to maintain a highly engaged, diverse and agile workforce that is committed to delivering outstanding client service while maintaining a strong risk and compliance culture.

Challenger's expectations of its workforce are encapsulated in the 'Challenger Principles' of integrity, commercial ownership, working together, compliance and creative customer solutions.

The combination of these principles and a strong risk management framework has been the key to Challenger's profitable and disciplined growth over many years.

3.3 Risk management

Challenger's Board is responsible, in conjunction with senior management, for the management of risks associated with the business and implementing structures and policies to adequately monitor and manage these risks.

The Board has established the Group Risk Committee (GRC) and the Group Audit Committee (GAC) to assist in discharging its risk management responsibilities. In particular, these committees assist the Board in setting the appropriate risk appetite for the business and for ensuring that there is a strong risk management

3 About Challenger (continued)

3.3 Risk management (continued)

framework that is able to manage, monitor and control the various risks to which the business is exposed.

The Executive Risk Management Committee (ERMC) is an executive committee chaired by the Chief Risk Officer which assists GRC, GAC and the Board in the discharge of their risk management obligations by implementing the Board-approved risk management framework. On a day-to-day basis, the Risk division, which is independent from the operating segments of the business, has the responsibility for the implementation of the framework including the monitoring, reporting and analysis of the various risks faced by the business.

Challenger has a robust risk management framework that supports its operating segments and its risk appetite distinguishes risks from which Challenger will seek to make an economic return from those which it seeks to minimise and which it does not consider provide a return. The management of these risks is fundamental to Challenger's business and building long-term shareholder value. Challenger is also prudentially supervised by APRA which prescribes certain prudential standards that must be met by Challenger and its life insurance subsidiary, CLC.

In addition to having an independent risk management function, Challenger recognises that a requirement for an effective risk management framework is for there to be a strong risk culture throughout the organisation where risk is everyone's responsibility. The foundation of this risk culture is a set of principles, the Challenger Principles, which staff are required to adhere to and on which their yearly performance and remuneration is judged. In addition to this, Challenger regularly assesses its risk culture with a combination of external audits and internal staff surveys to ensure that the management of risk and day-to-day compliance remains entrenched within the way in which Challenger operates.

Challenger's risk appetite statement provides that, subject to earning acceptable economic returns, it can retain exposure to credit risk, property risk, equity risk and life insurance risk.

- Credit risk – is the risk of loss in the value of an asset due to a counterparty failing to perform its contractual obligations when they fall due;
- Property risk – is the potential impact of movements in the market value of property investments on Challenger's income and includes leasing risk which may impact the cash flows from these investments;
- Equity risk – is the potential impact of movements in the market value of listed and unlisted equity investments; and
- Life insurance risk – represents both longevity risk and mortality risk. Through selling lifetime annuities and assuming wholesale reinsurance agreements, CLC takes longevity risk, which is the risk that customers who have bought a lifetime annuity live longer, in aggregate, than expected. This is in contrast to mortality risk, which is the risk that people die earlier than expected. CLC is exposed to mortality risk on its wholesale maturity reinsurance business.

Challenger seeks to minimise or hedge the risks for which it does not consider an appropriate return can be generated. These risks include:

- Foreign exchange risk – is the risk of a change in asset values and Challenger's earnings as a result of movements in foreign exchange rates;
- Interest rate risk – is the risk of fluctuations in Challenger's earnings arising from movements in interest rates;
- Inflation risk – is the risk of a change in asset values and Challenger's earnings as a result of movements in inflation both in Australia and jurisdictions in which Challenger owns assets;
- Operational risk – is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events; and
- Regulatory and compliance risk – is the risk of legal or regulatory sanctions or loss as a result of Challenger's failure to comply with laws, regulations or regulatory policy applying to its business.

Further details on Challenger's approach to risk management are included in Section 5 of the financial report.

4 Review of operations

Challenger has built on its growth momentum during the 2016 financial year, delivering increased sales in its Life segment, increased funds under management in its FM segment[1] and an overall growth in income.

4.1 Key performance indicators (KPIs)

KPIs for the year ended 30 June 2016 (with the year to 30 June 2015 being the prior comparative period (PCP), unless otherwise stated) include:

	30 June 2016	30 June 2015	Change %
Profitability			
Statutory profit attributable to equity holders ($M)	327.7	299.0	9.6
Normalised NPAT ($M)	361.7	334.0	8.3
Statutory EPS (cents)	58.5	54.8	6.8
Normalised EPS (cents)	64.6	61.2	5.6
Total dividend (cents)	32.5	30.0	8.3
Total dividend franking	100%	85.5%	17.0
Normalised cost: income ratio	34.6%	33.8%	2.4
Statutory RoE after tax	12.5%	12.4%	0.8
Normalised RoE after tax	13.7%	13.9%	(1.4)
Growth			
Total Life annuity sales ($M)	3,351.2	2,753.1	21.7
Life annuity net book growth ($M)	740.4	738.2	0.3
Life annuity net book growth (%)	8.5%	9.4%	(9.6)
Total FM net flows ($bn)[1]	(2.5)	7.7	(Large)
Total AUM ($bn)	60.0	59.8	0.3

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[1] Funds under management includes the derecognition of $5.4 billion as a result of the sale of Kapstream to Janus Capital in July 2015.

4 Review of operations (continued)

4.1 Key performance indicators (KPIs) (continued)

Challenger's statutory profit attributable to equity holders was higher for the year ended 30 June 2016 primarily as a result of increased income during the period and significant item gains, partially offset by fair value losses.

Normalised net profit after tax was 8.3% greater than the prior year, reflecting higher earnings generated by the business.

A final dividend of 16.5 cents was announced, franked at 100%, taking the total dividend for 2016 to 32.5 cents franked at 100%, up from 30.0 cents (85.5% franked).

Statutory EPS has increased for the year when compared to the prior year, reflecting the increased profit attributable to equity holders as a result of increased earnings, significant item gains and the impact of fair value changes on CLC's assets and liabilities.

Challenger's normalised cost to income ratio of 34.6% remains within the targeted range and is marginally higher than the ratio at 30 June 2015 (33.8%). This is as a result of the additional costs and reduced earnings associated with the Dexion Capital business purchased in July 2015 being reflected for the year ended 30 June 2016. Challenger's medium-term expected normalised cost to income ratio target is a range of 32-36%.

Statutory return on equity (RoE) after tax of 12.5% has increased slightly (30 June 2015: 12.4%) as a result of higher earnings partially offset by higher investment experience after tax.

4.2 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 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 2016 $M	30 June 2015 $M	Change $M	Change %
Net income[1]	721.1	662.6	58.5	8.8
Comprising:				
– Life normalised COE	592.4	543.8	48.6	8.9
– FM net income	127.7	117.5	10.2	8.7
– Corporate and other net income	1.0	1.3	(0.3)	(23.1)
Operating expenses[1]	(249.6)	(224.2)	(25.4)	11.3
Normalised EBIT	**471.5**	**438.4**	**33.1**	**7.6**
Comprising:				
– Life normalised EBIT	499.8	456.7	43.1	9.4
– FM normalised EBIT	37.4	44.1	(6.7)	(15.2)
– Corporate and other normalised EBIT	(65.7)	(62.4)	(3.3)	5.3
Interest and borrowing costs	(4.1)	(3.8)	(0.3)	7.9
Tax on normalised profit	(105.7)	(100.6)	(5.1)	5.1
Normalised NPAT	**361.7**	**334.0**	**27.7**	**8.3**
Investment experience after tax	(56.1)	(35.0)	(21.1)	60.3
Significant items after tax	22.1	-	22.1	Large
Statutory net profit after tax attributable to equity holders	**327.7**	**299.0**	**28.7**	**9.6**

[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.

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 8.3% as a result of increased net book growth in annuities and valuation movements on those assets.

Funds Management net fee income increased (up $10.2 million) primarily due to increased Fidante Partners income, partially offset by reduced performance fees during the period. Funds Management average FUM increased by 10% (excluding the impact of the sale of Kapstream) as a result of inflows throughout the year and mark-to-market gains on investments.

4 Review of operations (continued)

4.2 Normalised profit and investment experience (continued)

Operating expenses increased for the year ended 30 June 2016 (up $25.4 million) primarily due to operating expenses associated with the Dexion Capital acquisition as well as additional expenses incurred to support the Company's growth ambitions. In 2016, Challenger's employee numbers increased by 75 (or 13.4%) to 635, of which 38 related to the acquisition of Dexion Capital.

Normalised tax for the year was $105.7 million, up $5.1 million (5.1%) from 2015 due to higher earnings before interest and tax (up 7.6%). The normalised effective tax rate for the period has reduced slightly to 22.6% (23.1% at 30 June 2015).

Management analysis – investment experience

	30 June 2016 $M	30 June 2015 $M
Actual capital growth[1]		
– Cash and fixed income	(139.1)	(95.2)
– Infrastructure	28.5	17.6
– Property (net of debt)	114.9	85.2
– Equity and other investments	(42.8)	32.9
Total actual capital growth	**(38.5)**	**40.5**
Normalised capital growth[2]		
– Cash and fixed income	(29.4)	(29.3)
– Infrastructure	22.0	21.2
– Property (net of debt)	63.7	52.3
– Equity and other investments	44.2	36.2
Total normalised capital growth	**100.5**	**80.4**
Investment experience		
– Cash and fixed income	(109.7)	(65.9)
– Infrastructure	6.5	(3.6)
– Property (net of debt)	51.2	32.9
– Equity and other investments	(87.0)	(3.3)
	(139.0)	(39.9)
Annuity valuation experience[3]	70.6	(10.1)
Investment experience before tax	(68.4)	(50.0)
Tax benefit/(expense)	12.3	15.0
Investment experience after tax	**(56.1)**	**(35.0)**

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.

2016 investment experience comprises a $139.0 million loss in relation to fair value movements on Life's assets and a $70.6 million gain in relation to fair value movements on Life's liabilities. Continued 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 together with adverse equity and alternative fair value movements as a result of falling global equity markets during the period.

Movements in credit spreads impact the fair value of fixed income assets as well as the illiquidity premium which forms part of the discount rate used to fair value liabilities. Credit spread expansion during the year has resulted in fair value losses associated with fixed income assets, while the discount rate used to fair value Life's liabilities has also expanded which has had a partially offsetting impact with Life's liabilities being fair valued at a lower amount thereby resulting in a gain in liability valuation.

Significant items after tax of $22.1 million primarily represents the gain on sale of Challenger's equity investment in Kapstream together with boutique impairments and related costs following the closure of Metisq and Areté ($12.1 million) and costs associated with Challenger's head office premises move to 5 Martin Place ($3.2 million).

4.3 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 eight years.

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.

Life normalised results	30 June 2016 $M	30 June 2015 $M	Change $M	Change %
Normalised COE	592.4	543.8	48.6	8.9
– Cash earnings	491.9	463.4	28.5	6.2
– Normalised capital growth	100.5	80.4	20.1	25.0
Operating expenses	(92.6)	(87.1)	(5.5)	6.3
Normalised EBIT	**499.8**	**456.7**	**43.1**	**9.4**

[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 +4.5% 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.

[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.

4 Review of operations (continued)

4.3 Life segment results (continued)

Life normalised EBIT increased by $43.1 million (up 9.4%) due to higher normalised COE (up $48.6 million or 8.9%), which was partially offset with operating expenses increasing by $5.5 million (or 6.3%). The higher normalised COE was as a result of higher investment assets, with Life average investment assets increasing 8.3%.

Life annuity sales increased strongly over the prior period (up 21.7%), with both increased fixed term sales (up 21.9%) and lifetime sales (up 21.2%) resulting from the impact of annuity sales on platforms. Life annuity sales have benefited during the period from the availability of annuities on the Colonial First State, Link Group and VicSuper platforms. In addition, annuity sales continue to benefit from an ageing population, retiree focus on secure incomes and retirees taking a more conservative approach to investing in retirement.

Life sales	30 June 2016 $M	30 June 2015 $M	Change $M	Change %
Fixed-term annuities	2,769.8	2,273.2	496.6	21.9
Lifetime annuities	581.4	479.9	101.5	21.2
Total Life annuity sales	3,351.2	2,753.1	598.1	21.7
Other Life sales	998.5	944.0	54.5	5.8
Total Life sales	**4,349.7**	**3,697.1**	**652.6**	**17.7**
Annuity net flows	740.4	738.2	2.2	0.3
Other Life net flows	327.9	(87.3)	415.2	Large

Annuity net flows (new annuity sales less capital repayments) increased by 0.3% to $740.4 million. Based on the opening Life annuity book for the 2016 financial year ($8,692.6 million), annuity net book growth for the period was 8.5%, down from 9.4% in the prior period.

Other Life sales represents Challenger's Guaranteed Index Return (GIR) product (disclosed in Note 9 External unit holders' liabilities), and this represents increased sales during the period together with reinvestments of maturities.

4.4 Funds Management segment results

Challenger's Funds Management segment is Australia's seventh[1] largest investment manager and one of Australia's fastest growing.

Fidante Partners' multi-boutique platform comprises a number of separately branded funds 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 85% of all funds and mandates outperforming their benchmark since inception.

FM normalised results	30 June 2016 $M	30 June 2015 $M	Change $M	Change %
Net income	127.7	117.5	10.2	8.7
– Fidante Partners	78.2	62.3	15.9	25.5
– CIP	49.5	55.2	(5.7)	(10.3)
Operating expenses	(90.3)	(73.4)	(16.9)	23.0
Normalised EBIT	**37.4**	**44.1**	**(6.7)**	**(15.2)**

Funds Management normalised EBIT decreased by 15.2% in 2016, with expense growth during the period (23.0%) being greater than the net income growth (8.7%). This was largely as a result of the expense growth associated with the acquisition of Dexion Capital (rebranded to Fidante Partners Europe) coupled with its revenue underperformance over the year. Fidante Partners Europe's result was materially affected by the market uncertainty associated with Britain's referendum to leave the European Union held in June 2016.

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 increased for the period primarily as a result of fees earned by Fidante Partners Europe (up $11.6 million).

Challenger Investment Partners' (CIP) net income decreased due to lower net management fees (down $5.7 million), partially offset by higher transaction and performance fees.

Funds Management normalised return on equity (RoE) (pre-tax) for the year was 23.5%, down by 12.0 percentage points from the prior year. This reduction comes largely as a result of the capital invested in the acquisition of Dexion Capital and its relative performance throughout the year following acquisition. Notwithstanding this, RoE continues to benefit from FUM growth and capturing the benefits of scale.

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

During the year, Challenger's equity interest in its associates Metisq and Areté were impaired following the decision to close the businesses. Along with wind-up costs, a total of $12.1 million after tax has been recognised as a significant item expense in the year.

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[1] Rainmaker – Consolidated FUM for Australian Fund Managers March 2016.

4 Review of operations (continued)

4.4 Funds Management segment results (continued)

FM FUM and flows	30 June 2016 $bn	30 June 2015 $bn	Change $bn	Change %
Total FUM	56.7	57.9	(1.2)	(2.1)
– Fidante Partners	43.0	44.7	(1.7)	(3.8)
– CIP	13.7	13.2	0.5	3.8
Net flows	(2.5)	7.7	(10.2)	(Large)
– Fidante Partners	(2.6)	6.1	(8.7)	(Large)
– CIP	0.1	1.6	(1.5)	(93.8)

Fidante Partners' FUM decrease ($1.7 billion) was driven by net outflows ($2.6 billion) and positive impact from investment markets (up $0.9 billion). Fidante Partners' net outflows includes the loss of FUM resulting from the sale of Kapstream in July 2015 ($5.4 billion).

CIP FUM growth (up $0.5 billion) is primarily a result of additional property flows (up $0.4 billion) and stronger property markets (up $0.2 billion) offset by movements in fixed income (down $0.2 billion).

4.5 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.

Corporate and other normalised results	30 June 2016 $M	30 June 2015 $M	Change $M	Change %
Net income	1.0	1.3	(0.3)	(23.1)
Operating expenses	(66.7)	(63.7)	(3.0)	4.7
Normalised EBIT	**(65.7)**	**(62.4)**	**(3.3)**	**5.3**
Interest and borrowing costs	(4.1)	(3.8)	(0.3)	7.9
Normalised loss before tax	**(69.8)**	**(66.2)**	**(3.6)**	**5.4**

Normalised EBIT for the Corporate and other segment was lower (down $3.3 million) as a result of higher operating expenses.

4.6 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 12 Contributed equity for further information on the Group's Internal Capital Adequacy Assessment Plan process.

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

Capital	30 June 2016	30 June 2015	Change
Net assets attributable to equity holders ($M)	2,680.9	2,543.2	137.7
CLC excess capital over PCA ($M)	1,010.4	1,009.4	1.0
Group cash ($M)	84.2	98.6	(14.4)
CLC excess capital over PCA + Group cash ($M)	1,094.6	1,108.0	(13.4)
CLC PCA ratio (times)	1.57	1.59	(0.02)
CLC Tier 1 ratio (times)	1.32	1.31	0.01

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 maintains a level of capital representing APRA's prescribed capital amount (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 1.3 to 1.6 times. This range will change over time and is dependent on a number of factors.

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 year.

Subordinated debt

CLC's total regulatory capital base includes $445.5 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 then amortise over the ensuing four years. For tranches already past their call date when LAGIC was introduced, the first coupon date following the call date is considered the first call date.

CLC's subordinated debt includes $166.9 million which had a call date on 7 June 2013. As a result, under APRA's transition arrangements, only $33.4 million (i.e. 20% of the total amount) is eligible as Tier 2 regulatory capital at 30 June 2016.

4 Review of operations (continued)

4.6 Capital management (continued)

The largest tranche of CLC's existing subordinated debt comprises $378.0 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 (as defined in Prudential Standard 3PS 001) 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 has been developing a supervisory framework for Level 3 (conglomerate) groups over a number of years with draft Level 3 standards initially issued by APRA in May 2013. At the time at which these draft standards were published, APRA did not specify a proposed implementation date.

In March 2016, APRA announced that it would defer the implementation of conglomerate capital requirements until a number of other domestic and international policy initiatives were further progressed.

4.7 Credit ratings

Challenger Limited and CLC are rated by Standard & Poor's (S&P). In December 2015, 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

Dividends	30 June 2016	30 June 2015	Change	Change %
Interim dividend (cents)[1]	16.0	14.5	1.5	10.3
Final dividend (cents)[2]	16.5	15.5	1.0	6.5
Total dividend (cents)	32.5	30.0	2.5	8.3
Interim dividend franking	100%	70%	30%	30%
Final dividend franking	100%	100%	-	-

[1] Interim dividend declared on 15 February 2016 and paid on 29 March 2016 in respect of the half year ended 31 December 2015.
[2] Final dividend declared on 15 August 2016 and payable on 28 September 2016 in respect of the half year ended 30 June 2016.

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 2016 was 50%.

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.

Challenger implemented a dividend reinvestment plan (DRP) commencing with the final dividend for 2015. The DRP participation rate for the 2015 final dividend was 7% of all issued shares and 890,868 ordinary shares were issued to satisfy the DRP requirements on 14 October 2015. The DRP participation rate for the 2016 interim dividend was 5% of all issued shares and 600,598 ordinary shares were issued to satisfy the DRP requirements on 29 March 2016.

The DRP will continue in operation for the final dividend and the Board has determined that new shares will be issued to fulfil DRP requirements in respect of the final dividend. 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 its customers with financial security for retirement. To continue to achieve this vision, the Group is focused on the following three core strategic objectives:

1 to increase the Australian retirement savings pool allocation to secure and stable incomes;
2 to be recognised as the leader and partner of choice in retirement income solutions with a broad product offering; and
3 to provide clients with relevant investment strategies exhibiting consistently superior performance.

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 the next 20 years the number of Australians over 65, which is Life's target demographic, is expected to increase by 75%[3].

Challenger Life is well positioned to benefit from changes in retiree risk preferences, including the focus on longevity risk by retirees and their advisers. Annuities address many of the financial concerns retirees face in retirement.

The retirement phase of superannuation is a high growth market driven by ageing demographics and rising superannuation balances from mandatory superannuation contributions. The annual flow moving from the accumulation phase to the retirement phase is forecast to increase by 13%[4] compound annual growth over the next 10 years.

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[3] Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2015-2035.
[4] Rice Warner 2015 Super Projections – forecasted growth over next 10 years based on existing regulatory environment.

6 Likely developments and expected results (continued)

Life segment outlook (continued)

There is a growing recognition that retirees need to take a different approach to investing in retirement and there is a move toward income layering and objectives-based investing. As retirees transition from Government funded aged pensions to private pensions, retirees are demanding safe, secure retirement income products that convert savings to income and provide financial security. Annuities provide safe, secure retirement incomes.

The industry is responding to consumer demand with a range of new retirement income products, including the emergence of Comprehensive Income Products for Retirement (CIPR), as recommended by the Financial System Inquiry and retirement income model portfolios.

The Australian Federal Government commissioned the Financial System Inquiry (FSI) to provide a 'blueprint' for Australia's financial system over the next decade. The FSI report (released December 2014) recommended the retirement phase of superannuation would benefit greatly from pre-selected retirement products for members. These products would provide regular and stable income streams with longevity protection. Annuities were recognised as providing this and could be part of pre-selected retirement products offered by all superannuation funds.

The Federal Government responded to the FSI recommendations in October 2015, and supported all major retirement income recommendations, including the implementation of CIPRs and will consult on legislation by the end of 2016.

As part of the Federal Budget in May 2016, the Australian Government announced as part of its Review of Retirement Income Streams Review, a new superannuation framework that will address current longevity product impediments and facilitate a wider range of retirement income products. The new retirement income product rules provide the building blocks for superannuation funds to develop CIPRs, as recommended by the FSI. The new rules remove the tax impediments to products which provide pooled longevity risk, including deferred lifetime annuities and are scheduled to come into effect on 1 July 2017.

As part of the Federal Budget, the Australian Government also proposed a definition for the objective of superannuation as being to provide income in retirement to substitute or supplement the age pension.

There are a range of Federal Government reforms underway to enhance the retirement income phase of Australia's superannuation system. The superannuation industry is responding and there is a growing acceptance that annuities are part of the optimal retirement income solution. Challenger is investing in technology to allow its annuities to be easily integrated with account-based pensions, in order to facilitate more comprehensive retirement income solutions.

During the year, Challenger's annuities were launched on the Colonial First State (CFS) platform, Australia's leading investment platform, providing access to half of Australia's financial adviser firms. This has resulted in a 100% increase in Challenger annuities sold via the CFS hub. Further growth is expected with a range of CFS platform badges starting to offer Challenger annuities in the 2017 financial year. From July 2016, white labelled Challenger annuities are also available to financial advisers through Clearview Wealth Solutions and IOOF FinHQ wrap platforms, which both utilise the CFS platform.

In the industry fund segment, Challenger-backed term and lifetime annuities have been integrated with VicSuper account-based pensions to create Australia's first CIPR. Challenger has also formed a partnership with the Link Group, which services the needs of 10 million Australian industry superannuation members. A technology build with the Link Group was completed during the year, allowing Link Group industry superannuation members to offer Challenger annuities to their members. Early in the 2017 financial year, three Link Group clients (Local Government Super, Legalsuper and Caresuper) will commence offering Challenger annuities to their members.

Early in the 2017 financial year, Challenger entered into a strategic partnership with Suncorp Group, a leading provider of general insurance, banking, life insurance and wealth management in Australia and New Zealand. The strategic partnership will result in Challenger's term and lifetime annuity products being Suncorp branded and forming part of the longevity solutions provided to Suncorp clients. This strategic partnership will further broaden and expand Life's distribution footprint.

These retail and industry fund platforms and partnerships are increasing Challenger's access to the Australia's superannuation industry and broadening Challenger's distribution footprint. Challenger expects to form more partnerships with both retail and industry funds in order to increase access to guaranteed retirement incomes and allow annuities to be combined with account-based pensions.

As Australia's leading retirement income specialist, Challenger is uniquely positioned to benefit from growth in Australia's retirement incomes market and the move to more guaranteed retirement incomes.

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 from $2.0 trillion[1] at March 2016 to in excess of $10.0 trillion[2] over the next 20 years.

Fidante Partners continues to identify new investment manager talent and is adding capacity to existing managers together with expanding the platform in Europe. The platform has a variety of managers across Australian equities, international equities, fixed income and alternatives.

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[1] APRA Superannuation statistics – March 2016.

[2] Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2015–2035.

6 Likely developments and expected results (continued)

Funds Management segment outlook (continued)

The acquisition and integration of Dexion Capital has substantially expanded Fidante Partners' successful multi-boutique model into the European market, whilst opening up global distribution opportunities for existing boutique investment managers.

Since the acquisition of Dexion Capital in July 2015, Fidante Partners has:

- integrated the business and combined London offices;
- rebranded the business to Fidante Partners Europe in February 2016, with the listed funds component of the business branded Fidante Capital. The rebrand reflects the need to unite Fidante Partners' people across the business behind one brand and culture;
- updated the European boutique sourcing strategy to ensure boutiques meet the demand from European alternatives investors; and
- achieved positive boutique net flows in the year with further commitments received.

While Fidante Partners Europe's multi-boutique platform has delivered positive net flows since acquisition, the Fidante Capital part of the business has been significantly impacted by the market uncertainty leading up to Britain's referendum to leave the European Union in June 2016. While this market uncertainty has affected transaction activity and financial performance in the near term, Challenger continues to expect that Fidante Partners Europe will fulfil its strategic rationale by delivering a global distribution and administrative support platform to replicate Fidante Partners Australia's success.

Challenger Investment Partners continues to build out its client base and leverage its capability. There are opportunities to add new mandates from domestic and international institutions, superannuation funds and sovereign wealth funds in order to grow its third party fiduciary business.

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

Guidance for the 2017 financial year

Life cash operating earnings

Life COE guidance for 2017 is a range of $620 million to $640 million.

Challenger Group ROE and dividend

Challenger continues to target a normalised 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

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. The primary purpose of the indemnity is to indemnify Ernst & Young for any loss that they may suffer as a result of a false representation given by Challenger management where a claim is made against Ernst & Young by a third party.

There is a caveat if Ernst & Young's loss results from their own negligence or wrongful or wilful acts or omissions. 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. Some of 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 Group’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 2016 Remuneration Report.

Our business performance during 2016 continued the strong growth of recent years and the results relative to our balanced scorecard are shown in Section 11.4. Our strong business performance is translating into higher dividends, with dividends increasing by 8.3% in 2016 and have more than doubled over the past five years.

Challenger has continued to deliver for our shareholders over an extended period, achieving a very strong total shareholder return of 101% over five years. Our total shareholder return is top quartile for all periods, including one, three and five years.

We continued to review our remuneration strategy during the year to examine potential changes which might further strengthen the alignment between executive remuneration and shareholder outcomes. This included potential changes to the structure of variable remuneration and the performance hurdles that apply. In particular, your Board examined the advantages and disadvantages of introducing a second performance measure for long term incentives. We determined that the current approach of using absolute total shareholder return (TSR) is best suited to our business model. While we believe in the simplicity of this measure, we did, however, conclude that the achievement of a 12% TSR for full long term incentive vesting is very challenging in the current low growth and low interest rate environment.

Your Board remains satisfied that the changes made in prior years that included lengthening the vesting period of share-based awards, increasing the minimum shareholding requirements and using a funding range for variable remuneration drives appropriate alignment between shareholders and employees. As a consequence, we are limiting the changes to our remuneration approach in 2016. One change, reflecting Challenger's focus on financially sustainable retirement, is that Superannuation Guarantee Contributions are now paid for both male and female employees while on parental leave, providing a material uplift in superannuation balances upon retirement.

Ongoing engagement with shareholders and external stakeholders remains a high priority for your Board and is a critical element in determining our approach to remuneration. In 2016, this engagement process continued, and I met with a range of institutional shareholders, proxy advisory firms and retail shareholder representatives. Overall feedback from these meetings endorsed Challenger's remuneration strategy.

Successful risk management is a critical component of Challenger delivering sustainable financial performance for shareholders. We maintain a strong risk management framework and a strong risk culture, which are supported by:

- direct input from the Risk Committee in remuneration decisions;
- a significant proportion of remuneration is deferred with extended vesting periods allowing the Board to align risk management and remuneration;
- consistent performance measures that do not encourage excessive risk-taking; and
- regular assessment of employee engagement and our risk culture.

Your Board is confident that Challenger's current remuneration strategy and practices are appropriate and that they will continue to:

- drive alignment between shareholders and employees;
- demonstrate a clear link between performance and remuneration outcomes; and
- ensure that remuneration outcomes are consistent with Challenger's short and long-term objectives and are focused on sustained performance over the long term.

Thank you for taking the time to review the 2016 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
• 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.	• 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.	• Significant portion of short term incentive (STI) subject to deferral and linked to Challenger's future share price performance. • Long-term share-based awards with the main component 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.

Remuneration components

Key components of Challenger's remuneration structure for KMP remain unchanged for 2016. Remuneration components comprise fixed and variable remuneration as summarised in the following table:

	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 including risk management.
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 2015, and in recognition of initiatives undertaken in 2016 focused on long-term value, the Board determined that a portion of 2016 DPSRs for all KMP would be deferred for three years. Subject to forfeiture and clawback provisions under the 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 Total Shareholder Return (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 within approved risk parameters, thus supporting shareholder alignment.

11 Remuneration report (continued)

11.1 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 number 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. The five Challenger Principles that are integral to Challenger's culture are Integrity; Compliance; Commercial Ownership; Working Together; and Creative Customer Solutions.

For 2016, objectives were set and agreed with KMP in July 2015. In July 2016, the Board assessed the performance of each KMP against these objectives, which determined individual STI awards for KMP as outlined in Section 11.5 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.

Deferred Performance Share Rights (DPSRs)

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. Three-year DPSRs promote KMP alignment with Challenger's long-term growth and provide retention of KMP. For 2016, 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 11.5 Key Management Personnel remuneration arrangements for further information.

The number of DPSRs granted is determined based on the five day volume weighted average price (VWAP) of shares to grant date.

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

Value for HPSRs

In making HPSR awards for KMP, 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.

Board-determined HPSR awards for KMP are allocated based on the fair value, at grant date. 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 a HPSR under a given set of assumptions. Refer Note 27 Employee entitlements for details.

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.

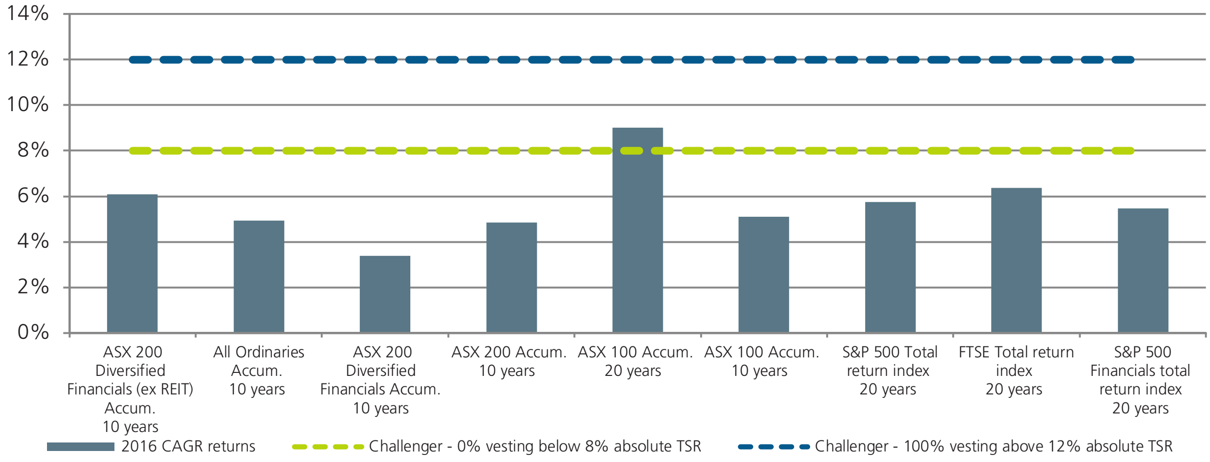
Absolute TSR compounded annually	% of HPSRs that vest
Less than 8% p.a.	0%
8% and above up to 12% p.a.	Straight-line vesting between 50% and 100%
12% p.a. and above	100%

The start and end price for absolute TSR performance testing is calculated using a 90-day 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:



Equity indices TSR - compound annual growth rates (CAGR) over 10 and 20 years
(Growth rates to 30 June 2016)

As evidenced in the chart above, Challenger's HPSR performance targets are above the compound average growth rates of a range of equity indices over 10 and 20 years. The 8% to 12% absolute TSR performance targets have applied since Challenger first awarded HPSRs in 2009.

11 Remuneration report (continued)

11.1 Remuneration strategy and structure (continued)

As an example, a share worth $8.50 today and paying a 31 cents per share dividend reinvested each year would need to produce a total return (i.e. share price appreciation and accumulated reinvested dividends) of $4.87 per share (a 57% return) over four years to achieve a 12% per annum compound return and for HPSR awards to vest in full.

During 2016, the Board again determined that the absolute TSR performance is best suited to Challenger's business model. The TSR performance target of 8% to 12% compounded annually has been maintained for 2016. The Board considers the achievement of these targets very challenging given an ongoing low growth and low interest rate environment. The targets will be reconsidered for grants made in the 2017 financial year to ensure the LTI continues to reward executives for delivering long-term sustainable shareholder growth and returns.

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 CPP Trust commenced operation in December 2006, no shares have been issued to the CPP 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 a mix of forward share purchase agreements and physical shares. 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 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 11.5 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

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	• 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	• The Board convenes a Remuneration Committee comprising at least three independent Directors to assist the Board in 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 2016, 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	• The Board, independent of management, appoints an adviser to the Remuneration Committee. • During 2016, 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 2016, KPMG attended all of the 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 $26,235 (inclusive of GST). KPMG provided internal audit, tax, accounting, actuarial and transaction services and general remuneration factual information in 2016. Fees paid or payable to KPMG in respect of these activities were $1,924,041 (inclusive of GST). • Mercer was retained in 2016 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.

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 2016 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.

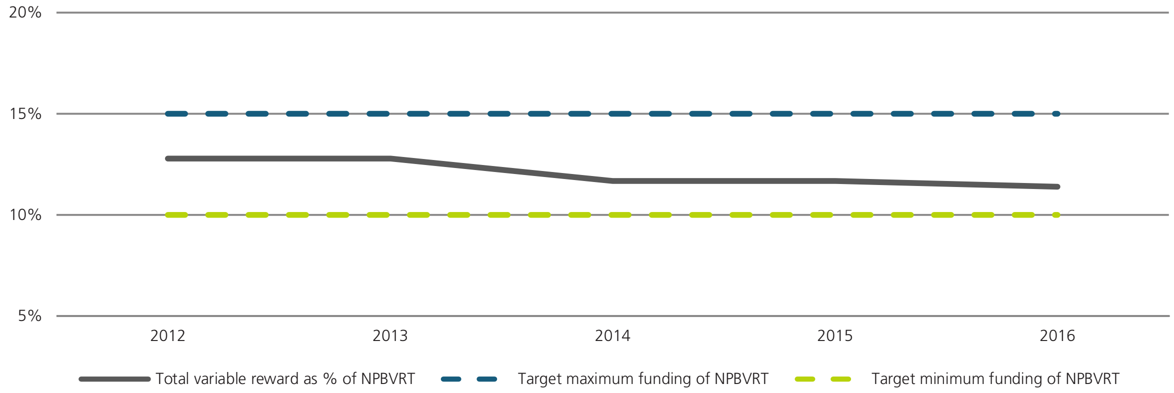
In August 2016, the Board considered remuneration benchmark data as a key input when determining 2016 remuneration outcomes for KMP and is confident that awarded remuneration reflects performance and is positioned and structured at a market competitive level reflective of the markets in which Challenger competes for talent, and the specialist nature of the skills and experience of Challenger KMP.

11 Remuneration report (continued)

11.2 Remuneration governance (continued)

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 2012 through 2016 are shown in the graph below:



While working within the targeted range, the Board considers several financial and non-financial factors when determining the size of the pool. Examples of factors that the Board considers include overall business results, external remuneration levels and movements, capacity to pay, progress on short and long-term strategic objectives, the cost and amount of capital employed, factors beyond management's control, quantum and quality of financial results and management of risk.

For 2016, the Board approved a variable remuneration pool of 11.4% of NPBVRT (11.7% in 2015). The Board considers that the 2016 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 2016, 54% (51% in 2015) of the pool was awarded as cash, 19% (20% in 2015) was awarded as equity deferred up to two years and 27% (29% in 2015) was awarded as equity deferred for three years or more.

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 12 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 2015, Challenger revised KMP and Non-Executive Director minimum shareholding guidelines in order to ensure alignment with shareholders. Minimum shareholding requirements are detailed in the following table:

Group	Requirement	Implied value[1]
Non-Executive Directors (NEDs)	One times base fees	Chair: $420,000 NEDs: $173,000
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 2016.

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 2016 are set out in Sections 11.5 Key Management Personnel remuneration arrangements and 11.7 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

11 Remuneration report (continued)

11.2 Remuneration governance (continued)

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 2016 (no requests in 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 2016, 75% of permanent employees hold unvested Challenger equity (83% in 2015) with the reduction caused by new employees including employees joining through the acquisition of Dexion Capital. This constitutes 3% employee ownership of Challenger (4% in 2015).

11.3 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 Risk Committee provides reports to the Remuneration Committee and the Board summarising risk management and risk outcomes, including 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, risk management, including any 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.

Risk management is an important component of Challenger's balanced scorecard which is outlined in Section 11.4 Performance and remuneration snapshot and the Remuneration Committee and the Board consider potential risk implications of performance targets when setting performance measures for variable remuneration plans.

The Board also places significant focus on risk culture and monitors and assesses Challenger's risk culture. In 2016, this included:

- a risk culture review by Challenger's risk management function;
- an assessment of employee responses to risk related questions in Challenger's employee engagement survey; and
- independent reviews by Ernst & Young (external auditor) and KPMG (internal auditor).

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).

11.4 Performance and remuneration snapshot

Since 2012, Challenger has increased both normalised net profit after tax (NPAT) by 22% and normalised earnings per share (EPS) by 12%, with this sustained strong business performance translating into increased dividends to shareholders by 81% over the period.

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

For the year ended	30 June 2012	30 June 2013	30 June 2014	30 June 2015	30 June 2016
Normalised NPAT ($M)	296.8	308.5	328.7	334.0	361.7
Normalised EPS (cents)	57.5	58.6	64.0	61.2	64.6
Closing share price ($)	3.25	4.01	7.44	6.72	8.63
Dividends per share (cents)	18.0	20.0	26.0	30.0	32.5

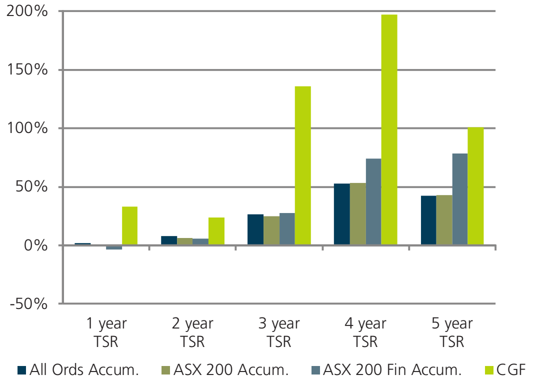
11 Remuneration report (continued)

11.4 Performance and remuneration snapshot (continued)

Total shareholder return (TSR)

Source: IRESS and Bloomberg

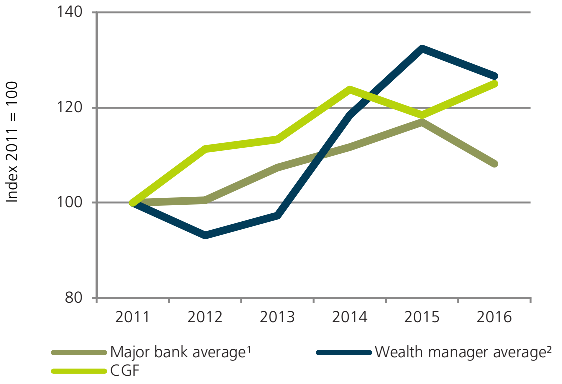
Challenger's TSR has increased by 101% since 2011 and delivered significant long-term outperformance.



Normalised EPS versus other Australian financial companies

Source: Bloomberg and Company data

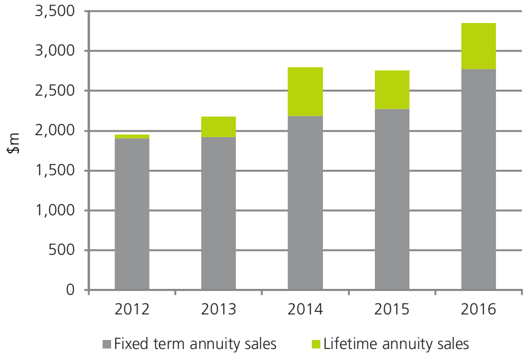
Challenger's normalised EPS has increased by 25% since 2011.



Life – Annuity sales

Source: Company data

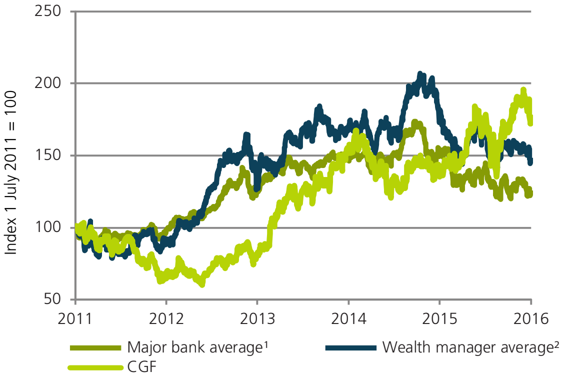
Annuity sales have increased by 71% since 2012.



Challenger share price performance versus other Australian financial companies

Source: Bloomberg and Company data

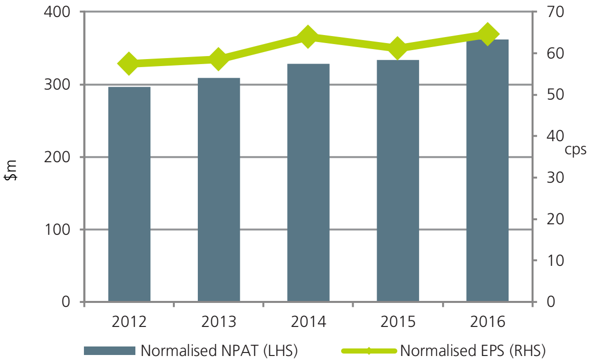
Challenger's share price has outperformed many Australian financial companies over the past five years.



Normalised NPAT and Normalised EPS

Source: Company data

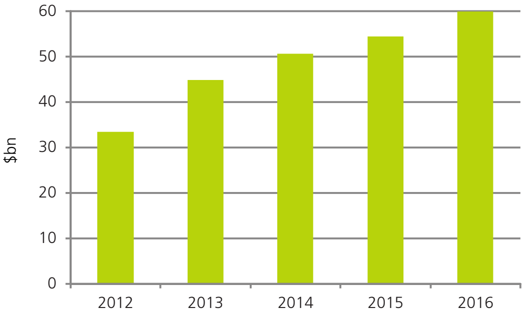
Normalised NPAT and EPS have increased by 22% and 12% respectively since 2012.



Annual growth in group assets under management[3]

Source: Company data

AUM has grown significantly, increasing by 80% since 2012.



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

[2] Wealth manager average – (AMP, IOOF, PPT)

[3] 2015 AUM excludes Kapstream institutional FUM ($5.4bn) following the FUM being derecognised as a result of the sale of Kapstream in July 2015.

11 Remuneration report (continued)

11.4 Performance and remuneration snapshot (continued)

2016 balanced scorecard outcomes

For 2016, 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 for KMP
Financial	Normalised NPAT	$361.7 million – exceeded target.	20%-40%
	Normalised EPS	64.6 cents per share – exceeded target.	
	Normalised RoE	Normalised RoE of 17.8% was marginally below the 18.0% target, primarily as a result of challenging market conditions in the United Kingdom which impacted Challenger's Fidante Partners Europe business.	
Growth and customer	Annuity net book growth	Annuity net book growth of 8.5% (on target).	22.5%-55%
	Funds Management expansion	Funds under management (FUM) of $56.9 billion (down 2%) driven by the derecognition of FUM resulting from the sale of Kapstream. Fidante Partners will no longer receive distribution fees on Kapstream institutional FUM. Despite the reduction in FUM, Fidante Partners' earnings over the short and medium term is not expected to be negatively impacted following new distribution and administration agreements. Over the past five years, Challenger's FUM has increased on average 19% per year compared to 8% average annual FUM growth[1] across the Australian market. The recently acquired Dexion Capital, a European alternative investments group based in London, was integrated and rebranded as Fidante Partners Europe. As a result of the acquisition, three new boutiques were added in Europe. New strategies were developed to provide further growth for existing Australian boutiques, including Wavestone, Ardea, Tempo and Alphinity. Challenger Investment Partners also continued to attract net flows ($0.1bn) and FUM growth including new property mandates from offshore clients.	
	Service delivery	The 2016 Wealth Insights Service Level Report ranked Challenger first in the following categories: • Overall Adviser Satisfaction (for the first time). • BDM Team (for fifth consecutive year). • Technical Services (for the first time). • Client Services (for the first time). • Image and Reputation (for the first time).	

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[1] Rainmaker – Consolidated FUM for Australian Fund Managers March 2016.

11 Remuneration report (continued)

11.4 Performance and remuneration snapshot (continued)

Objective	Performance measure	Outcome achieved	Weighting range for KMP
Growth and customer (continued)	Product and service growth	The following initiatives in 2016 provide a platform for growth, enabling Challenger to secure the financial future of more Australians in retirement: • Challenger annuities were made available on the Colonial First State (CFS) FirstChoice and CFS FirstWrap platforms. This initiative won Investment Trends 2015 best functionality award. Sales via the CFS distribution channel more than doubled in 2016. • A Challenger lifetime annuity backed Australia's first Comprehensive Income Product for Retirement, which was launched by VicSuper. • A technology project with the Link Group, which services 10 million industry superannuation members, allowed Link Group industry superannuation funds to make Challenger annuities available to its members. Three Link Group clients (Legalsuper, Local Government Super and Caresuper) will be adding Challenger annuities in the first quarter of financial year 2017. • A new aged care product, CarePlus, was developed and launched in August 2015. • A range of options were developed to enhance the award winning Liquid Lifetime product. • Liquid Lifetime was the joint winner of the Chant West 2016 Pension Fund of the Year. The ongoing success of Challenger initiatives to support growth was demonstrated in the achievement of record annuity sales of over $3.3 billion in 2016, including strong growth in both term annuities (up 22%) and lifetime annuities (up 21%).	
	Brand effectiveness	Recognition of Challenger's brand amongst both financial advisers and consumers continued in 2016: • 95% of advisers surveyed recognised Challenger as a leader in retirement income. • Brand awareness increased by 2 percentage points to 61%. • Challenger was recognised as Overall Annuity Provider of the Year (eighth year running) and won the Long Term Income Stream award in the 2016 Plan for Life/AFA Life Company of the Year awards. • Challenger was awarded best longevity product by Chant West in 2016. During 2016, Challenger launched its third national advertising campaign, which focused on consumer concerns of outliving their retirement savings. The early results from the new campaign were positive, with 52% of those surveyed likely to ask a financial adviser about an annuity.	
	Retirement income thought leadership and education	Challenger continued to make significant contributions to retirement income awareness and education, including: • Partnering with the University of New South Wales (UNSW) to add a new Aged Care Planning Course, which won an Annuity and Income Stream Innovation award from UNSW's Business School. • Launching the University of Adelaide/Accurium 'SMSF Retirement Essentials' workshop.	

11 Remuneration report (continued)

11.4 Performance and remuneration snapshot (continued)

Objective	Performance measure	Outcome achieved	Weighting range for KMP
Growth and customer (continued)	Retirement income thought leadership and education (continued)	• Collaborating with globally recognised Wade Pfau and Drew Walk & Co to produce research papers and reports to highlight key retirement issues for financial advisers and the media. • Delivering presentations to over 6,000 financial advisers.	
Risk and compliance	Control exposures from growth related activities through the risk management framework and maintain compliance with the Risk Appetite Statement	Compliance with Board Risk Appetite Statement for 2016 included: • 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. A strong culture of compliance and prudent risk-taking continued as evidenced in the 2016 employee engagement survey results in which more than 90% of employees indicated that: • Challenger clearly communicates its expectations for ethical behaviour; • Challenger takes action to learn from risk events and mistakes that occur; and • if they observed unethical behaviour or misconduct they would raise it.	15%-30%
People, community and sustainability		Challenger's Sustainability Report provides further information on people, community and sustainability.	10%-25%
	Sustainability outcomes	Challenger continued its strong approach to sustainability, including: • becoming a signatory to the United Nations Principles for Responsible Investment (UNPRI); • advocating for policy reforms that allow people to use their superannuation savings to create long-term, sustainable incomes; • maintaining carbon neutrality for business operations; • ensuring compliance with the responsible investment policy; • continuing to reduce the environmental impact of real estate – both the assets we occupy and the assets owned. In early 2016, Challenger moved its head office to a new 5 Star NABERS rated building in Sydney which will further reduce Challenger's carbon footprint; and • completing an initial and voluntary submission in accordance with the Global Reporting Initiative.	
	Employee engagement	Challenger's 2016 engagement survey results were outstanding. At 88%, Sustainable Engagement was above the global high performing companies norm and results across all surveyed categories exceeded both the Australian national and global financial services norms.	

11 Remuneration report (continued)

11.4 Performance and remuneration snapshot (continued)

<table>
<tr><th>Objective</th><th>Performance measure</th><th>Outcome achieved</th><th>Weighting range for KMP</th></tr>
<tr><td></td><td>Diversity and inclusion</td><td>Challenger's efforts towards creating and maintaining an inclusive work environment that values and enables diversity were reflected in the 2016 employee engagement survey results:
• 94% of employees indicated their immediate manager genuinely supports equality between women and men and 97% of employees indicated that sex-based harassment is not tolerated;
• 92% of employees indicated that their manager effectively works with people who are different from him or herself (in gender, racial/ethnic background, lifestyle, etc.); and
• 89% of employees indicated that they had the flexibility needed to manage their work and personal responsibilities (including caring).
Initiatives undertaken in 2016 in support of gender diversity objectives included:
• gender diversity targets were implemented and progress made towards the interim target set for 30 June 2017 as follows:
<table>
<tr><th></th><th>Dec 15</th><th>Jun 16</th><th>FY17 Target</th></tr>
<tr><td>Women in all roles</td><td>39.5%</td><td>41.7%</td><td>42%</td></tr>
<tr><td>Women in management</td><td>27.4%</td><td>29.3%</td><td>32%</td></tr>
</table>
• four scholarships were awarded under Challenger's Scholarship Program to support the development and advancement of high potential women. CEO, Brian Benari, continued as a Workplace Gender Equality Agency Equal Pay Ambassador;
• commencing superannuation contributions for employees during periods of parental leave without pay; and
• introducing leave and counselling for victims of domestic violence.</td><td></td></tr>
<tr><td></td><td>Leadership development and succession management</td><td>The Leadership Team and the Board continue to review future leadership needs and plan for, and address, capability gaps to successfully deliver Challenger's business strategy. Challenger continued to invest in leadership development and the fifth cohort of Challenger employees completed the Leadership Foundations Program.</td><td></td></tr>
<tr><td></td><td>Office move to 5 Martin Place, Sydney</td><td>The fitout of new office premises at 5 Martin Place, Sydney, was completed and the head office move was achieved with material employee involvement and minimal business disruption.</td><td></td></tr>
</table>

11 Remuneration report (continued)

11.5 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 2016 are detailed in the table below:

Name	Role	Term as KMP in 2016
Brian Benari	Managing Director & CEO	Full year
Richard Howes	Chief Executive, Life	Full year
Paul Rogan	Chief Executive, Distribution, Marketing & Research	Full year
Ian Saines	Chief Executive, Funds Management	Full year
Andrew Tobin	Chief Financial Officer	Full year

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	**2016**	**1,236,380**	**19,308**	**800,000**	**2,880,964**	**223,995**	**5,160,647**
	2015	1,235,947	18,783	900,000	3,001,935	212,826	5,369,491
R Howes	**2016**	**632,124**	**19,308**	**700,000**	**1,805,404**	**131,903**	**3,288,739**
	2015	632,387	18,783	700,000	1,995,380	133,263	3,479,813
P Rogan	**2016**	**641,926**	**19,308**	**675,000**	**1,597,214**	**120,306**	**3,053,754**
	2015	640,579	18,783	512,500	1,852,369	136,759	3,160,990
I Saines[4]	**2016**	**841,258**	**19,308**	**325,000**	**652,427**	**41,462**	**1,879,455**
	2015	277,927	6,261	170,000	88,460	6,910	549,558
A Tobin	**2016**	**636,524**	**19,308**	**450,000**	**1,098,340**	**90,651**	**2,294,823**
	2015	632,470	18,783	425,000	1,126,036	87,359	2,289,648
R Woods[5]	**2016**	**-**	**-**	**-**	**-**	**-**	**-**
	2015	426,181	12,608	369,178	1,241,981	81,879	2,131,827
Total	**2016**	**3,988,212**	**96,540**	**2,950,000**	**8,034,349**	**608,317**	**15,677,418**
	2015	3,845,491	94,001	3,076,678	9,306,161	658,996	16,981,327

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

[2] Calculated on the basis outlined in Note 27 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] Values represent distributions from the CPP Trust and long service leave accruals.

[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)

11.5 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	**2016**	**24%**	**16%**	**56%**	**4%**	**100%**
	2015	23%	17%	56%	4%	100%
R Howes	**2016**	**20%**	**21%**	**55%**	**4%**	**100%**
	2015	19%	20%	57%	4%	100%
P Rogan	**2016**	**22%**	**22%**	**52%**	**4%**	**100%**
	2015	21%	16%	59%	4%	100%
I Saines[1]	**2016**	**46%**	**17%**	**35%**	**2%**	**100%**
	2015	52%	31%	16%	1%	100%
A Tobin	**2016**	**28%**	**20%**	**48%**	**4%**	**100%**
	2015	28%	19%	49%	4%	100%
R Woods[2]	**2016**	-	-	-	-	-
	2015	21%	17%	58%	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.

		Short-term employee benefits			**Share-based payments**				
KMP	Year	Salary[1] $	Super-annuation $	Cash STI $	1&2 year DPSR[2] $	3 year DPSR[3] $	HPSR[4] $	Other[5] $	Total $
B Benari	**2016**	**1,236,380**	**19,308**	**800,000**	**800,000**	**600,000**	**1,800,000**	**203,676**	**5,459,364**
	2015	1,235,947	18,783	900,000	900,000	550,000	1,650,000	190,683	5,445,413
R Howes	**2016**	**632,124**	**19,308**	**700,000**	**700,000**	**312,500**	**937,500**	**121,458**	**3,422,890**
	2015	632,387	18,783	700,000	700,000	287,500	862,500	122,133	3,323,303
P Rogan	**2016**	**641,926**	**19,308**	**675,000**	**675,000**	**125,000**	**375,000**	**106,597**	**2,617,831**
	2015	640,579	18,783	512,500	512,500	262,500	787,500	113,584	2,847,946
I Saines	**2016**	**841,258**	**19,308**	**325,000**	**325,000**	**162,500**	**487,500**	**37,390**	**2,197,956**
	2015	277,927	6,261	170,000	170,000	287,500	862,500	5,078	1,779,266
A Tobin	**2016**	**636,524**	**19,308**	**450,000**	**450,000**	**200,000**	**600,000**	**73,474**	**2,429,306**
	2015	632,470	18,783	425,000	425,000	200,000	600,000	68,060	2,369,313

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

[2] DPSRs will be formally granted in September 2016 and vest 50% one year after grant and 50% two years after grant.

[3] DPSRs will be formally granted in September 2016 and vest three years after grant.

[4] HPSR awards are determined following consideration of potential realised value under a range of vesting outcomes, including full vesting. HPSRs will be formally granted in September 2016 with reference to the fair value at the time of grant.

[5] Values represent distributions from the CPP Trust.

11 Remuneration report (continued)

11.5 Key Management Personnel remuneration arrangements (continued)

Share Rights granted

Deferred Performance Share Rights

DPSRs granted to KMP during the year ended 30 June 2016 are detailed below:

					Vesting					
					Tranche 1		Tranche 2		Tranche 3	
					1 September 2016		1 September 2017		1 September 2018	
KMP	Deferral from 2015 $	Allocation price $	Total number of DPSRs granted	Date of grant	Number[1]	Fair value $	Number[1]	Fair value $	Number[1]	Fair value $
B Benari	1,450,000	6.9894	207,456	13/9/15	64,383	6.73	64,383	6.44	78,690	6.16
R Howes	987,500	6.9894	141,283	13/9/15	50,075	6.73	50,075	6.44	41,133	6.16
P Rogan	775,000	6.9894	110,880	13/9/15	36,662	6.73	36,662	6.44	37,556	6.16
I Saines	457,500	6.9894	65,455	13/9/15	12,161	6.73	12,161	6.44	41,133	6.16
A Tobin	625,000	6.9894	89,420	13/9/15	30,403	6.73	30,403	6.44	28,614	6.16

[1] The number of DPSRs granted is determined by dividing the dollar value of the award by the VWAP in the five days to grant.

Hurdled Performance Share Rights

HPSRs granted to KMP during the year ended 30 June 2016 are detailed below:

				Vesting			
				Tranche 1		Tranche 2	
				1 September 2018		1 September 2019	
KMP	Grant date	TSR start price[1] $	Total number of HPSRs granted	Number vesting[2]	Fair value at grant $	Number vesting[2]	Fair value at grant $
B Benari	13/9/15	7.0127	530,053	336,391	3.27	193,662	2.84
R Howes	13/9/15	7.0127	277,073	175,840	3.27	101,233	2.84
P Rogan	13/9/15	7.0127	252,980	160,550	3.27	92,430	2.84
I Saines	13/9/15	7.0127	277,073	175,840	3.27	101,233	2.84
A Tobin	13/9/15	7.0127	192,746	122,324	3.27	70,422	2.84

[1] The TSR start price is the VWAP of shares traded in the 90 calendar days immediately preceding the Valuation Date. The TSR start price can be used as a proxy for the face value at grant.

[2] The number of HPSRs granted is determined by dividing the dollar value of the award by the fair value of the relevant grant. The fair value is independently calculated and has been determined by the Board as the best estimate of the financial value.

Share Rights vested

The following tables show the short and long-term incentives that vested during the year and form part of realised remuneration for the KMP.

Deferred Performance Share Rights

DPSRs which vested to KMP during the year ended 30 June 2016 are detailed below:

KMP	Date of grant	Number	Fair value at grant $	Vesting date
B Benari	17/9/13	110,135	518,736	1/9/15
	16/9/14	63,559	449,998	1/9/15
R Howes	17/9/13	78,012	367,437	1/9/15
	16/9/14	44,138	312,497	1/9/15
P Rogan	17/9/13	79,542	374,643	1/9/15
	16/9/14	40,607	287,498	1/9/15
A Tobin	17/9/13	50,478	237,751	1/9/15
	16/9/14	28,248	199,996	1/9/15

11 Remuneration report (continued)

11.5 Key Management Personnel remuneration arrangements (continued)

Share Rights vested (continued)

Hurdled Performance Share Rights

HPSR grants considered by shareholders in prior periods and which vested to KMP during the year ended 30 June 2016 are detailed below, providing increased transparency of grants by tranche, together with TSR performance and vesting outcome. The share price on the vesting dates of 1 September 2015 and 16 February 2016 were $6.98 and $7.18 respectively.

Total shareholder return outcomes for all HPSRs vesting during the year range between 15% and 35%, per annum 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 at grant[1] $	Date	Number	TSR outcome per annum	Number vested or lapsed in prior years	Number yet to vest or lapse
B Benari	12/9/11	600,000	1,086,000	1/9/15	200,000	15%	400,000	-
	16/3/12	1,250,000	1,450,000	16/2/16	416,668	32%	833,332	-
	17/9/13	850,000	2,751,166	1/9/15	283,333	35%	-	566,667
R Howes	12/9/11	600,000	1,086,000	1/9/15	200,000	15%	400,000	-
	12/9/12	850,000	1,207,000	1/9/15	283,333	32%	283,333	283,334
	17/9/13	525,000	1,699,250	1/9/15	175,000	35%	-	350,000
P Rogan	12/9/11	500,000	905,000	1/9/15	166,668	15%	333,332	-
	12/9/12	700,000	994,000	1/9/15	233,333	32%	233,333	233,334
	17/9/13	500,000	1,618,332	1/9/15	166,666	35%	-	333,334
A Tobin	12/9/11	140,000	253,400	1/9/15	46,668	15%	93,332	-
	12/9/12	400,000	568,000	1/9/15	133,333	32%	133,333	133,334
	17/9/13	300,000	971,000	1/9/15	100,000	35%	-	200,000

[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.

Share Rights held

Performance Share Rights held

Details of KMP DPSRs and HPSRs held as at 30 June 2016 are set out below:

KMP	Instrument	Number held at 1 July 2015	Number granted as remuneration	Number vested	Number held at 30 June 2016
B Benari	DPSRs	438,597	207,456	(173,694)	472,359
	HPSRs	1,885,757	530,053	(900,001)	1,515,809
R Howes	DPSRs	229,200	141,283	(122,150)	248,333
	HPSRs	1,516,733	277,073	(658,333)	1,135,473
P Rogan	DPSRs	223,528	110,880	(120,149)	214,259
	HPSRs	1,342,879	252,980	(566,667)	1,029,192
I Saines[1]	DPSRs	-	65,455	-	65,455
	HPSRs	204,383	277,073	-	481,456
A Tobin	DPSRs	142,497	89,420	(78,726)	153,191
	HPSRs	760,792	192,746	(280,001)	673,537

[1] Mr Saines became a KMP on 2 March 2015.

11 Remuneration report (continued)

11.5 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 2016 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	**2016**	**1,000,000**	**1,073,695**	**(1,073,695)**	**1,000,000**	**6.9**
	2015	1,000,000	1,325,663	(1,325,663)	1,000,000	5.4
R Howes	**2016**	**179,693**	**780,483**	**(860,176)**	**100,000**	**1.3**
	2015	179,693	1,127,576	(1,127,576)	179,693	1.9
P Rogan	**2016**	**100,000**	**686,816**	**(636,816)**	**150,000**	**2.0**
	2015	150,000	888,372	(938,372)	100,000	1.0
I Saines[2]	**2016**	**-**	**-**	**-**	**-**	**-**
	2015	-	-	-	-	-
A Tobin	**2016**	**195,851**	**358,727**	**(324,342)**	**230,236**	**3.0**
	2015	100,000	385,851	(290,000)	195,851	2.0
R Woods[3]	**2016**	**-**	**-**	**-**	**-**	**-**
	2015	300,000	1,085,142	(1,085,142)	-	-
Total	**2016**	**1,475,544**	**2,899,721**	**(2,895,029)**	**1,480,236**	
	2015	1,729,693	4,812,604	(4,766,753)	1,475,544	

[1] Shareholding multiple based on 30 June 2016 closing share price of $8.63 (30 June 2015: $6.72).

[2] Mr Saines became a KMP on 2 March 2015 and has a five-year transitional period in which to acquire the required shareholding.

[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.

11.6 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.

11 Remuneration report (continued)

11.6 Contractual arrangements (continued)

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.

11.7 Non-Executive Director disclosures

Composition

Challenger's Non-Executive Directors for 2016 are detailed in the table below:

Name	Term as Non-Executive Director in 2016
Peter Polson (Chair)	Full year
Graham Cubbin	Full year
Steven Gregg	Full year
Jonathan Grunzweig	Full year
Brenda Shanahan	Full year
JoAnne Stephenson	Full year
Leon Zwier	Full year

Fee pool

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

The current fee pool of $2,000,000 was approved by shareholders in 2007.

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 fee structure is benchmarked annually to align with market and to attract, retain and appropriately reward quality independent directors. Based on the results of the benchmarking, fees were increased for the year ended 30 June 2016.

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 2016:

Board/Committee	Chair fee $	Member fee $
Board[1]	420,000	173,000
Group Risk[2]	23,500	11,750
Group Audit[2]	23,500	11,750
Remuneration	41,500	21,000

[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.

11 Remuneration report (continued)

11.7 Non-Executive Director disclosures (continued)

Non-Executive Director fees for the year ended 30 June 2016

The following table summarises Non-Executive Director fees for the year ended 30 June 2016:

Non-Executive Director	Year	Director fees $	Superannuation $	Total $
P Polson	**2016**	**438,775**	**19,308**	**458,083**
	2015	407,217	18,783	426,000
G Cubbin[1]	**2016**	**235,333**	**-**	**235,333**
	2015	222,000	-	222,000
S Gregg	**2016**	**175,495**	**16,672**	**192,167**
	2015	167,123	15,877	183,000
J Grunzweig[1]	**2016**	**171,667**	**-**	**171,667**
	2015	165,000	-	165,000
R Hooper[1, 2]	**2016**	**-**	**-**	**-**
	2015	110,000	-	110,000
B Shanahan	**2016**	**196,880**	**18,704**	**215,584**
	2015	188,128	17,872	206,000
J Stephenson	**2016**	**199,025**	**19,308**	**218,333**
	2015	191,217	18,783	210,000
L Zwier[1]	**2016**	**171,667**	**-**	**171,667**
	2015	165,000	-	165,000
Total	**2016**	**1,588,842**	**73,992**	**1,662,834**
	2015	1,615,685	71,315	1,687,000

[1] Mr Cubbin, Mr Grunzweig, Mr Hooper and Mr Zwier provide services through companies. Fees exclude GST.

[2] Mr Hooper retired from the Board on 27 February 2015.

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 2016

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	**2016**	**122,000**	**-**	**122,000**
	2015	122,000	-	122,000
G Cubbin	**2016**	**97,702**	**-**	**97,702**
	2015	97,702	-	97,702
S Gregg	**2016**	**10,000**	**-**	**10,000**
	2015	10,000	-	10,000
J Grunzweig	**2016**	**250**	**-**	**250**
	2015	250	-	250
R Hooper[1]	**2016**	**-**	**-**	**-**
	2015	160,000	(160,000)	-
B Shanahan	**2016**	**252,112**	**-**	**252,112**
	2015	250,000	2,112	252,112
J Stephenson	**2016**	**7,000**	**6,000**	**13,000**
	2015	2,000	5,000	7,000
L Zwier	**2016**	**2,360**	**-**	**2,360**
	2015	2,360	-	2,360
Total	**2016**	**491,424**	**6,000**	**497,424**
	2015	644,312	(152,888)	491,424

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

11 Remuneration report (continued)

11.7 Non-Executive Director disclosures (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						
2016	**1,588,842**	**73,992**	**-**	**-**	**-**	**1,662,834**
2015	1,615,685	71,315	-	-	-	1,687,000
KMP						
2016	**6,938,212**	**96,540**	**8,034,349**	**608,317**	**-**	**15,677,418**
2015	6,922,169	94,001	9,306,161	658,996	-	16,981,327
All KMP and Non-Executive Directors						
2016	**8,527,054**	**170,532**	**8,034,349**	**608,317**	**-**	**17,340,252**
2015	8,537,854	165,316	9,306,161	658,996	-	18,668,327

11 Remuneration report (continued)

11.8 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	*Challenger Performance Plan.* Deferred equity awards are issued under the CPP.
CPP Trust	*Challenger Performance Plan Trust.* The CPP Trust was set up in 2007 for the purpose of acquiring, holding and transferring shares to employees upon the vesting of their equity awards.
DPSR	*Deferred Performance Share Right.* Deferred STI awards are delivered as DPSRs under the CPP. DPSRs represent the right to receive a fully-paid ordinary Challenger share for zero consideration subject to continued employment at the time of vesting. DPSRs do not provide an entitlement to vote or a right to dividends; 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 27 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	*Hurdled Performance Share Right.* 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	*Key Management Personnel.* Persons having authority and responsibility for planning, directing and controlling the activities of an entity, directly or indirectly, including any Director (whether executive or otherwise) as defined in AASB 124 *Related Party Disclosures*.
Normalised NPAT	*Normalised net profit after tax.* 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)	*Normalised return on equity (pre-tax).* Normalised profit before tax divided by average net assets.
Normalised NPBVRT	*Normalised net profit before variable reward and tax.* Excludes any asset or liability valuation movements that are above or below expected long-term trends and any significant items that may positively or negatively impact the financial results, and excludes 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	*Short term incentive.* STIs are used to reward KMP and employees for significant contributions to Challenger's results over the course of the financial year. Individual STI awards are allocated on the basis of annual contribution and with reference to market benchmarks. The Board has discretion to amend or withdraw the STI at any point. STIs may be awarded in the form of cash and/or DPSRs.
TSR	*Total shareholder return.* TSR represents the change in share price plus dividends received over a given timeframe. Challenger uses absolute TSR as the measure of performance for HPSRs.
Variable remuneration	Consists of Cash STI and share-based awards (DPSRs and HPSRs).
VWAP	*Volume weighted average price.* Ratio of the value of shares traded to total volume traded over a particular time horizon. A 90-day VWAP is used to calculate the number of DPSRs per dollar of deferred STI. A 90-day VWAP is also used for absolute TSR performance testing (start and end price).

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) Corporations Instrument 2016/191.

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 2016 by the Company's auditor, Ernst & Young.

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 28 Remuneration of auditor of the financial report.

14 Auditor's independence declaration

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

EY
Building a better working world

Ernst & Young
200 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

As lead auditor for the audit of Challenger Limited for the financial year ended 30 June 2016, I declare to the best of my knowledge and belief, there have been:

a. no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and

b. no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Challenger Limited and the entities it controlled during the financial year.

Ernst & Young

Ernst & Young

S J Ferguson
Partner

Sydney
15 August 2016

15 Authorisation

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

G A Cubbin Director	Brian Benari B R Benari Managing Director & Chief Executive Officer
Sydney 15 August 2016	Sydney 15 August 2016

Sustainability

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

With a vision of providing our customers with financial security for retirement, we believe in having a retirement system that encourages long-term savings and the conversion of those savings into retirement income that lasts for a lifetime. This is important given more people are retiring and are also living much longer.

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

Sustainable retirement

Providing our customers with security for their retirement requires Challenger to engage and collaborate with multiple stakeholders. Successful collaborations help create a sustainable retirement income system, which is good for shareholders, customers and the broader economy.

Over the past 12 months, Challenger yielded significant results by continuing to lead the debate for revised policy settings which support the provision of a new range of retirement income products.

Our activities centred on participation in key policy forums; meetings with political decision makers; and media activities. As a result, the Federal Government announced in its May Budget the removal of tax barriers impeding the development of a new form of longevity products.

The reforms lay the pathway for further innovation through the creation of Comprehensive Income Products for Retirement or CIPRs. The benefits of these reforms are numerous, but most importantly:

- they ensure retirees have more options available to them to secure guaranteed income streams in retirement; and
- they also mean retirees will be less reliant on the aged pension, which benefits taxpayers.

Challenger was also a sponsor of the Committee for Sustainable Retirement Incomes Leadership Forum, a think tank advocating for the design of a world-class retirement income system. Educating the superannuation industry on better ways to manage income in retirement has been an important focus complementing our advocacy activities.

Challenger also supports the education of financial advisers through university accreditation courses at UNSW and University of Adelaide, as well as contributing to ongoing education for various professional bodies in the industry.

Challenger is also a key collaborator with National Seniors Australia and the publication of the Seniors Sentiment Index, considering how older Australians are coping across a range of wealth, health and social indicators.

Sustainable business practices

Risk management

At Challenger, risk is everyone's business. Culturally, it permeates all levels of the organisation in the behaviours displayed towards the identification, discussion and mitigation of risk.

The Board's Risk Appetite Statement outlines the level of risk that is acceptable in striving to achieve Challenger's strategic goals and financial objectives. It also provides clear boundaries for acceptable risk taking activities across the organisation.

Our employees take risk seriously. In our most recent employee engagement survey, 87% of employees had a favourable view towards risk culture (this is 10 points above the Australian national norm). In addition, 83% of employees proactively identify risk management issues as part of their standard work practices.

Responsible investment

As institutional investors, Challenger has a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social and governance (ESG) issues can affect the performance of investment portfolios to varying degrees across companies, sectors, regions, asset classes and through time.

Adding to a Board approved Responsible Investment Policy, in July 2015 Challenger became a signatory to the United Nations Principles of Responsible Investment (UNPRI). This is a further step towards a framework for investment governance which has been developing over many years.

It is Challenger's policy that, to the extent that information is available, investment managers should incorporate ESG issues into investment analysis and decision making. We also recognise that applying the UNPRI aligns investors with the broader objectives of society.

Our workplace and people

At Challenger, our employees are key to our success and we foster and promote a work environment where diversity is embraced and our people are motivated to perform at their best.

Challenger seeks to provide an inclusive workforce and values the capability and experience diversity brings to the organisation. We recognise that an inclusive work environment increases our ability to attract and retain the best talent from the widest pool of candidates, enabling us to build upon our high performing team. We also recognise that successfully harnessing diverse thought and working styles contributes to innovative and long-term sustainable outcomes.

Sustainability (continued)

Sustainable business practices (continued)

Our workplace and people (continued)

Our Diversity Policy emphasises Challenger's commitment to employees being treated fairly, equally and with respect when employment and career decisions are made; and sets measurable objectives to ensure that the policy is effective.

The Board has oversight of diversity, and the Leadership Team is accountable for promoting and fostering an environment with equal access to opportunities and growth. Gender diversity targets are monitored by both groups on a monthly basis and on a quarterly basis by all managers using our diversity scorecard.

Challenger is committed to creating a great place to work for all employees. An employee engagement survey was conducted in March 2016 and administered by a new external provider – Willis Towers Watson. Participation was high with 89% of employees providing feedback.

The overall sustainable employee engagement score was 88%, placing us well above the Australian National norm, Global Financial Services norm and Global High Performing Companies norm.

Sustainable business impacts

Environmental management

Challenger is committed to reducing our impact on the environment by raising employee awareness; using technologies that minimise our use of resources; and occupying sustainable places of work.

Premises

In January 2016, we relocated our Sydney head office to 5 Martin Place (representing 90% of our workforce), a 5 star NABERS and Green Star rated building.

In addition to improvements in energy efficiency, enhanced waste management, recycling processes and improved printer ratios have been implemented. This move reinforces our commitment to energy efficiency and reducing our carbon footprint.

Challenger is carbon neutral for our business operations

Challenger commenced a partnership with Climate Friendly and introduced a program of offsetting our greenhouse gas emissions in 2013.

The following year we extended this commitment to include our waste (Sydney head office), taxi trips, paper disposal, and 20% of air travel.

In 2015, Challenger offset all relevant greenhouse gas emissions for all offices making our business operations carbon neutral. This will be continued in 2016.

Community partnerships and giving

We partner, and have long-standing relationships with, a range of charitable and not-for-profit organisations supporting a broad demographic of Australians.

Our community partnerships include Alzheimer's Australia; Barnardos; Bear Cottage; beyondblue; Meals on Wheels; and the National Seniors Foundation Trust.

Through Challenger's Community Giving Program, employees can make regular pre-tax donations directly from their salary to one of our community partners. Employee contributions are matched by Challenger up to $500 per employee per year.

Volunteering

Challenger believes volunteering is a significant way in which employees can contribute to the community. Employees are provided with one paid day of volunteering leave each year to offer voluntary services to a not-for-profit organisation, or environmental, community or charitable project.

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

challenger.com.au/sustainabilityreport

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	2016 $M	2015 $M
Revenue	1	1,813.3	1,689.0
Expenses	2	(1,188.6)	(1,051.1)
Finance costs	15	(229.6)	(246.8)
Share of profits of associates	22	16.6	15.3
Profit before income tax		**411.7**	**406.4**
Income tax expense	4	(81.8)	(78.5)
Profit for the year		**329.9**	**327.9**
Profit attributable to shareholders of Challenger Limited		327.7	299.0
Profit attributable to non-controlling interests		2.2	28.9
Profit for the year		**329.9**	**327.9**
Other comprehensive income			
Items that may be reclassified to profit and loss, net of tax			
Translation of foreign entities	14	35.0	20.7
Hedge of net investment in foreign operations	14	(35.5)	(23.5)
Cash flow hedges – SPV[1]	14	(1.4)	1.8
Other comprehensive expense for the year		(1.9)	(1.0)
Total comprehensive income for the year		**328.0**	**326.9**
Comprehensive income attributable to shareholders of Challenger Limited		325.8	298.0
Comprehensive income attributable to non-controlling interests		2.2	28.9
Total comprehensive income for the year		**328.0**	**326.9**
Earnings per share attributable to ordinary shareholders of Challenger Limited		cents	cents
Basic	17	58.5	54.8
Diluted	17	55.4	51.4

[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	2016 $M	2015 $M
Assets			
Cash and cash equivalents	11	526.9	409.7
Cash and cash equivalents – SPV	7	146.9	183.9
Receivables		257.8	245.3
Mortgage assets – SPV	7	1,677.6	2,231.3
Derivative assets	10	788.3	584.7
Financial assets – fair value through profit and loss	5	13,104.3	10,926.4
Investment property held for sale	6	70.6	286.7
Investment and development property	6	3,499.3	2,826.4
Finance leases		57.8	40.4
Current tax assets	4	13.1	-
Property, plant and equipment		145.4	138.8
Investment in associates	22	51.5	43.4
Other assets		54.9	65.2
Goodwill	24	571.6	531.0
Other intangible assets	24	12.3	18.4
Total assets of shareholders of Challenger Limited, policyholders, external unit holders and non-controlling interests		**20,978.3**	**18,531.6**
Liabilities			
Payables		607.0	258.9
Derivative liabilities	10	843.6	698.9
Interest bearing financial liabilities	13	4,148.8	2,925.6
Interest bearing financial liabilities – SPV	7	1,628.4	2,192.8
External unit holders' liabilities	9	1,315.5	944.7
Provisions		12.5	23.8
Current tax liability	4	-	23.6
Deferred tax liabilities	4	180.0	131.7
Life contract liabilities	8	9,558.5	8,693.0
Total liabilities of shareholders of Challenger Limited, policyholders, external unit holders and non-controlling interests		**18,294.3**	**15,893.0**
Net assets of shareholders of Challenger Limited and non-controlling interests		**2,684.0**	**2,638.6**
Equity			
Contributed equity	12	1,546.7	1,527.2
Reserves	14	(7.9)	23.7
Retained earnings	14	1,142.1	992.3
Total equity of shareholders of Challenger Limited		**2,680.9**	**2,543.2**
Non-controlling interests		3.1	95.4
Total equity of shareholders of Challenger Limited and non-controlling interests		**2,684.0**	**2,638.6**

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 2015	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 2014		1,237.5	54.9	(0.4)	(4.0)	19.3	846.0	2,153.3	122.8	2,276.1
Profit for the year	14	-	-	-	-	-	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										
Ordinary shares issued	12	287.2	-	-	-	-	-	287.2	-	287.2
Shares purchased in the CPP Trust	12	(60.9)	-	-	-	-	-	(60.9)	-	(60.9)
Vested shares released from the CPP Trust	12	78.4	-	-	-	-	-	78.4	-	78.4
CPP deferred share purchases	12	(15.0)	-	-	-	-	-	(15.0)	-	(15.0)
Share-based payment expense less releases	14	-	(44.9)	-	-	-	-	(44.9)	-	(44.9)
Dividends paid	16	-	-	-	-	-	(152.7)	(152.7)	-	(152.7)
Other movements	14	-	-	-	0.2	(0.4)	-	(0.2)	(56.3)	(56.5)
Balance at 30 June 2015 and 1 July 2015		**1,527.2**	**10.0**	**1.4**	**(6.6)**	**18.9**	**992.3**	**2,543.2**	**95.4**	**2,638.6**
For the year ended 30 June 2016										
Profit for the year	14	-	-	-	-	-	327.7	327.7	2.2	329.9
Other comprehensive income for the year		-	-	(1.4)	(0.5)	-	-	(1.9)	-	(1.9)
Total comprehensive income for the year		**-**	**-**	**(1.4)**	**(0.5)**	**-**	**327.7**	**325.8**	**2.2**	**328.0**
Other equity movements										
Ordinary shares issued[1]	12	11.2	-	-	-	-	-	11.2	-	11.2
Shares purchased in the CPP Trust	12	(41.3)	-	-	-	-	-	(41.3)	-	(41.3)
Vested shares released from the CPP Trust	12	53.7	-	-	-	-	-	53.7	-	53.7
CPP deferred share purchases	12	(4.1)	-	-	-	-	-	(4.1)	-	(4.1)
Share-based payment expense less releases	14	-	(22.9)	-	-	-	-	(22.9)	-	(22.9)
Dividends paid	16	-	-	-	-	-	(177.9)	(177.9)	-	(177.9)
Other movements	14	-	-	-	-	(6.8)	-	(6.8)	(94.5)	(101.3)
Balance at 30 June 2016		**1,546.7**	**(12.9)**	**-**	**(7.1)**	**12.1**	**1,142.1**	**2,680.9**	**3.1**	**2,684.0**

[1] The Company issued 890,868 ordinary shares on 14 October 2015 and 600,598 ordinary shares on 29 March 2016 to shareholders who took part in the Company's Dividend Reinvestment Plan (DRP).

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	2016 $M	2015 $M
Operating activities			
Receipts from customers		636.2	631.7
Annuity and premium receipts	8	3,367.8	2,764.2
Annuity and claim payments	8	(2,955.1)	(2,361.3)
Payments to reinsurer	8	(5.2)	(4.6)
Receipts from external unit holders		998.5	944.0
Payments to external unit holders		(706.1)	(1,130.7)
Payments to vendors and employees		(563.2)	(539.7)
Dividends received		56.4	77.1
Interest received		611.0	588.0
Interest paid		(93.4)	(84.6)
Income tax paid		(64.5)	(68.2)
Net cash inflows from operating activities	11	**1,282.4**	**815.9**
Investing activities			
Payments on net purchases of investments		(2,054.1)	(1,392.5)
Payments for purchase of controlled entities		(36.5)	-
Net mortgage loan repayments		505.6	749.0
Proceeds from sale of associate		45.0	-
Payments for purchase of associate interest		(17.4)	-
Payments for net purchases of property, plant and equipment		(19.1)	(5.1)
Net cash outflows from investing activities		**(1,576.5)**	**(648.6)**
Financing activities			
Proceeds from issue of ordinary shares		11.2	290.2
Proceeds from/(repayment) of borrowings – interest bearing financial liabilities[1]	13	590.0	(574.7)
Payments for Treasury shares		(49.0)	(74.8)
Dividends paid		(177.9)	(152.7)
Proceeds from issue of Challenger Capital Notes		-	345.0
Costs associated with issue of Challenger Capital Notes and ordinary shares		-	(13.6)
Distributions paid to non-controlling interests		-	(1.1)
Net cash inflows/(outflows) from financing activities		**374.3**	**(181.7)**
Net increase/(decrease) in cash and cash equivalents		**80.2**	**(14.4)**
Cash and cash equivalents at the beginning of the year		593.6	608.0
Cash and cash equivalents at the end of the year		**673.8**	**593.6**
Cash and cash equivalents	11	526.9	409.7
Cash and cash equivalents – SPV	7	146.9	183.9
Cash and cash equivalents at the end of the year		**673.8**	**593.6**

[1] Includes $569.9 million relating to SPV's.

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 2016 was authorised for issue in accordance with a resolution of the Directors of the Company on 15 August 2016.

(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 107 *Statement of Cash Flows*

On 29 January 2016, IFRS announced amendments to IAS 7 *Statement of Cash Flows*. The changes require increased information with respect to changes in financing liabilities. An entity shall provide disclosures that enable users of financial liabilities to evaluate changes in a company's debt. The revised standard is effective for annual periods beginning on or after 1 January 2017. The AASB has adopted the amendment to its equivalent standard AASB 107 in March 2016. The Group has elected to early adopt with a revised interest bearing financial liability disclosure note and footnote back to the statement of cash flows. There is no impact to the financial position of the Group as a result of early adoption.

In addition to AASB 107, a number of new accounting standards and amendments have become effective from 1 July 2015 but have not been considered to have a material impact on the financial statements.

Accounting standards and interpretations issued but not yet effective

AASB 16 *Leases*

This standard amends the accounting for leases. The amendment removes the distinction between operating and finance leases. Lessees will be required to bring all leases on to the statement of financial position. Lessor accounting remains largely unchanged. IFRS 16 will be effective for annual periods beginning on or after 1 January 2019.

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 currently not anticipated.

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 has not quantified the impact of adopting the 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 or insurance contracts. The effective date of this standard has been deferred to 1 January 2018.

The Group has performed an initial assessment and does not expect any material impact as a result of complying with the new requirements.

(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 contained in this report and the financial report have been rounded to the nearest $100,000 under the option available to the Group under Australian Securities and Investments Commission (ASIC) Corporations Instrument 2016/191.

(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 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 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 10 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 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) Receivables

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.

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

(ix) Payables

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

(x) 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.

(xi) 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 (CGU) 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 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.

(xii) 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 8 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 2016 $M	30 June 2015 $M
Investment revenue		
Fixed income securities and cash		
Interest revenue	711.9	796.2
Net realised and unrealised gains on fixed income securities[1]	149.8	134.6
Investment property and property securities		
Property rental revenue	334.1	266.2
Dividend revenue	19.2	22.2
Net realised and unrealised gains on investment property and property securities	132.1	98.2
Revenue from sale of development properties	30.2	25.6
Equity and infrastructure investments		
Dividend revenue	22.9	39.8
Net realised and unrealised (losses)/gains on equity investments	(8.7)	25.9
Net realised and unrealised gains on infrastructure investments	69.6	39.5
Other		
Net realised and unrealised gains on foreign exchange translation and hedges	41.3	48.5
Net realised and unrealised losses on interest rate derivatives	(85.5)	(99.3)
Net realised and unrealised gains on equity swap derivatives	25.2	28.8
Management fee revenue	172.3	158.9
Other revenue		
Life insurance contract premiums and related revenue	598.0	490.8
Gain on sale of associate	40.0	-
Change in life insurance contract liabilities	(395.6)	(332.6)
Change in life investment contract liabilities	(4.9)	(56.1)
Change in reinsurance contract liabilities	(38.6)	1.8
Total revenue	**1,813.3**	**1,689.0**

[1] Includes fair value movements in subordinated debt (Note 19 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.
- 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.

Note 1 Revenue (continued)

Recognition and measurement (continued)

- 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 8 Life contract liabilities for more detail on the recognition and measurement of life contract liabilities.

Note 2 Expenses

	30 June 2016 $M	30 June 2015 $M
Life insurance contract claims and expenses	226.6	210.5
Cost of life insurance contract liabilities	146.4	124.1
Cost of life investment contract liabilities	242.2	238.1
Reinsurance contracts	1.7	1.6
Investment property related expenses[1]	103.0	68.4
Development properties cost of sales	35.3	23.9
Management fee expense	83.1	87.7
Distribution expenses	37.7	41.8
Employee expenses	147.7	127.0
Employee share-based payments	24.0	26.3
Superannuation	7.0	6.7
Occupancy expense – operating lease	14.0	4.2
Depreciation and amortisation expense	16.1	18.6
Technology and communications	24.4	23.9
Professional fees	18.4	19.1
Impairment loss on equity accounted associates	10.6	-
Other expenses	50.4	29.2
Total expenses	**1,188.6**	**1,051.1**

[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.
- 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 8 Life contract liabilities for more detail on the recognition and measurement of life contract liabilities.

Note 3 Segment information

The reporting segments[1] 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	
	2016 $M	2015 $M	2016 $M	2015 $M	2016 $M	2015 $M	2016 $M	2015 $M	2016 $M	2015 $M
Net income	592.4	543.8	127.7	117.5	720.1	661.3	1.0	1.3	721.1	662.6
Operating expenses	(92.6)	(87.1)	(90.3)	(73.4)	(182.9)	(160.5)	(66.7)	(63.7)	(249.6)	(224.2)
Normalised EBIT	**499.8**	**456.7**	**37.4**	**44.1**	**537.2**	**500.8**	**(65.7)**	**(62.4)**	**471.5**	**438.4**
Interest and borrowing costs	-	-	-	-	-	-	(4.1)	(3.8)	(4.1)	(3.8)
Normalised net profit/(loss) before tax	**499.8**	**456.7**	**37.4**	**44.1**	**537.2**	**500.8**	**(69.8)**	**(66.2)**	**467.4**	**434.6**
Tax on normalised profit									(105.7)	(100.6)
Normalised net profit after tax									**361.7**	**334.0**
Investment experience after tax									(56.1)	(35.0)
Significant items after tax									22.1	-
Profit attributable to the shareholders of Challenger Ltd									**327.7**	**299.0**
Other statutory segment information										
Revenue from external customers	948.8	760.6	144.9	128.1	1,093.7	888.7	7.7	4.1	1,101.4	892.8
Interest revenue	689.4	758.9	-	-	689.4	758.9	22.5	37.3	711.9	796.2
Interest expense	(209.7)	(230.0)	(0.5)	-	(210.2)	(230.0)	(19.4)	(16.8)	(229.6)	(246.8)
Intersegment revenue	(33.7)	(40.1)	33.7	40.1	-	-	-	-	-	-
Depreciation and amortisation	(7.2)	(11.1)	(0.4)	(0.1)	(7.6)	(11.2)	(8.5)	(7.4)	(16.1)	(18.6)
As at 30 June										
Segment assets	14,627.7	13,251.0	219.3	161.1	14,847.0	13,412.1	6,128.2	5,024.1	20,975.2	18,436.2
Segment liabilities	(12,138.3)	(10,842.0)	(43.6)	(32.9)	(12,181.9)	(10,874.9)	(6,112.4)	(5,018.1)	(18,294.3)	(15,893.0)
Net assets attributable to shareholders	**2,489.4**	**2,409.0**	**175.7**	**128.2**	**2,665.1**	**2,537.2**	**15.8**	**6.0**	**2,680.9**	**2,543.2**

[1] Refer below 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.

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 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.

Note 3 Segment information (continued)

Definitions (continued)

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.

The normalised growth rates for the year are +4.5% 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. The equity normalised growth rate was reduced from 6.0% in prior periods to 4.5% on 1 July 2015, reflecting lower equity risk premium expectations for future periods.

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.

Significant items after tax

The Group presents additional non-IFRS financial information to the market to provide meaningful insights into the financial condition of the business. Due consideration has been given to ensure that disclosure of Challenger's normalised profit framework is explained, reconciled and calculated consistently period-on-period. Within this framework, Challenger defines significant items as non-recurring or abnormal income or expense items. None of these items are deemed to have occurred as part of normal operating activities and are considered by management to be non-recurring or abnormal items and have therefore been classified as significant items for the year ending 30 June 2016 in accordance with the definition.

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.

Note 3 Segment information (continued)

	30 June 2016 $M	30 June 2015 $M
Reconciliation of management to statutory view of after-tax profit		
Operating segments normalised net profit before tax	537.2	500.8
Corporate and other normalised net loss before tax	(69.8)	(66.2)
Normalised net profit before tax (management view of pre-tax profit)	**467.4**	**434.6**
Tax on normalised profit	(105.7)	(100.6)
Normalised net profit after tax	**361.7**	**334.0**
Investment experience after tax	(56.1)	(35.0)
Significant items after tax	22.1	-
Profit attributable to the shareholders of Challenger Limited	**327.7**	**299.0**
Profit attributable to non-controlling interests excluded from management view	2.2	28.9
Statutory view of profit after tax	**329.9**	**327.9**
Reconciliation of management view of revenue to statutory revenue		
Operating segments	720.1	661.3
Corporate and other	1.0	1.3
Net income (management view of revenue)	**721.1**	**662.6**
Expenses and finance costs offset against revenue		
SPV expenses and finance costs offset against SPV income	53.3	81.7
Distribution expenses offset against related income	37.7	41.8
Change in life contract liabilities and reinsurance contracts recognised in expenses	616.9	574.4
Property related expenses offset against property income	103.0	68.4
Interest and loan amortisation costs	156.3	148.2
Management fee expense	83.1	87.7
Gain on sale of associate	40.0	-
Adjustment for non-controlling interests and other items	70.3	74.2
Difference between management view of investment experience and statutory recognition		
Actual capital growth	(38.5)	40.5
Normalised capital growth	(100.5)	(80.4)
Annuity valuation experience	70.6	(10.1)
Statutory revenue (refer Note 1 Revenue)	**1,813.3**	**1,689.0**

Note 4 Income tax

Analysis of income tax expense	30 June 2016 $M	30 June 2015 $M
Current income tax expense for the year	(47.2)	(76.1)
Current income tax benefit/(expense) prior year adjustment	8.7	(1.0)
Deferred income tax expense	(38.3)	(2.5)
Deferred income tax (expense)/benefit prior period adjustment	(5.0)	1.1
Income tax expense	**(81.8)**	**(78.5)**
Income tax expense on translation of foreign entities	(15.4)	(9.2)
Income tax benefit on hedge of net investment in foreign operations	15.2	10.0
Income tax (expense)/benefit from other comprehensive income	**(0.2)**	**0.8**

Reconciliation of income tax expense	30 June 2016 $M	30 June 2015 $M
Profit before income tax	411.7	406.4
Prima facie income tax based on the Australian company tax rate of 30%	(123.5)	(121.9)
Tax effect of amounts not assessable/deductible in calculating taxable income:		
– non-assessable and non-deductible items[1]	24.6	14.2
– rate differential on offshore income	16.3	14.9
– tax adjustment in respect of non-controlling interests	0.7	8.7
– other items	0.1	5.6
Income tax expense	**(81.8)**	**(78.5)**
Underlying effective tax rate[2]	**20.0%**	**20.8%**

[1] The 30 June 2016 amount includes a reduction in the tax expense for $14.7 million for previously unbooked capital losses brought onto the balance sheet in respect of the capital gain on sale of Kapstream.

[2] The calculation of the underlying effective tax rate excludes the non-controlling interests' profit of $2.2 million (30 June 2015: $28.9 million).

	Statement of financial position		Statement of comprehensive income	
Analysis of deferred tax	30 June 2016 $M	30 June 2015 $M	30 June 2016 $M	30 June 2015 $M
Deferred tax assets				
Accruals and provisions	32.1	30.8	1.3	(2.7)
Employee entitlements	3.5	3.3	0.2	0.3
Losses	23.7	21.8	7.4	1.1
Other	28.0	14.1	14.7	(3.1)
Total deferred tax assets	**87.3**	**70.0**	**23.6**	**(4.4)**
Deferred tax liabilities				
Deferred acquisition and origination costs	-	(1.4)	1.4	0.5
Unrealised foreign exchange movements	(22.3)	(17.3)	(4.7)	(8.5)
Unrealised gains on investments	(167.5)	(116.4)	(51.1)	19.4
Other	(77.5)	(66.6)	(12.5)	(8.4)
Total deferred tax liabilities	**(267.3)**	**(201.7)**	**(66.9)**	**3.0**
Net deferred tax liability (statement of financial position)	**(180.0)**	**(131.7)**		
Deferred income tax expense (statement of comprehensive income)			**(43.3)**	**(1.4)**

Note 4 Income tax (continued)

Analysis of current tax (asset)/liability	30 June 2016 $M	30 June 2015 $M
Opening balance	23.6	34.4
Current year income tax expense	47.2	76.1
Current tax prior year adjustment	(8.7)	1.0
Tax in equity	(7.6)	(12.5)
Tax losses utilised	(1.7)	(6.7)
Income tax paid	(64.5)	(68.2)
Other	(1.4)	(0.5)
Closing balance	**(13.1)**	**23.6**

Income tax paid in 2016 was $64.5 million (2015: $68.2 million) and was higher than the current year income tax expense for the period due to using a higher PAYG instalment rate based on prior year tax payable. This is predominantly a timing difference 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 remaining revenue losses of the Challenger tax consolidated group have been utilised in the year to 30 June 2016. A deferred tax asset in relation to $23.4 million (30 June 2015: $20.0 million) of revenue losses (net) has been recognised in respect of non-tax consolidated group entities. A further deferred tax asset of $17.5 million (30 June 2015: $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

The Group has $422.3 million (30 June 2015: $299.0 million) of gross unused capital losses for which no deferred tax asset has been recognised. The increase in the period is largely attributable to a trust joining the Challenger tax consolidated group which brought in 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 of the Group.

Note 5 Financial assets – fair value through profit and loss

	30 June 2016 $M	30 June 2015 $M
Domestic sovereign bonds and semi-government bonds	4,364.4	2,111.5
Floating rate notes and corporate bonds	4,788.0	5,016.0
Residential mortgage and asset-backed securities	2,065.2	2,238.5
Non-SPV mortgage assets	245.9	318.3
Fixed income securities	**11,463.5**	**9,684.3**
Shares in listed and unlisted corporations	54.8	43.9
Unit trusts, managed funds and other	545.4	304.7
Equity securities	**600.2**	**348.6**
Units in listed and unlisted infrastructure trusts	369.4	290.1
Other infrastructure investments	331.7	306.0
Infrastructure investments	**701.1**	**596.1**
Indirect property investments in listed and unlisted trusts	339.5	297.4
Property securities	**339.5**	**297.4**
Total financial assets – fair value through profit and loss	**13,104.3**	**10,926.4**
Current	5,744.1	5,476.9
Non-current	7,360.2	5,449.5
	13,104.3	**10,926.4**

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 and when all risks and rewards of ownership have been substantially transferred. Financial assets are then derecognised when the right to receive cash flows from the asset has expired.

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 at 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 18 Financial risk management for further disclosure.

Note 6 Investment and development property

	30 June 2016 $M	30 June 2015 $M
Investment property held for sale[1,2]	70.6	286.7
Investment property in use	3,378.7	2,736.6
Investment property under development	83.3	19.2
Total investment property	**3,532.6**	**3,042.5**
Development property held for resale[2]	37.3	70.6
Total investment and development property[3]	**3,569.9**	**3,113.1**

[1] Held for sale properties: Innaloo Cinema and Elder House (30 June 2015: The Forum, Cisco, Innaloo Cinema and Jam Factory).

[2] Development property held for resale is held at the lower of cost or net realisable value.

[3] 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)

Reconciliation of carrying amounts	Investment property in use 30 June 2016 $M	Investment property in use 30 June 2015 $M	Investment property under development 30 June 2016 $M	Investment property under development 30 June 2015 $M	Development property held for resale 30 June 2016 $M	Development property held for resale 30 June 2015 $M
Balance at the beginning of the year	2,736.6	2,125.5	19.2	18.8	70.6	77.8
Movements for the year						
– acquisitions[1]	558.1	886.8	12.0	-	-	-
– disposals	(84.7)	-	-	-	(35.3)	(23.9)
– transfers to investment property held for sale	(25.8)	(286.7)	-	-	-	-
– capital expenditure	16.9	7.7	50.2	0.5	16.8	16.7
– net revaluation gain/(loss)	64.8	(3.9)	1.9	(0.1)	(14.8)	-
– foreign exchange gain	112.8	7.2	-	-	-	-
Balance at the end of the year	**3,378.7**	**2,736.6**	**83.3**	**19.2**	**37.3**	**70.6**

[1] Investment property acquisitions: Gateway, NT $12.0 million; 215 Adelaide Street, QLD $237.9 million; Channel Court, TAS $79.8 million; North Rocks, NSW $135.0 million; 21 O'Sullivan Circuit, NT $47.6 million; 31 O'Sullivan Circuit, NT $28.6 million; Fitta Natalie Hatsukaichi, Japan $11.4 million; MaxValu Tarumi, Japan $16.9 million; Karratha (additional land), WA $0.9 million.

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).

Challenger considers 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 for sale 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 2016 $M	Cap rate 2016[3] %	Last external valuation date	Carrying value 2015 $M	Cap rate 2015[3] %
Investment property in use							
Australia							
1-9 Toll Drive, Altona North, VIC	31-Dec-08	3.3	4.0	7.50	30-Jun-16	4.0	8.00
2-10 Toll Drive, Altona North, VIC	31-Dec-08	6.3	7.1	7.00	31-Dec-15	6.6	7.75
12-30 Toll Drive, Altona North, VIC	31-Dec-08	13.9	13.3	7.50	30-Jun-16	14.0	7.75
6 Foray Street, Fairfield, NSW	31-Dec-08	-	-	-	31-Dec-15	11.9	9.00
Spotlight, Laverton North, VIC	31-Dec-08	16.3	20.6	7.00	31-Dec-15	19.5	7.50
Cosgrave Industrial Park, Enfield, NSW	31-Dec-08	56.9	69.5	6.84	30-Jun-16	65.0	7.00
21 O'Sullivan Circuit, NT	27-Jan-16	47.6	47.6	7.75	-	-	-
31 O'Sullivan Circuit, NT	27-Jan-16	28.6	28.6	8.25	-	-	-
31 Queen Street, VIC	31-Mar-11	96.2	118.4	6.50	31-Dec-15	102.1	7.50
35 Clarence Street, NSW	15-Jan-15	145.0	149.0	6.50	31-Dec-15	144.9	7.00
53 Albert Street, QLD	12-Dec-14	222.5	217.5	6.63	30-Jun-16	210.5	6.75
565 Bourke Street, VIC	28-Jan-15	86.4	88.6	6.50	31-Dec-15	85.6	7.25
ABS Building, ACT	01-Jan-00	120.3	126.5	7.50	30-Jun-16	126.5	7.75
215 Adelaide Street, QLD	31-Jul-15	238.3	230.0	6.75	30-Jun-16	-	-
County Court, VIC	30-Jun-00	212.0	290.6	6.50	31-Dec-15	281.5	7.43
DIBP (formerly DIAC) Building, ACT	01-Dec-01	103.3	121.0	7.50	30-Jun-16	119.0	8.75
Discovery House, ACT	28-Apr-98	87.4	104.2	7.75	31-Dec-15	101.5	7.75
Elder House, SA	21-Jun-02	48.2	25.8	8.75	30-Jun-16	27.0	9.25
Executive Building, TAS	30-Mar-01	30.4	38.2	7.75	31-Dec-15	33.2	8.50
Makerston House, QLD	14-Dec-00	66.9	65.4	8.50	31-Dec-15	66.7	8.75
The Forum, Cisco, NSW	05-Jan-01	-	-	-	-	111.7	8.25
The Forum, Verizon, NSW	05-Jan-01	-	-	-	-	71.7	8.50
Bunbury Forum, WA	03-Oct-13	152.1	151.0	6.50	30-Jun-16	147.0	6.75
Century City Walk, VIC	16-Oct-06	30.1	41.2	7.25	30-Jun-16	39.1	7.50
Channel Court, TAS	21-Aug-15	80.1	80.0	7.50	30-Jun-16	-	-
Golden Grove, SA	31-Jul-14	139.1	142.3	6.50	30-Jun-16	132.9	6.75
Innaloo Cinema, WA	17-Dec-01	32.0	44.8	7.25	30-Jun-16	45.1	7.25
Jam Factory, VIC	04-Jul-00	-	-	-	-	129.8	7.25
Karratha, WA	28-Jun-13	53.4	62.3	7.00	30-Jun-16	57.4	7.00
Kings Langley, NSW	29-Jul-01	15.9	21.0	6.50	30-Jun-16	19.5	7.25
Lennox, NSW	27-Jul-13	27.5	33.5	6.50	30-Jun-16	29.7	7.00
Next Hotel, QLD	25-Mar-15	142.0	136.5	6.85	31-Dec-15	141.8	7.38
North Rocks, NSW	18-Sep-15	135.4	127.5	6.75	30-Jun-16	-	-
The Barracks, QLD	31-Oct-14	153.2	149.5	7.50	30-Jun-16	147.0	7.50
Total Australia		**2,590.6**	**2,755.5**			**2,492.2**	

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[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 2016 $M	Cap rate 2016 %	Last external valuation date	Carrying value 2015 $M	Cap rate 2015 %
Europe							
Rozalia Park	12-Apr-07	81.1	20.4	9.25	30-Jun-16	17.3	10.19
Rue Charles Nicolle, Villeneuve les Beziers	31-Dec-08	18.3	12.5	8.75	30-Jun-16	10.7	8.75
Avenue de Savigny, Aulnay sous Bois	31-Dec-08	20.3	14.0	7.00	30-Jun-16	14.4	6.75
105 Route d'Orleans, Sully sur Loire	31-Dec-08	27.1	10.0	10.00	30-Jun-16	10.2	9.75
140 Rue Marcel Paul, Gennevilliers	31-Dec-08	14.0	10.1	9.75	30-Jun-16	10.1	9.50
ZAC Papillon, Parcay-Meslay	31-Dec-08	10.1	7.2	9.25	30-Jun-16	6.9	9.25
Japan							
Aeon Kushiro	31-Jan-10	27.8	33.0	5.50	30-Jun-16	26.6	5.60
Carino Chitosedai	31-Jan-10	118.3	131.2	4.80	31-Dec-15	102	5.00
Carino Tokiwadai	31-Jan-10	77.0	84.3	4.80	30-Jun-16	67.5	4.90
DeoDeo Kure	31-Jan-10	31.4	31.8	5.80	30-Jun-16	25.9	5.90
Fitta Natalie Hatsukaichi	28-Aug-15	11.4	14.5	6.00	31-Dec-15	-	-
Izumiya Hakubaicho	31-Jan-10	68.8	74.4	5.10	31-Dec-15	59.2	5.30
Kansai Super Saigo	31-Jan-10	13.1	14.1	5.50	30-Jun-16	11.3	5.60
Kojima Nishiarai	31-Jan-10	12.2	14.1	4.90	30-Jun-16	9.2	5.00
Life Asakusa	31-Jan-10	27.8	34.8	4.70	30-Jun-16	26.2	4.90
Life Higashinakano	31-Jan-10	32.9	37.3	4.80	31-Dec-15	29.7	4.90
Life Nagata	31-Jan-10	25.2	28.5	5.00	30-Jun-16	22.8	5.10
MaxValu Tarumi	28-Aug-15	16.9	20.2	5.80	31-Dec-15	-	-
Seiyu Miyagino	31-Jan-10	9.7	10.9	5.70	30-Jun-16	8.7	5.80
Valor Takinomizu	31-Jan-10	26.8	26.3	6.10	31-Dec-15	21.3	6.10
Valor Toda	31-Jan-10	42.5	45.2	5.70	30-Jun-16	36.3	5.80
Yaoko Sakato Chiyoda	31-Jan-10	18.2	19.0	5.10	31-Dec-15	14.8	5.40
Total international		**730.9**	**693.8**			**531.1**	
Total investment property in use and held for sale[1]		**3,321.5**	**3,449.3**			**3,023.3**	
Investment property under development							
Australia							
Gateway, NT	01-Jul-15	51.6	51.8	-	n/a	-	-
TRE Data Centre, ACT	14-Apr-10	12.8	12.8	-	n/a	12.4	-
Enfield, NSW	31-Dec-08	30.3	18.7	-	30-Jun-16	6.8	-
Total investment property under development		**94.7**	**83.3**			**19.2**	
Development property							
Australia							
Maitland	6-Dec-06	52.1	37.3	-	n/a	70.6	-
Total development property		**52.1**	**37.3**			**70.6**	

[1] At 30 June 2016, the investment property portfolio occupancy rate for Australia was 94.7% (30 June 2015: 98.0%) with a weighted average lease expiry of 4.1 years (30 June 2015: 4.4 years), Europe 95.0% (30 June 2015: 87.9%) with a weighted average lease expiry of 1.7 years (30 June 2015: 1.7 years) and Japan 100% (30 June 2015: 100%) with a weighted average lease expiry of 8.4 years (30 June 2015: 9.1 years).

Note 7 Special Purpose Vehicles

Consolidated	30 June 2016 $M	30 June 2015 $M
Cash and cash equivalents	146.9	183.9
Mortgage assets[1]	1,677.6	2,231.3
Derivative assets	0.7	2.2
Other assets	-	1.0
Total assets	**1,825.2**	**2,418.4**
Payables	196.1	223.4
Derivative liabilities	0.7	0.8
Interest bearing financial liabilities[1]	1,628.4	2,192.8
Total liabilities	**1,825.2**	**2,417.0**
Net assets	**-**	**1.4**
Cash flow hedge reserve	-	1.4
Total equity attributable to residual income unit holders	**-**	**1.4**

[1] $381.8 million (30 June 2015: $518.2 million) of the Mortgage assets balance is considered current, and $370.7 million (30 June 2015: $509.3 million) of the Interest bearing financial liabilities balance is considered current.

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.

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.

Analysis of SPV mortgage assets impairment provision	30 June 2016 $M	30 June 2015 $M
Balance at the beginning of the year	40.8	62.7
Additional provisions and adjustments to estimates	1.6	(0.7)
Utilisation of provision against incurred losses	(2.0)	(21.2)
Balance at the end of the year	**40.4**	**40.8**

Note 8 Life contract liabilities

Fair value of life contract liabilities	30 June 2016 $M	30 June 2015 $M
Life investment contract liabilities – at fair value	6,915.3	6,626.9
Life insurance contract liabilities – at margin on services value	2,555.3	2,013.3
Reinsurance contract liabilities – at margin on services value	87.9	52.8
Total life contract liabilities	**9,558.5**	**8,693.0**

	Life investment contract liabilities		Life insurance contract liabilities		Reinsurance contract liabilities		Total life contract liabilities	
Movement in life contract liabilities	30 June 2016 $M	30 June 2015 $M	30 June 2016 $M	30 June 2015 $M	30 June 2016 $M	30 June 2015 $M	30 June 2016 $M	30 June 2015 $M
Balance at the beginning of the year	6,626.9	6,210.1	2,013.3	1,556.6	52.8	57.6	8,693.0	7,824.3
Deposits and premium receipts	2,769.8	2,273.4	598.0	490.8	-	-	3,367.8	2,764.2
Payments and withdrawals	(2,728.5)	(2,150.8)	(226.6)	(210.5)	(5.2)	(4.6)	(2,960.3)	(2,365.9)
Revenue per Note 1	4.9	56.1	(202.4)	(158.2)	38.6	(1.8)	(158.9)	(103.9)
Expense per Note 2	242.2	238.1	373.0	334.6	1.7	1.6	616.9	574.3
Balance at the end of the year	**6,915.3**	**6,626.9**	**2,555.3**	**2,013.3**	**87.9**	**52.8**	**9,558.5**	**8,693.0**

Analysis of life insurance and reinsurance contract liability and expenses	30 June 2016 $M	30 June 2015 $M
Best estimate liability		
Value of future life insurance contract benefits	2,564.4	2,009.7
Value of future expenses	102.8	79.0
Value of future premiums	(267.4)	(203.7)
Total best estimate liability	**2,399.8**	**1,885.0**
Value of future profit margins	243.4	181.1
Net life insurance and reinsurance contract liability	**2,643.2**	**2,066.1**
Life insurance and reinsurance contract operating expenses		
Maintenance expenses	10.0	7.8
Total life insurance and reinsurance contract operating expenses	**10.0**	**7.8**
Analysis of life contract profit		
Profit margin release on life insurance contracts	14.5	9.4
Loss recognition in respect of life insurance contracts[1]	(103.7)	(86.0)
Loss recognition in respect of life investment contracts	(106.2)	(94.4)
Difference in actual and assumed experience in respect of life insurance contracts	102.2	78.4
Difference in actual and assumed experience in respect of life investment contracts	266.7	251.0
Profit arising from difference between actual and assumed experience	**173.5**	**158.4**
Investment earnings on assets in excess of life contract liabilities	164.9	145.1
Life contract profit after tax	**338.4**	**303.5**

[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 8 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, including 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 2015. Discount rates applied for Australian liabilities were between 2.3-3.3% (30 June 2015: 2.5-4.0%) 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 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.

Note 8 Life contract liabilities (continued)

Valuation (continued)

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

Inflation

Inflation estimates are based on long-term expectations and reviewed at least 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 0.9% for short-term inflation and 1.8% for long-term (30 June 2015: 1.4% short-term, 2.6% 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 LML08 and LFL08 tables, adjusted for Challenger's own recent experience. LML08 and LFL08 are mortality tables developed by the Continuous Mortality Investigation (CMI) based on United Kingdom annuitant lives experience from 2007–2010. 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 0.0-2.8% (30 June 2015: 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 2015: 0.0-4.0%) 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 $3.3 million, $9,552.1 million and $3.1 million respectively (2015: $3.9 million, $8,685.6 million, $3.5 million).

Current/non-current split for total life contracts

There is a fixed settlement date for the majority of life contract liabilities. Approximately $2,481.6 million (2015: $2,071.6 million) of life contract liabilities have a contractual maturity within 12 months of the reporting date. Based on assumptions applied for the 30 June 2016 valuation of life contract liabilities, $2,781.7 million of principal payments on fixed term and lifetime business are expected in the year to 30 June 2017 (30 June 2016: $2,248.3 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 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.

Note 8 Life contract liabilities (continued)

Insurance risk sensitivity analysis

The following table 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	
Insurance risk sensitivity analysis	30 June 2016 $M	30 June 2015 $M	30 June 2016 $M	30 June 2015 $M	30 June 2016 $M	30 June 2015 $M	30 June 2016 $M	30 June 2015 $M
50% increase in the rate of mortality improvement	42.0	104.7	21.5	53.9	(29.4)	(73.3)	(15.1)	(37.7)
10% increase in maintenance expenses	9.0	6.6	9.0	6.6	(6.3)	(4.6)	(6.3)	(4.6)

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 18 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
2016	228.5	399.3	344.5	2,310.1	3,282.4
2015	206.1	348.4	287.9	2,086.3	2,928.7

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 9 External unit holders' liabilities

	30 June 2016 $M	30 June 2015 $M
Current	750.0	590.0
Non-current	565.5	354.7
Total liabilities to external unit holders	**1,315.5**	**944.7**

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 10 Derivative financial instruments

Analysis of derivative financial instruments	30 June 2016 Notional value $M	30 June 2016 Net fair value assets $M	30 June 2016 Net fair value liabilities $M	30 June 2015 Notional value $M	30 June 2015 Net fair value assets $M	30 June 2015 Net fair value liabilities $M
Non-SPV						
Interest rate swaps						
Less than one year	3,094.8	42.2	(3.4)	6,942.8	16.0	(3.5)
One to three years	6,730.5	53.9	(29.7)	6,396.4	88.3	(30.0)
Three to five years	2,640.9	68.1	(42.6)	2,673.7	64.7	(31.3)
Greater than five years	11,834.3	457.9	(410.3)	10,174.2	338.6	(243.7)
Total interest rate swaps	**24,300.5**	**622.1**	**(486.0)**	**26,187.1**	**507.6**	**(308.5)**
Inflation-linked swaps						
Less than one year	297.0	9.4	(0.1)	315.0	-	(6.8)
One to three years	664.0	16.5	(6.0)	335.0	-	(1.1)
Three to five years	162.0	6.2	-	40.0	0.7	-
Greater than five years	499.0	31.7	(13.2)	344.0	0.1	(2.3)
Total inflation-linked swaps	**1,622.0**	**63.8**	**(19.3)**	**1,034.0**	**0.8**	**(10.2)**
Futures contracts						
Less than one year	3,963.1	-	(0.5)	3,148.2	-	(0.1)
Total futures contracts	**3,963.1**	**-**	**(0.5)**	**3,148.2**	**-**	**(0.1)**
Forward currency contracts						
Less than one year	2,415.2	46.9	(16.8)	1,950.4	20.8	(24.5)
One to three years	3.7	-	-	12.5	0.1	-
Total forward currency contracts	**2,418.9**	**46.9**	**(16.8)**	**1,962.9**	**20.9**	**(24.5)**
Cross-currency swaps						
Less than one year	246.0	-	(47.7)	669.7	2.7	(81.4)
One to three years	788.4	9.5	(98.7)	693.0	15.5	(105.1)
Three to five years	639.4	22.3	(117.9)	649.0	23.8	(86.5)
Greater than five years	83.5	-	(23.7)	193.4	-	(55.2)
Total cross-currency swaps	**1,757.3**	**31.8**	**(288.0)**	**2,205.1**	**42.0**	**(328.2)**
Equity swaps						
Less than one year	1,053.2	16.1	(22.1)	771.5	5.3	(18.7)
One to three years	261.4	6.0	(5.5)	415.7	4.0	(4.9)
Total equity swaps	**1,314.6**	**22.1**	**(27.6)**	**1,187.2**	**9.3**	**(23.6)**
Credit default swaps						
Less than one year	134.3	0.8	-	32.5	-	(0.1)
One to three years	175.9	0.1	(3.9)	222.5	1.9	(1.8)
Three to five years	10.0	-	(0.1)	49.0	-	(0.8)
Greater than five years	9.4	-	(0.7)	9.1	-	(0.3)
Total credit default swaps	**329.6**	**0.9**	**(4.7)**	**313.1**	**1.9**	**(3.0)**
Options						
Less than one year	-	-	-	0.4	-	-
One to three years	0.3	-	-	0.5	-	-
Total options	**0.3**	**-**	**-**	**0.9**	**-**	**-**
Total non-SPV	**35,706.3**	**787.6**	**(842.9)**	**36,038.5**	**582.5**	**(698.1)**

Note 10 Derivative financial instruments (continued)

Analysis of derivative financial instruments (continued)	30 June 2016 Notional value $M	30 June 2016 Net fair value assets $M	30 June 2016 Net fair value liabilities $M	30 June 2015 Notional value $M	30 June 2015 Net fair value assets $M	30 June 2015 Net fair value liabilities $M
SPV						
Interest rate swaps – SPV						
Less than one year	11.1	-	(0.1)	17.8	-	(0.1)
One to three years	13.2	-	(0.2)	17.0	-	(0.3)
Three to five years	2.5	-	(0.1)	2.9	-	(0.1)
Total interest rate swaps – SPV	**26.8**	**-**	**(0.4)**	**37.7**	**-**	**(0.5)**
Cross-currency swaps – SPV						
Greater than five years	727.6	0.7	(0.3)	999.8	2.2	(0.3)
Total cross-currency swaps – SPV	**727.6**	**0.7**	**(0.3)**	**999.8**	**2.2**	**(0.3)**
Total – SPV	**754.4**	**0.7**	**(0.7)**	**1,037.5**	**2.2**	**(0.8)**
Total derivative financial instruments[1]		**788.3**	**(843.6)**		**584.7**	**(698.9)**

[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 $453.5 million (30 June 2015: $341.8 million) and the derivative liabilities would reduce by $453.5 million (30 June 2015: $341.8 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 differences and are assessed on an ongoing basis to determine that they actually have been 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 10 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 2016, a post-tax loss of $35.5 million (30 June 2015: post-tax loss of $23.5 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 18 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 used 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 2016, a post-tax loss of $1.4 million (30 June 2015: post-tax gain of $1.8 million) was recognised in equity for cash flow hedges with no statement of comprehensive income impact in relation to any ineffective portions during either the current or prior comparative periods.

Note 11 Notes to statement of cash flows

Reconciliation of profit to operating cash flow	30 June 2016 $M	30 June 2015 $M
Profit for the year	**329.9**	**327.9**
Adjusted for		
Net realised and unrealised gains on investment assets	(323.8)	(276.2)
Share of associates' net profit	(16.6)	(15.3)
Change in life contract liabilities[1]	458.0	470.4
Depreciation and amortisation expense	16.1	18.6
Impairment in associates and other investments	22.7	-
Share-based payments	24.0	26.3
Dividends from associates	16.5	15.6
Change in operating assets and liabilities		
(Increase)/decrease in receivables	(12.5)	1.4
Decrease/(increase) in other assets	9.6	(30.1)
Increase/(decrease) in payables	(33.2)	10.9
Decrease in provisions	(11.3)	(2.7)
Increase in life contract liabilities	407.5	398.3
Increase/(decrease) in external unit holders' liabilities	370.8	(127.7)
Increase/(decrease) in net tax liabilities	24.7	(1.5)
Net cash flows from operating activities	**1,282.4**	**815.9**

[1] Changes relate to movements through the statement of comprehensive income.

Reconciliation of cash	30 June 2016 $M	30 June 2015 $M
Cash at bank and on hand	516.2	371.5
Other cash equivalents	10.7	38.2
Total cash and cash equivalents[2]	**526.9**	**409.7**

[2] 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.

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 12 Contributed equity

	30 June 2016		30 June 2015	
	No. of shares M	Value of shares $M	No. of shares M	Value of shares $M
Analysis of contributed equity				
Ordinary shares issued	571.2	1,633.9	569.7	1,622.7
CPP Trust shares treated as Treasury shares	(6.1)	(36.3)	(8.7)	(48.7)
CPP deferred share purchases treated as Treasury shares	(6.3)	(50.9)	(7.6)	(46.8)
Total contributed equity	**558.8**	**1,546.7**	**553.4**	**1,527.2**
Movements in contributed equity				
Ordinary shares				
Balance at the beginning of the year	569.7	1,622.7	530.9	1,335.5
Issued under share placement and dividend reinvestment plan	1.5	11.2	38.8	287.2
Balance at the end of the year	**571.2**	**1,633.9**	**569.7**	**1,622.7**
CPP Trust				
Balance at the beginning of the year	8.7	48.7	12.5	66.2
Shares purchased (including settled forwards)	6.9	41.3	10.3	60.9
Vested shares released to employees	(9.5)	(53.7)	(14.1)	(78.4)
Balance at the end of the year	**6.1**	**36.3**	**8.7**	**48.7**
CPP deferred share purchases				
Balance at the beginning of the year	7.6	46.8	7.8	31.8
CPP deferred share purchases	4.0	34.1	4.6	33.8
Settled forward purchases	(5.3)	(30.0)	(4.8)	(18.8)
Balance at the end of the year	**6.3**	**50.9**	**7.6**	**46.8**

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 27 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 12 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. 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 (as defined in Prudential Standard 3PS 001) 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 has been developing a supervisory framework for Level 3 (conglomerate) groups over a number of years with draft Level 3 standards initially issued by APRA in May 2013. At the time at which these draft standards were published, APRA did not specify a proposed implementation date.

In March 2016, APRA announced that it would defer the implementation of conglomerate capital requirements until a number of other domestic and international policy initiatives were further progressed.

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 Company or CLC's 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.

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 2016 and none are anticipated in 2017.

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

Dividend reinvestment plan

On 18 August 2015, the Company announced the establishment of a Dividend Reinvestment Plan (DRP) that commenced for the final 2015 dividend. On 14 October 2015, the Company issued 890,868 ordinary shares to shareholders under the DRP. The DRP issue price per share for the final 2015 dividend was $7.0059 and represents the volume weighted average share price over the 10 trading days from 4 to 17 September 2015. The DRP participation rate was 7% of all issued shares, resulting in proceeds of $6.3 million.

The Company continued the DRP for the interim 2016 dividend and on 29 March 2016 issued 600,598 ordinary shares. The DRP issue price per share for the interim 2016 dividend was $8.1835 and represents the volume weighted average share price over the 10 trading days from 4 to 17 March 2016. The interim DRP participation rate was 5.4% of all issued shares, resulting in proceeds of $4.9 million.

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 year.

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.

The introduction of the LAGIC standards in August 2012 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.

Note 12 Contributed equity (continued)

Capital management (continued)

Prescribed capital amount (PCA) (continued)

Therefore the final $107.6 million of the LAGIC transition balance amortised on 1 January 2016.

CLC's excess capital above the PCA at 30 June 2016 was $1,010.4 million, up $1.0 million for the year, after absorbing the final LAGIC transition balance of $107.6 million on 1 January 2016.

While CLC does not target a specific PCA ratio, CLC's internal capital models result in a PCA ratio under current circumstances in the range of 1.3 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 1.3 to 1.6 times.

The PCA ratio at 30 June 2016 was 1.57 times, down from 1.59 times at 30 June 2015, reflecting, changes in asset allocation, net AUM growth, changes in retained earnings and the amortisation of the final LAGIC transition balance.

Subordinated debt

CLC's total regulatory capital base includes $445.5 million (30 June 2015: $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 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 $166.9 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 $33.4 million (i.e. 20% of the total amount) is eligible as Tier 2 regulatory capital on 30 June 2016.

The largest tranche of CLC's existing subordinated debt comprises $378.0 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.

Tier 1 and Tier 2 regulatory capital

Under APRA's transition arrangements, from 1 January 2013 CLC's statutory funds have three years to transition to the minimum requirement of Tier 1 capital representing 80% of the PCA. CLC is currently meeting these requirements at both the statutory and consolidated level. The Tier 1 ratio was 1.32 times the PCA at 30 June 2016 (30 June 2015: 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 2016 $M	30 June 2015 $M
CLC's excess capital under LAGIC		
Common Equity Tier 1 regulatory capital	2,003.6	1,907.6
Additional Tier 1 regulatory capital	345.0	345.0
Tier 2 regulatory capital – subordinated debt[1]	445.5	474.0
CLC total regulatory capital base	**2,794.1**	**2,726.6**
Prescribed capital amount		
Asset risk charge[2]	1,712.0	1,773.6
Insurance risk charge	168.3	120.5
Operational risk charge	28.7	22.6
Aggregation benefit	(125.3)	(91.9)
Prescribed capital amount – excluding transition relief	**1,783.7**	**1,824.8**
LAGIC transition relief[3]	-	(107.6)
CLC prescribed capital amount	**1,783.7**	**1,717.2**
CLC excess over prescribed capital amount	**1,010.4**	**1,009.4**
Capital adequacy ratio (times)	**1.57**	**1.59**

[1] Differs from $576.7 million disclosed in Note 13 Interest bearing financial liabilities due to $2.3 million (30 June 2015: $2.5 million) of accrued interest and $133.5 million (30 June 2015: $95.3 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 reduced by one third ($107.6 million) on each of 1 January 2014, 1 January 2015 and 1 January 2016.

Note 13 Interest bearing financial liabilities

	30 June 2015		Cash flows	Non-cash movements			30 June 2016	
	Facility	Opening balance	Proceeds/ (repayments)	Foreign exchange	Fair value changes	Other	Closing balance	Facility
	$M	$M	$M	$M	$M	$M	$M	$M
Bank loans								
Corporate	350.0	-		-	-	-	-	350.0
Controlled property trusts[1]	769.8	535.8	(43.9)	68.9	(0.3)	(4.2)	556.3	568.5
Controlled infrastructure trusts	206.0	206.0	(1.7)	-	-	-	204.3	206.0
Repurchase agreements	1,267.4	1,267.3	1,186.9	-	-	-	2,454.2	2,454.2
Total bank loans	**2,593.2**	**2,009.1**	**1,141.3**	**68.9**	**(0.3)**	**(4.2)**	**3,214.8**	**3,578.7**
Non-bank loans								
Subordinated debt issuance	567.0	567.0	-	5.8	3.9	-	576.7	576.7
Challenger Capital Notes	336.8	336.8	-	-	1.7	-	338.5	338.5
Other finance	1.4	1.4	18.6	-	(1.2)	-	18.8	18.8
Controlled property trusts	11.3	11.3	-	-	-	(11.3)	-	-
Total non-bank loans	**916.5**	**916.5**	**18.6**	**5.8**	**4.4**	**(11.3)**	**934.0**	**934.0**
Total interest bearing financial liabilities	**3,509.7**	**2,925.6**	**1,159.9**	**74.7**	**4.1**	**(15.5)**	**4,148.8**	**4,512.7**
Current		1,379.4					2,733.9	
Non-current		1,546.2					1,414.9	
		2,925.6					**4,148.8**	

[1] Total facility limit consists of redraw loan facilities limits totalling $121.0 million (30 June 2015: $300.0 million) and non-redraw loan facility limits totalling $477.5 million (30 June 2015: $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. Repurchase agreements are all short-term in nature and are therefore valued at amortised cost.

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 2016 balance includes $377.2 million (30 June 2015: $236.3 million) of Yen denominated loans in the Japanese property trusts. Other controlled property trusts loans total $179.1 million (30 June 2015: $299.5 million).

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.

Note 13 Interest bearing financial liabilities (continued)

Details of liabilities (continued)

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 2016 are current and all except $345 million matured in July 2016. The remaining agreements mature in August 2016 ($270 million) and September 2016 ($75 million). 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 US$150.0 million in December 2006 and $400.0 million in November 2007.

The December 2006 notes are unsecured and were issued in two maturities (US$125.0 million at 10 years with a non-call period of five years and US$25.0 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 continues 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 2016, there was $445.5 million (30 June 2015: $474.0 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.

Other finance

During the year, the Group entered into limited recourse non-bank loan financing of equipment totalling $19.9 million, of which $1.3 million was repaid.

Controlled property trusts

Non-bank loans in the unlisted property trusts are secured solely by fixed and floating first-ranking mortgages over properties. The remaining loan was discharged during the year, resulting in a nil balance at 30 June 2016.

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 14 Reserves and retained earnings

	30 June 2016 $M	30 June 2015 $M
Share-based payments reserve		
Balance at the beginning of the year	10.0	54.9
Share-based payments for the period	24.0	26.3
Releases from share-based payments reserve	(53.7)	(78.4)
Tax on equity	6.8	7.2
Balance at the end of the year	**(12.9)**	**10.0**
Cash flow hedge reserve – SPV[1]		
Balance at the beginning of the year	1.4	(0.4)
(Loss)/gain on cash flow hedges	(1.4)	1.8
Balance at the end of the year	**-**	**1.4**
Foreign currency translation reserve[1]		
Balance at the beginning of the year	(6.6)	(4.0)
Gain on translation of foreign entities[2]	35.0	20.7
Loss on hedge of net investment in foreign entities[2]	(35.5)	(23.5)
Recycled to the profit and loss	-	0.2
Balance at the end of the year	**(7.1)**	**(6.6)**
Adjusted controlling interests reserve[1]		
Balance at the beginning of the year	18.9	19.3
Change in holdings in controlled entities	(6.8)	(0.4)
Balance at the end of the year	**12.1**	**18.9**
Total reserves	**(7.9)**	**23.7**
Retained earnings		
Balance at the beginning of the year	992.3	846.0
Profit attributable to equity holders	327.7	299.0
Dividends paid	(177.9)	(152.7)
Total retained earnings	**1,142.1**	**992.3**

[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.

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 price, which may be higher or lower than the initial recognised valuation price.

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 15 Finance costs

	30 June 2016 $M	30 June 2015 $M
Interest expense	141.2	125.1
Interest expense – SPV	53.3	81.7
Interest expense – property trusts	15.1	23.1
Other finance costs	20.0	16.9
Total finance costs	**229.6**	**246.8**

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 16 Dividends paid and proposed

	30 June 2016 $M	30 June 2015 $M
Dividends declared and paid during the year		
Final 30 June 2015 100% franked dividend: 15.5 cents (30 June 2014: 13.5 cents 40% franked dividend)	87.5	71.4
Interim 30 June 2016 100% franked dividend: 16.0 cents (30 June 2015: 14.5 cents 70% franked dividend)	90.4	81.3
Total dividends paid	**177.9**	**152.7**
Dividend proposed (not recognised as a liability at 30 June)		
Final 30 June 2016 100% franked dividend: 16.5 cents (30 June 2015: 100% franked 15.5 cents)	93.3	87.0

Refer to Note 12 Contributed equity for details of the dividend policy and dividend payout ratios. A dividend reinvestment plan will be in operation for the 30 June 2016 final dividend.

Group franking credits account	30 June 2016 $M	30 June 2015 $M
Franking account balance at the beginning of the year	57.1	25.3
Franking credits from the payment of income tax during the year	64.0	65.3
Franking credits from dividends received during the year	8.1	6.6
Franking credits applied to dividend payments to shareholders	(76.8)	(37.1)
Franking credits applied to Challenger Capital Notes	(5.7)	(3.0)
Franking credits balance	**46.7**	**57.1**

Note 17 Earnings per share

	30 June 2016 cents	30 June 2015 cents
Basic earnings per share	58.5	54.8
Diluted earnings per share	55.4	51.4

	$M	$M
Profit attributable to ordinary shareholders	327.7	299.0
Add back interest expense on Challenger Capital Notes	13.5	11.3
Total earnings used in the calculation of dilutive earnings per share	341.2	310.3

Number of shares

	Number	Number
Weighted average of ordinary shares issued	570,515,364	562,823,248
Weighted average of Treasury shares	(10,330,749)	(17,157,558)
Weighted average ordinary shares for basic earnings per share	560,184,615	545,665,690
Adjusted for potential ordinary shares:		
Weighted average effect of Challenger Performance Plan	16,791,573	20,712,359
Weighted average effect of Challenger Capital Notes	39,060,802	37,152,650
Weighted average ordinary shares for diluted earnings per share	616,036,990	603,530,699

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.

The weighted average number of Treasury shares for the period was 10,330,749 (2015: 17,157,558).

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 (Notes) of 39.1 million shares (2015: 37.2 million) and shares granted under the CPP of 16.8 million shares (2015: 20.7 million). The profit attributable to ordinary shareholders is adjusted by $13.5 million interest on the Notes (2015: $11.3 million) for the diluted calculation when the Notes are considered dilutive. 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 18 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 GRC assists 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 and included in the relevant notes to the financial statements.

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 a 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 18 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 2016 $M	Change in equity 30 June 2016 $M	Profit/(loss) 30 June 2015 $M	Change in equity 30 June 2015 $M
Non-SPV	+100bps	5.6	5.6	7.1	7.1
	-100bps	(5.6)	(5.6)	(7.1)	(7.1)
SPV	+100bps	(1.5)	(1.5)	(2.0)	(2.0)
	-100bps	1.5	1.5	2.0	2.0
Total	**+100bps**	**4.1**	**4.1**	**5.1**	**5.1**
	-100bps	**(4.1)**	**(4.1)**	**(5.1)**	**(5.1)**

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:

Asset class	Change in variable	Profit/(loss) 30 June 2016 $M	Change in equity 30 June 2016 $M	Profit/(loss) 30 June 2015 $M	Change in equity 30 June 2015 $M
Property securities	+10%	23.8	23.8	20.8	20.8
	-10%	(23.8)	(23.8)	(20.8)	(20.8)
Infrastructure investments	+10%	25.9	25.9	20.3	20.3
	-10%	(25.9)	(25.9)	(20.3)	(20.3)
Other assets	+10%	30.0	30.0	13.1	13.1
	-10%	(30.0)	(30.0)	(13.1)	(13.1)
Total assets	**+10%**	**79.7**	**79.7**	**54.2**	**54.2**
	-10%	**(79.7)**	**(79.7)**	**(54.2)**	**(54.2)**

Note 18 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 2016, 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 $71.3 million (30 June 2015: $80.5 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 materially 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 2016					
Financial assets	584.5	1,853.3	475.7	297.5	379.2
Financial liabilities	(43.3)	(201.0)	(21.2)	-	-
Foreign currency contracts and cross currency swaps	(531.6)	(1,620.3)	(458.9)	(286.4)	(373.9)
Net exposure in Australian dollars	**9.6**	**32.0**	**(4.4)**	**11.1**	**5.3**
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)**

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 18 Financial risk management (continued)

Currency risk (continued)

	Movement in variable against $	Profit/(loss) 30 June 2016 $M	Change in equity 30 June 2016 $M	Profit/(loss) 30 June 2015 $M	Change in equity 30 June 2015 $M
British Pound (GBP)	+10%	0.7	0.7	0.3	0.3
	-10%	(0.7)	(0.7)	(0.3)	(0.3)
US Dollar (USD)	+10%	7.0	7.0	1.9	1.9
	-10%	(7.0)	(7.0)	(1.9)	(1.9)
Euro (EUR)	+10%	(0.3)	(0.3)	(0.3)	(0.3)
	-10%	0.3	0.3	0.3	0.3
Japanese Yen (JPY)	+10%	-	0.8	-	0.3
	-10%	-	(0.8)	-	(0.3)
Other	+10%	0.4	0.4	(0.2)	(0.2)
	-10%	(0.4)	(0.4)	0.2	0.2

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.		
	AAA $M	AA $M	A $M	BBB $M	grade $M	Other $M	Total $M
30 June 2016							
Cash and cash equivalents	523.7	3.2	-	-	-	-	526.9
Cash and cash equivalents – SPV	146.9	-	-	-	-	-	146.9
Receivables	22.7	12.4	8.5	20.0	6.6	187.6	257.8
Mortgage assets – SPV	909.6	452.2	309.9	4.7	1.2	-	1,677.6
Fixed income securities	5,320.4	714.4	1,519.6	2,103.2	1,703.8	102.1	11,463.5
Derivative assets	-	770.9	58.0	(40.6)	-	-	788.3
Total assets with credit exposures	**6,923.3**	**1,953.1**	**1,896.0**	**2,087.3**	**1,711.6**	**289.7**	**14,861.0**
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	1,653.6	1,768.9	2,016.2	139.0	9,684.3
Derivative assets	-	609.7	0.5	(26.1)	-	0.6	584.7
Total assets with credit exposures	**5,192.9**	**2,064.0**	**2,000.9**	**1,747.5**	**2,039.6**	**294.3**	**13,339.2**

Note 18 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:

		Past due but not impaired				
Amortised cost financial assets	Not past due/not impaired $M	0-1 months $M	1-3 months $M	3-6 months $M	Past due and impaired $M	Total $M
30 June 2016						
Receivables	256.4	0.4	0.6	0.4	-	257.8
Mortgage assets – SPV	1,538.4	75.6	41.5	12.1	10.0	1,677.6
Total receivables	**1,794.8**	**76.0**	**42.1**	**12.5**	**10.0**	**1,935.4**
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**

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 US$150.0 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 2016 was a loss of $3.9 million (30 June 2015: $5.9 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 12 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.

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:

Note 18 Financial risk management (continued)

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 2016					
Payables	578.0	(8.7)	27.7	5.6	602.6
Payables – SPV	4.4	-	-	-	4.4
Interest bearing financial liabilities	2,814.1	104.8	859.5	695.5	4,473.9
Interest bearing financial liabilities – SPV	449.1	618.6	368.8	536.6	1,973.1
External unit holders' liabilities	750.0	565.5	-	-	1,315.5
Life investment contract liabilities	2,973.6	2,551.8	1,087.1	684.8	7,297.3
Life insurance contract liabilities[1]	228.5	399.3	344.5	2,310.1	3,282.4
Derivative liabilities	90.7	144.1	160.7	448.1	843.6
Total undiscounted financial liabilities[1]	**7,888.4**	**4,375.4**	**2,848.3**	**4,680.7**	**19,792.8**
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 investment contract liabilities	2,510.8	2,739.3	1,027.2	891.5	7,168.8
Life insurance contract liabilities[1]	206.1	348.4	287.9	2,086.3	2,928.7
Derivative liabilities	135.2	143.2	118.7	301.8	698.9
Total undiscounted financial liabilities[1]	**5,857.9**	**5,079.6**	**2,452.8**	**4,721.1**	**18,111.4**

[1] Disclosure of life insurance contract liabilities is not required under AASB 7 *Financial Risk Management*, for reference purposes they have been included. Refer to Note 8 Life contract liabilities for further details.

Note 19 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).

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's 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

Note 19 Fair values of financial assets and liabilities (continued)

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 2016		30 June 2015	
Difference between amortised cost and fair value	Carrying value $M	Fair value $M	Carrying value $M	Fair value $M
Mortgage assets – SPV[1]	1,677.6	1,703.2	2,231.3	2,293.1
Interest bearing financial liabilities – SPV[2]	1,628.4	1,548.6	2,192.8	2,118.1
Challenger Capital Notes[3]	345.0	330.3	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 which generally meets monthly, or more frequently if required.

All financial instruments and investment properties are measured on a recurring basis. Refer Note 5 Financial assets – fair value through profit and loss and Note 6 Investment and development property for further details on the valuation process applied to unlisted financial instruments and investment properties.

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 19 Fair values of financial assets and liabilities (continued)

Valuation process (continued)

	Level 1 $M	Level 2 $M	Level 3 $M	Total $M
30 June 2016				
Derivative assets	-	788.3	-	788.3
Fixed income securities[1]	-	9,455.2	2,008.3	11,463.5
Equity securities	40.6	198.6	361.0	600.2
Infrastructure investments[1]	82.6	109.4	509.1	701.1
Property securities	196.3	-	143.2	339.5
Investment and development property[2]	-	70.6	3,499.3	3,569.9
Total assets	**319.5**	**10,622.1**	**6,520.9**	**17,462.5**
Derivative liabilities	-	843.5	0.1	843.6
Interest bearing financial liabilities	330.3	70.9	595.5	996.7
External unit holders' liabilities	-	1,315.5	-	1,315.5
Life investment contract liabilities	-	80.1	6,835.2	6,915.3
Total liabilities	**330.3**	**2,310.0**	**7,430.8**	**10,071.1**
30 June 2015				
Derivative assets	-	584.7	-	584.7
Fixed income securities	-	7,521.8	2,162.5	9,684.3
Equity securities	10.0	100.7	237.9	348.6
Infrastructure investments[1]	128.0	-	468.1	596.1
Property securities	177.4	-	120.0	297.4
Investment and development property[2]	-	111.7	3,001.4	3,113.1
Total assets	**315.4**	**8,318.9**	**5,989.9**	**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	-	88.3	6,538.6	6,626.9
Total liabilities	**327.2**	**1,812.9**	**7,107.2**	**9,247.3**

[1] The Group has exposures to structured entities (entities designed so that voting or similar rights are not the dominant factor in determining who controls the entity; for example, when any voting rights relate purely to administrative tasks) via investments in asset-backed finance vehicles (where it may act as a lender or purchaser of notes and/or residual income units) and securitisations (such as mortgages, finance leases and other types of collateralised vehicles). 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 2016 the carrying value of asset-backed financing assets was $8.4 million (30 June 2015: $7.7 million) with no undrawn commitments (30 June 2015: nil) and securitisations was $2,815.9 million (30 June 2015: $3,367.2 million) plus $142.1 million undrawn commitments (30 June 2015: $184.4 million).

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

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 2016		30 June 2015	
	Assets $M	Liabilities $M	Assets $M	Liabilities $M
Balance at the beginning of the year	2,988.5	7,107.2	2,336.5	6,638.6
Fair value gains/(losses)	53.3	259.8	168.9	336.7
Acquisitions	1,471.2	2,695.4	1,758.4	2,176.7
Maturities and disposals	(1,413.8)	(2,631.6)	(1,222.9)	(2,044.8)
Transfers to other categories[1,2]	(77.6)	-	(52.4)	-
Balance at the end of the year[3]	**3,021.6**	**7,430.8**	**2,988.5**	**7,107.2**
Unrealised gains/(losses) included in the statement of comprehensive income for assets and liabilities held at the statement of financial position date	65.0	260.1	(128.5)	(331.1)

[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.

Note 19 Fair values of financial assets and liabilities (continued)

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 2016					
Fixed income securities	2,008.3	26.7	(43.2)	Discounted cash flow	Primarily credit spreads
Interest bearing financial liabilities	(595.5)	(9.3)	9.6	Discounted cash flow	Primarily credit spreads
Net fixed income	**1,412.8**	**17.4**	**(33.6)**		
Equity, infrastructure, property assets	1,013.3	53.9	(55.3)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Investment contract liabilities	(6,835.2)	7.2	(7.2)	Discounted cash flow	Primarily expense assumptions
Derivative liabilities	(0.1)	0.2	(0.1)	Discounted cash flow	Primarily credit spreads
Total Level 3	**(4,409.2)**	**78.7**	**(96.2)**		
30 June 2015					
Fixed income securities	2,162.5	65.7	(23.0)	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	**1,594.1**	**55.3**	**(11.5)**		
Equity, infrastructure, property assets	826.0	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	**(4,118.7)**	**106.3**	**(62.7)**		

[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 and any acquisitions and/or disposals of businesses in the year. Disclosure on related parties is also provided in this section.

Note 20 Parent entity

Company	30 June 2016 $M	30 June 2015 $M
Statement of comprehensive income for the year ended		
Revenue	238.9	164.5
Finance costs	(15.2)	(12.6)
Profit before income tax	223.7	151.9
Income tax benefit	15.0	1.3
Profit and total comprehensive income for the year	**238.7**	**153.2**
Statement of financial position as at		
Assets		
Cash and cash equivalents	1.8	1.4
Receivables	1,097.1	980.5
Financial asset – fixed income security[1]	345.0	345.0
Current tax asset	14.3	-
Deferred tax assets	0.9	1.7
Investment in controlled entities	1,528.1	1,504.1
Total assets	**2,987.2**	**2,832.7**
Liabilities		
Payables	443.9	308.4
Interest bearing financial liability	338.5	336.8
Current tax liability	-	23.4
Total liabilities	**782.4**	**668.6**
Net assets	**2,204.8**	**2,164.1**
Equity		
Contributed equity	1,633.8	1,622.6
Share-based payments reserve	(49.9)	(20.2)
Retained earnings	620.9	561.7
Total equity	**2,204.8**	**2,164.1**

[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 26 Contingent liabilities, contingent assets and credit commitments for details of any contingent liabilities applicable to the parent entity.

Note 21 Controlled entities

The table below presents the hierarchical structure of Challenger Limited showing its controlled entities that form the main composition of the Group as at 30 June 2016:

Entity name

Challenger Limited
  Challenger Group Holdings Limited
  Challenger Group Services Pty Limited
  Challenger Treasury Limited
  Challenger Funds Management 2 Holdings Pty Limited
  Challenger Funds Management Holdings Pty Limited
  Fidante Partners Holdings Pty Limited
  Fidante Partners Holdings Europe Limited (incorporated in the UK)
  Challenger Management Services Limited
  Challenger Life Company Holdings Limited
  Challenger Life Company Limited
  Challenger Wholesale Finance Holdings Pty Limited

Challenger's percentage holding of the above entities is 100% and all are incorporated in Australia unless otherwise stated.
Entities with non-controlling interests represent net assets of $3.1 million.

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 22 Investment in associates

Name of company	Principal activity	Country of domicile	30 June 2016 %[1]	30 June 2015 %[1]	30 June 2016 $M	30 June 2015 $M
Agricultural Asset Management Ltd[2]	Funds Management	UK	50	-	-	-
Alphinity Investment Management Pty Ltd	Funds Management	Australia	30	30	1.7	0.9
Ardea Investment Management Pty Ltd	Funds Management	Australia	30	30	3.1	3.1
Arete Investment Partners Pty Ltd	Funds Management	Australia	35	35	-	0.8
Bentham Asset Management Pty Ltd	Funds Management	Australia	49	49	0.6	0.6
Greencape Capital Pty Ltd	Funds Management	Australia	50	35	33.7	14.9
Kapstream Capital Pty Ltd	Funds Management	Australia	-	25	-	6.7
Kinetic Investment Partners Pty Ltd	Funds Management	Australia	20	20	0.5	0.2
Metisq Capital Holdings Pty Ltd	Funds Management	Australia	49	49	-	6.8
Merlon Capital Partners Pty Ltd	Funds Management	Australia	30	30	0.6	0.8
Novaport Capital Pty Ltd	Funds Management	Australia	49	49	0.7	1.3
Resonance Asset Management Ltd[2,3]	Funds Management	UK	-	-	1.0	-
Tempo Asset Management Pty Ltd	Funds Management	Australia	40	40	1.1	0.8
Wavestone Capital Pty Ltd	Funds Management	Australia	33	33	2.1	2.2
Whitehelm Capital Pty Ltd	Funds Management	Australia	30	30	5.0	4.3
Wyetree Asset Management Pty Ltd	Funds Management	Australia	50	-	1.4	-
Total investment in associates[4]					**51.5**	**43.4**

[1] Represents ownership and voting rights percentages.
[2] Agricultural Asset Management Ltd and Resonance Asset Management Ltd were acquired as part of the Dexion Capital acquisition on 17 July 2015.
[3] Challenger holds a board position and is deemed to have significant influence.
[4] Investment in associates is all considered non-current, with the exception of Kapstream Capital Pty Ltd which was disposed of on 2 July 2015.

Note 22 Investment in associates (continued)

	30 June 2016 $M	30 June 2015 $M
Movements in carrying amount of investment in associates		
Opening balance	43.4	39.4
Acquisition of investment in associates	21.2	3.7
Share of associates' net profit	16.6	15.3
Dividend and net capital (redemptions)/injections	(19.1)	(15.0)
Impairment of investment in associates	(10.6)	-
Carrying amount at the end of the year	**51.5**	**43.4**
Share of associates' profit or loss		
Profit before tax	16.6	15.3
Profit after tax for the year	**16.6**	**15.3**
Share of the associates' statement of financial position		
Current assets	25.8	27.1
Non-current assets	1.2	5.9
Total assets	**27.0**	**33.0**
Current liabilities	12.4	17.6
Non-current liabilities	0.4	0.2
Total liabilities	**12.8**	**17.8**
Net assets	**14.2**	**15.2**

Recognition and measurement

Associates are entities over which the Group has significant influence of the entities' 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 23 Related parties

Directors and key executives

The Directors and key executives of Challenger Limited 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

Key executives	
Richard Howes	Chief Executive, Life
Paul Rogan	Chief Executive, Distribution, Marketing & Research
Ian Saines	Chief Executive, Funds Management
Andrew Tobin	Chief Financial Officer

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 21 Controlled entities.

Other related parties

During the year, there were transactions between the Group and Challenger-sponsored managed funds for the provision of investment management, transaction advisory and other professional services.

Transactions were also entered into between the Group and associated entities (refer to Note 22 Investment in associates) for the provision of distribution and administration services. The Group earned fee income during the year of $40.3 million (2015: $33.5 million) from transactions entered into with non-controlled funds and associates. Transactions are conducted on an arm's length basis under normal commercial terms and conditions.

Loans to Directors and key executives

There were no loans made to Directors or key executives as at 30 June 2016 (30 June 2015: nil).

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						
2016	**1,588,842**	**73,992**	**-**	**-**	**-**	**1,662,834**
2015	1,615,685	71,315	-	-	-	1,687,000
KMP						
2016	**6,938,212**	**96,540**	**8,034,349**	**608,317**	**-**	**15,677,418**
2015	6,922,169	94,001	9,306,161	658,996	-	16,981,327
All KMP and Non-Executive Directors						
2016	**8,527,054**	**170,532**	**8,034,349**	**608,317**	**-**	**17,340,252**
2015	8,537,854	165,316	9,306,161	658,996	-	18,668,327

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 24 Goodwill and other intangible assets

	30 June 2016 $M	30 June 2015 $M
Goodwill	**571.6**	**531.0**
Other intangible assets		
Software at cost	20.8	11.2
Less: accumulated amortisation	(8.6)	(6.3)
	12.2	**4.9**
Customer list at cost	0.2	0.2
Less: accumulated amortisation	(0.1)	-
	0.1	**0.2**
Operating lease intangible at cost	-	22.8
Less: accumulated amortisation	-	(7.2)
Less: foreign exchange losses	-	(2.3)
	-	**13.3**
Total other intangible assets	**12.3**	**18.4**

	Goodwill		Customer list		Software		Operating lease	
	30 June 2016 $M	30 June 2015 $M	30 June 2016 $M	30 June 2015 $M	30 June 2016 $M	30 June 2015 $M	30 June 2016 $M	30 June 2015 $M
Balance at the beginning of the year	531.0	531.0	0.2	0.2	4.9	2.1	13.3	12.5
Additions	40.6	-	-	-	9.6	3.7	-	-
Foreign exchange gain	-	-	-	-	-	-	-	1.6
Impairment	-	-	-		-	-	(12.1)	-
Amortisation expense	-	-	(0.1)	-	(2.3)	(0.9)	(1.2)	(0.8)
Balance at the end of the year	**571.6**	**531.0**	**0.1**	**0.2**	**12.2**	**4.9**	**-**	**13.3**

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 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.

Note 24 Goodwill and other intangible assets (continued)

Recognition and measurement (continued)

Goodwill (continued)

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.

Sensitivity to change in assumptions

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 2016. 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.

Impairment testing of goodwill

The following CGUs represent the carrying amounts of goodwill:

CGU	30 June 2016 $M	30 June 2015 $M	30 June 2016 Discount rate %	30 June 2015 Discount rate %	Cash flow horizon (years)
Life	444.0	444.0	10.5	11.0	5
Funds Management	127.6	87.0	10.5	11.0	5
Total	**571.6**	**531.0**			

Note 25 Acquisitions and disposals of subsidiaries, businesses and associates

On 15 July 2015, the Company's boutique funds management division, Fidante Partners, agreed to acquire 100% of Dexion Capital Holdings Limited (Dexion Capital), a European alternative investment group comprising interests in three specialist fund managers, as well as an investments distribution business, based in London. On 17 July 2015, the acquisition was completed with Fidante Partners acquiring all the capital, with a combination of upfront and deferred cash payments.

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.

The acquisition substantially expands Fidante Partners' presence in Europe where it already holds interests in UK-based alternative asset managers Whitehelm Capital (global infrastructure) and WyeTree Asset Management (asset-backed securities). The acquisition also provided Fidante Partners with established distribution channels to UK and European alternative focused investors.

Subsequent to the acquisition, Dexion Capital was rebranded to Fidante Partners Europe Limited.

From the date of acquisition, Fidante Partners Europe contributed $11.6 million of revenue and $9.6 million loss before tax. If the combination had taken place at the beginning of the period, the additional contribution to revenue would have been immaterial. Acquisition related transaction costs of $2.2 million have been incurred through other expenses with $1.8 million expensed in the prior year.

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

	$M
Total purchase consideration[1]	58.8
Less: fair value of net identifiable assets acquired	18.2
Goodwill on acquisition	40.6

[1] The consideration comprises an upfront payment of £17.3 million ($36.5 million), deferred payment of £4 million ($8.9 million), and estimated contingent consideration linked to Dexion's profitability. The deferred consideration is to be paid on 30 June 2018 and the contingent consideration payable between 30 June 2018 and 30 June 2021. The fair value of the contingent consideration has been probability assessed and discounted to its present value. The contingent consideration increases or decreases in line with Dexion's profitability. Outperformance or underperformance relative to purchase price assumptions will be taken through the statement of comprehensive income. The goodwill on acquisition is subject to annual impairment testing.

The balance sheet of Dexion Capital at acquisition date was as follows:

	Acquiree's carrying amount $M	Fair value $M
Assets		
Cash	7.6	7.6
Receivables	15.5	15.5
Investment in associates	1.0	1.0
Property, plant and equipment	0.6	0.6
Deferred tax assets	4.4	4.4
Intangible assets	5.7	-
Total assets	**34.8**	**29.1**
Liabilities		
Payables	(10.9)	(10.9)
Total liabilities	**(10.9)**	**(10.9)**
Net assets	**23.9**	**18.2**

Significant entities, businesses and associates acquired, consolidated, disposed of or deconsolidated due to loss of control

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

The Company recognised a $40 million pre-tax profit from the sale during the year.

Fidante Partners continues to provide distribution and operational support services to Kapstream in Australia through renewed Administration, Distribution and Responsible Entity service agreements.

There were no other significant entities, businesses or associates acquired, consolidated, disposed of or deconsolidated due to loss of control during the year.

Note 26 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 2016. 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 2016 there are potential future commitments totalling $242.4 million (30 June 2015: $303.0 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.

Analysis of credit commitments	30 June 2016 $M	30 June 2015 $M
Non-cancellable operating leases – Group as lessee		
Amounts due in less than one year	13.5	18.0
Amounts due between one and two years	12.8	11.7
Amounts due between two and five years	38.8	35.5
Amounts due in greater than five years	124.1	153.5
Total operating leases – Group as lessee	**189.2**	**218.7**
Contracted capital expenditure		
Amounts due in less than one year	65.3	7.9
Amounts due between one and two years	4.0	5.1
Amounts due between two and five years	5.2	7.5
Amounts due in greater than five years	2.6	3.2
Total capital expenditure commitments	**77.1**	**23.7**
Non-cancellable operating leases – Group as lessor		
Amounts due in less than one year	(237.6)	(234.0)
Amounts due between one and two years	(209.3)	(197.3)
Amounts due between two and five years	(471.3)	(439.1)
Amounts due in greater than five years	(318.2)	(306.0)
Total operating leases – Group as lessor	**(1,236.4)**	**(1,176.4)**
Other contracted commitments		
Amounts due in less than one year	2.0	306.7
Total other contracted commitments	**2.0**	**306.7**
Net commitments	**(968.1)**	**(627.3)**

Note 26 Contingent liabilities, contingent assets and credit commitments (continued)

Operating leases

Group as lessee

The Group has entered into commercial operating leases for the rental of properties where it is not in the best interests of the Group to purchase these properties. These leases have an average life of between one and 18 years with renewal terms included in the contracts. Renewals are at the specific option of the entity that holds the lease.

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 pre balance date and will settle subsequent to the end of the financial year.

Note 27 Employee entitlements

	30 June 2016 $M	30 June 2015 $M
Employee[1] entitlements provision	**11.9**	**10.9**

[1] The total number of employees of the Group at 30 June 2016 was 635 (30 June 2015: 560).

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 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).

Note 27 Employee entitlements (continued)

Recognition and measurement

Share-based payment transactions (continued)

Long-term equity-based incentive plan (continued)

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 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).

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 CPP 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.

The table below sets out the details of the DPSRs granted under the Challenger Performance Plan during 2016 and movements on previous issues.

Grant date	Latest date for vesting[1]	Reference price $	Fair value at grant $	Outstanding at 1 July 2015	Granted during the year	Vested during the year	Expired during the year	Outstanding at 30 June 2016
13 Sep 15	01 Sep 18	6.989	6.16	-	703,347	-	(7,153)	696,194
13 Sep 15	01 Sep 17	6.989	6.44	-	780,590	(4,394)	(3,079)	773,117
13 Sep 15	01 Sep 16	6.989	6.73	-	776,727	(4,394)	(3,079)	769,254
16 Sep 14	01 Sep 17	7.698	6.54	802,263	-	(11,772)	(9,937)	780,554
16 Sep 14	01 Sep 16	7.698	6.81	729,935	-	(47,975)	(3,665)	678,295
16 Sep 14	01 Sep 15	7.698	7.08	702,090	-	(699,022)	(3,068)	-
17 Sep 13	01 Sep 16	4.086	4.46	122,372	-	-	-	122,372
17 Sep 13	01 Sep 15	4.086	4.71	1,157,214	-	(1,154,034)	(3,180)	-
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)	-	-
Total				**3,547,788**	**2,260,664**	**(1,955,505)**	**(33,161)**	**3,819,786**

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

Note 27 Employee entitlements (continued)

Recognition and measurement (continued)

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.

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 2016 and movements on previous issues:

Grant date	Expected date for vesting[1]	Reference price $	Fair value at grant $	Outstanding at 1 July 2015	Granted during the year	Vested during the year	Expired during the year	Outstanding at 30 June 2016
13 Sep 15	01 Sep 19	7.013	2.84	-	1,256,318	-	-	1,256,318
13 Sep 15	01 Sep 18	7.013	3.27	-	2,182,191	-	-	2,182,191
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	-	-	(17,385)	793,997
16 Sep 14	01 Sep 17	7.698	3.37	1,622,730	-	-	(34,767)	1,587,963
17 Sep 13	01 Sep 17	4.086	2.69	2,189,056	-	-	(153,674)	2,035,382
17 Sep 13	01 Sep 16	4.086	3.23	2,188,972	-	-	(153,663)	2,035,309
17 Sep 13	01 Sep 15	4.086	3.79	2,188,972	-	(2,188,972)	-	-
11 Jun 13	01 Jun 17	3.928	1.33	133,334	-	(66,666)		66,668
12 Sep 12	01 Sep 16	3.448	1.42	5,182,021	-	(2,590,999)	(230,002)	2,361,020
16 Mar 12	16 Feb 16	4.361	1.16	416,668	-	(416,668)	-	-
14 Dec 11	01 Sep 15	4.747	1.56	250,000	-	(250,000)	-	-
12 Sep 11	01 Sep 15	4.747	1.93	2,061,030	-	(2,061,030)	-	-
Total				**17,248,548**	**3,438,509**	**(7,574,335)**	**(589,491)**	**12,523,231**

[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	13 Sep 15 PSR[1]	13 Sep 15 HPSR[1]
Dividend yield (%)	4.00	4.00
Risk-free rate (%)	1.89–1.88	1.89–2.13
Volatility[2] (%)	28	28
Valuation ($)	6.73–6.16	3.27–2.84

[1] Staggered deferred vesting applies to these grants.
[2] Forecast volatility rate implied from historic trend.

Note 28 Remuneration of auditor

Amounts received or due and receivable by Ernst & Young relating to:	30 June 2016 $'000	30 June 2015 $'000
Full year audit and half year review of the Group financial report	1,271.0	1,274.0
Other audit services – audit and review of trusts and funds	603.2	560.5
Other services in relation to the Group		
– taxation services	414.0	327.3
– other assurance services	633.0	537.2
Total auditor remuneration[1]	**2,921.2**	**2,699.0**

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

Note 29 Subsequent events

At the date of this report, no 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 2016 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 2016.

On behalf of the Board

G A Cubbin
Director

Sydney
15 August 2016

B R Benari
Managing Director and Chief Executive Officer

Sydney
15 August 2016

Building a better
working world

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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 2016, 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 2016 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 2016. 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 2016 complies with section 300A of the *Corporations Act 2001*.

Ernst & Young

Ernst & Young

S J Ferguson
Partner

Sydney
15 August 2016

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 2016	Number of shares	% of issued capital
Caledonia (Private) Investments Pty Ltd	38,094,758	6.67
20 largest individual shareholders as at 31 July 2016		
1. HSBC Custody Nominees (Australia) Limited	161,612,494	28.29
2. J P Morgan Nominees Australia Limited	86,905,339	15.21
3. National Nominees Limited	56,578,110	9.90
4. Citicorp Nominees Pty Limited	44,218,126	7.74
5. BNP Paribas Noms Pty Ltd <DRP>	14,361,353	2.51
6. HSBC Custody Nominees (Australia) Limited – A/C 2	11,713,889	2.05
7. National Nominees Limited <DB A/C>	11,262,384	1.97
8. Citicorp Nominees Pty Limited <Colonial First State INV A/C>	8,162,288	1.43
9. CPU Share Plans Pty Ltd <CGF Performance Plan A/C>	6,055,323	1.06
10. Argo Investments Limited	4,190,311	0.73
11. HSBC Custody Nominees (Australia) Limited <NT – Comnwlth Super Corp A/C>	3,115,672	0.55
12. Australian Foundation Investment Company Limited	2,741,556	0.48
13. HSBC Custody Nominees (Australia) Limited – GSCO ECA	2,667,380	0.47
14. HSBC Custody Nominees (Australia) Limited – A/C 3	2,034,854	0.36
15. AMP Life Limited	1,874,199	0.33
16. Sandhurst Trustees Limited <DMP Asset Management A/C>	1,656,896	0.29
17. BNP Paribas Nominees Pty Ltd <Agency Lending DRP A/C>	1,591,300	0.28
18. RBC Investor Services Australia Pty Limited <VFA A/C>	1,499,958	0.26
19. UBS Nominees Pty Ltd <TP00014 15 A/C>	1,425,205	0.25
20. Washington H Soul Pattinson & Company Limited	1,329,282	0.23
Total 20 largest individual shareholders – issued capital	**424,995,919**	**74.39**
Total remaining shareholders balance	**146,221,368**	**25.61**

Distribution of shares (as at 31 July 2016)

Range	Number of shareholders	Number of shares	% of issued capital
1 – 1,000	12,657	6,331,974	1.11
1,001 – 5,000	15,462	37,696,070	6.60
5,001 – 10,000	3,386	24,403,391	4.27
10,001 – 100,000	2,038	44,035,067	7.71
100,001 and over	131	458,750,785	80.31
Total	33,674	571,217,287	100.00

Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum $500.00 parcel at $9.50 per unit	53	515	6,732

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)

Buy-back

There is currently no market buy-back.

On market acquisitions for employee incentive schemes during the financial year ended 30 June 2016

6.9 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 $5.99.

Top 20 noteholders of Challenger Capital Notes as at 31 July 2016

	20 largest individual noteholders as at 31 July 2016	Number of notes	% of issued notes
1.	HSBC Custody Nominees (Australia) Limited	487,716	14.14
2.	National Nominees Limited	129,105	3.74
3.	Pejr Pty Ltd <Lederer Group A/C>	100,000	2.90
4.	J P Morgan Nominees Australia Limited	83,044	2.41
5.	Navigator Australia Ltd <MLC Investment Settlement A/C>	47,827	1.39
6.	Sandhurst Trustees Ltd <DMP Asset Management A/C>	46,725	1.35
7.	Eastcote Pty Ltd <Van Lieshout Family A/C>	40,000	1.16
8.	Australia Executor Trustees Limited <DDH Preferred Income Fund>	31,509	0.91
9.	JDB Services Pty Ltd <RAC & JD Brice Invest A/C>	30,400	0.88
10.	Citicorp Nominees Pty Ltd	28,929	0.84
11.	HSBC Custody Nominees (Australia) Limited – A/C 2	24,787	0.72
12.	Netwealth Investments Limited <Wrap Services A/C>	22,090	0.64
13.	Willimbury Pty Ltd	22,000	0.64
14.	Boodup Nominees Pty Ltd <Otter Super Fund A/C>	21,000	0.61
15.	Catholic Church Insurance Limited	20,400	0.59
16.	GCF Investments Pty Ltd	20,000	0.58
17.	Winchelada Pty Limited	19,500	0.57
18.	Nulis Nominees (Australia) Limited <Navigator Mast Plan Sett A/C>	18,328	0.53
19.	270 King Street Pty Ltd	17,600	0.51
20.	Dakshina Pty Ltd <Dakshina A/C>	17,381	0.50
	Total 20 largest individual noteholders – issued notes	**1,228,341**	**35.61**
	Total remaining noteholders balance	**2,221,659**	**64.39**

Distribution of notes (as at 31 July 2016)

Range	Number of holders	Number of notes	% of notes
1 – 1,000	2,532	956,478	27.72
1,001 – 5,000	350	786,022	22.78
5,001 – 10,000	43	320,363	9.29
10,001 – 100,000	30	770,316	22.33
100,001 and over	2	616,821	17.88
Total	2,957	3,450,000	100.00

Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum $500.00 parcel at $98.45 per unit	6	1	3

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.

Additional information

Principal place of business and registered office in Australia

Level 2
5 Martin Place
Sydney NSW 2000
Telephone: 02 9994 7000
Facsimile: 02 9994 7777
Investor services: 13 35 66
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

Website

challenger.com.au

Manage your shareholding at Computershare Investor Services

Computershare Investor Services Pty Limited
Level 4, 60 Carrington Street
Sydney NSW 2000
Telephone: 02 8234 5000
computershare.com.au
Telephone: 1800 780 782

Auditor

Ernst & Young
200 George Street
Sydney NSW 2000

Go electronic

Challenger can deliver all of your shareholder communications electronically, just update your details via Computershare Investor Services.

Online digital version of this report

The Annual Report 2016 is available at:
challenger.com.au/annualreport2016

challenger

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