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Challenger Limited ACN 106 842 371

2017 Annual Report

Providing our customers with financial security for retirement

challenger

Contents

Key dates

27 September 2017
Final dividend payment date

26 October 2017
2017 Annual General Meeting

13 February 2018
Half year financial results

27 March 2018
Interim dividend payment date

14 August 2018
Full year financial results

26 September 2018
Final dividend payment date

26 October 2018
2018 Annual General Meeting

Full listing of key dates available at

challenger.com.au/share/keydates

Dates may be subject to change

About this Annual Report

The 2017 Annual Report, including the financial report for the year ended 30 June 2017, can be downloaded from Challenger's online Shareholder Centre at:

challenger.com.au/share

2017 Annual Review

The 2017 Annual Review is intended to provide you with useful information about your company in an easy-to-read document. Included in the Annual Review is an operational and financial performance update, reports from the Chair and the Chief Executive Officer, and information on the environmental, social and governance matters that affect your company. The Annual Review can be viewed online at:

challenger.com.au/annualreview2017

2017 Corporate Governance Report

The 2017 Corporate Governance Report can be viewed online at:

challenger.com.au/corporategovernance

2017 Sustainability Report

The 2017 Sustainability Report can be viewed online at:

challenger.com.au/ sustainabilityreport2017

2017 Annual General Meeting

Location

Wesley Centre, 220 Pitt Street, Sydney NSW

Date

26 October 2017

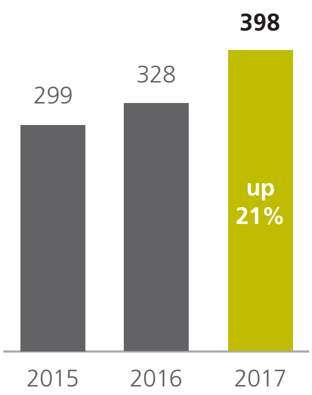
Time

10.30am (Sydney time)

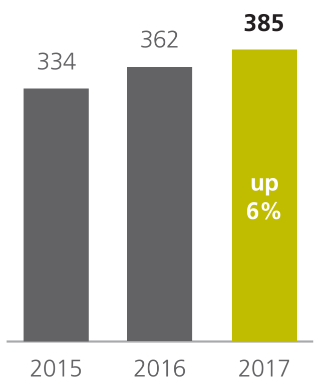
Full details of the meeting will be included in your Notice of Annual General Meeting, which will be sent to shareholders in September 2017.

Group performance highlights

Statutory net profit after tax ($m)



Normalised net profit after tax ($m)



Full year dividend

34.5

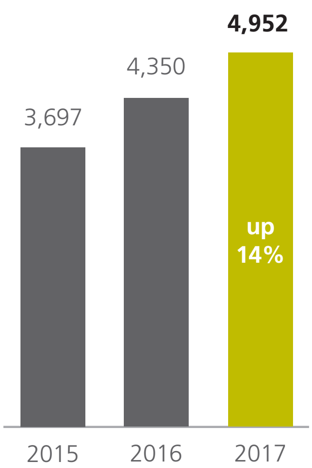
cents per share and fully franked

Total Group assets under management

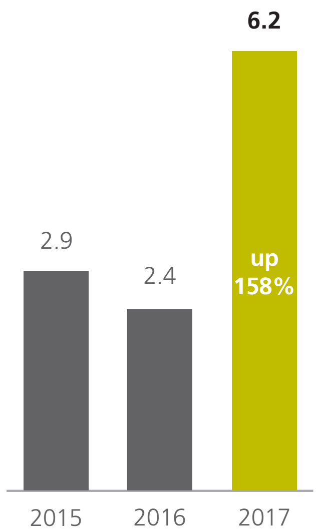
$70bn

up 17%

Life sales ($m)



Funds Management net flows[2] ($bn)



56th largest listed Australian company[1]

Market capitalisation of **$7.6 billion** up **55%** for the year[1]

Normalised return on equity (pre-tax) **18.3%** for the year

Life book growth **12.1%** for the year

Normalised cost to income ratio **33.4%** for the year

[1] As at 30 June 2017.
[2] 2015 and 2016 represent organic net flows and exclude boutique acquisitions and disposals.

Overview

1 About Challenger

Challenger Limited (Challenger, CGF, the Group or the Company) is an investment manager with offices in Australia, London, New York, Stockholm and Tokyo. 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 655 people managing assets of $70.0 billion with total equity of $2.9 billion as at 30 June 2017.

2 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, Product and Marketing team which is responsible for ensuring the appropriate marketing and distribution of both operating segments' products. Both operating segments and the Distribution, Product and Marketing team are supported by centralised operations functions which are responsible for appropriate processes and systems and for 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.

During the year, Life began issuing Australian dollar fixed-rate annuities with a 20-year term to support a reinsurance agreement it entered with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary) in Japan.

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. Fidante Partners also has a presence in Europe with interests in UK-based alternative asset managers.

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 other than those mentioned above, during the year.

3 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 outcomes to customers and 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 customers 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 sustainable business practices and 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 Challenger's vision and strategy (continued)

2017 strategic progress

Our progress in 2017 against our strategic priorities is set out below:

Increase the Australian retirement savings pool allocation to secure and stable incomes	• $4.0 billion of Life annuity sales, up 20%; • $0.9 billion of Life other sales, representing institutional, guaranteed rate products; • Launch of the Challenger Index Plus Fund in December 2016, a new pooled institutional fixed income product; • Development of a new deferred lifetime annuity product to be launched in the first half of 2018; • Enhancement of Liquid Lifetime (lifetime annuity product) in order to increase customer options following the release of the new Government retirement income product rules; • Launch of the Challenger Retirement Illustrator to support advisers and the para-planning process; • Continued superannuation reform engagement and advocacy following new retirement income rules and the Government's development of a framework for Comprehensive Income Products for Retirement; • Increased product access via investment and administration platforms, with Challenger annuities being made available by three profit-for-member funds – CareSuper, Legalsuper, and Local Government Super; and • Annuity relationships being formed with AMP and BT, with Challenger annuities to launch on these platforms during 2018.
Be recognised as the leader and partner of choice in retirement income solutions with a broad product offering	• Challenger annuities launched on three retail platforms – ClearView, Colonial (CarePlus product) and Suncorp; • Partnership formed with Standard Life Investments to distribute the Standard Life Absolute Return Global Bond Strategies Fund in Australia under Challenger's brand; • In October 2016, annuity relationship announced with MS Primary, a leading Japanese insurer. Life issues Australian dollar fixed-rate annuities with a 20-year term to support a reinsurance agreement it has entered into with MS Primary. 15% of Life's total annuity sales in 2017 are represented by sales with MS Primary; • Rated number one by Wealth Insights for – Overall Adviser Satisfaction (2nd year running); BDM Team (6th consecutive year); Client Services (2nd consecutive year); Image and Reputation (2nd consecutive year); and Technical Services (2nd consecutive year); • Received second highest industry net promoter score (conducted by Wealth insights), with peers including Australia's top 20 fund managers; and • Won the Financial Advisers/Plan for Life award for Annuity Provider of the Year and Long Term Income Stream; won Chant West 2017 Super Funds award for Best Longevity Fund; and won Money Management/Lonsec award for Retirement Income Innovation.
Provide customers with relevant investment strategies exhibiting consistently superior performance	• Added two new boutique managers, Avenir Capital, a global equities manager, and Lennox Capital Partners, an Australian small cap equities manager; • Maintained superior investment performance with 97% of FUM in Fidante Partners outperforming benchmarks over the last five years; • Continued Fidante Partners' Europe growth, including restoring the business to profitability; • Expanded the product offering for existing boutique managers, helping increase manager capacity by $30 billion in 2017; and • Continued as one of Australia's fastest growing managers, with FUM increasing at an 18% compound annual growth rate over the past five years.
Maintain a highly engaged, diverse and agile workforce that is committed to sustainable business practices and a strong risk and compliance culture	• 2017 staff engagement survey, conducted by Willis Towers Watson, showed a sustainable engagement score of 88%, which is well above Willis Towers Watson's global high performing norm; • Exceeded diversity targets, with women in all roles at Challenger increasing by 3% to 42.5% (2017 target of 42%) and women in management increasing by 6.1% to 33.5% (2017 target of 32%); • Cost-to-income ratio lowered to an all-time low of 33.4%; and • 88% of employees in the most recent staff engagement survey had a positive view towards Challenger's risk culture (this is 9 percentage points above the Australian national norm).

3 Challenger's vision and strategy (continued)

Market overview and outlook

The Australian superannuation system is underpinned by mandatory contributions, which are scheduled to increase from 9.5% of gross salaries to 12.0% by 2025. Due to the mandated nature of Australia's superannuation system, Australia has the fourth largest pension market globally, and it is expected to grow strongly over the next 20 years. The superannuation system is forecast to grow from $2.3 trillion today to over $10 trillion by 2035[1].

The Life and FM businesses both benefit from growth in Australia's superannuation system. The FM business targets the retirement savings (or accumulation) phase of superannuation by providing investment products seeking to deliver superior investment returns that help build retirement savings. The Life business targets the retirement spending (or retirement) phase of superannuation by providing investment products that convert savings into safe and secure retirement incomes.

Life outlook

Life expects to benefit in the future from the strong growth in the retirement market, which is driven by positive demographic changes, increasing superannuation mandatory contributions and balances and changing retiree risk preferences.

The retirement spending phase of superannuation is expected to grow strongly over the next 20 years as a result of demographic changes, with the number of Australians over the age of 65 expected to increase by 75%[1] as Australia's Baby Boomers (born 1946 to 1964) move into the retirement phase.

Reflecting the demographic changes underway, and growth in Australia's superannuation system, the annual transfer from the retirement savings phase to the retirement spending phase is expected to increase from ~$57 billion per year in 2017 to ~$198 billion by 2030, representing a ~11% compound annual increase[2]. Annuities currently capture less than 5% of this annual transfer to the retirement phase. Challenger is focused on growing the allocation of the Australian retirement savings pool allocated to secure and stable incomes.

There is 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 age pensions to private pensions, retirees are demanding safe, secure retirement income products that convert savings to income and provide financial security. Annuities are seen as a product that addresses these retiree needs.

There are a range of retirement income regulatory reforms currently underway which are designed to enhance the retirement phase of superannuation. These reforms provide a significant opportunity to increase the proportion of retirement savings invested in longevity products, including annuities.

Life is also diversifying its product range and expanding its distribution relationships outside of Australia. In 2016, Life commenced an annuity relationship with MS Primary, a leading provider of Australian dollar denominated annuity products in Japan. The relationship provides Challenger access to Japan's signicantly larger Australian dollar annuities market. The relationship accounted for 15% of Life's 2017 annutiy sales.

Japan has one of the world's most rapidly ageing populations and a low domestic interest rate environment, which is making higher returning foreign currency annuities popular. Challenger is well placed to build on the MS Primary annuity relationship.

Funds Management outlook

Challenger's Funds Management business has experienced significant FUM growth over the past five years, with over $25 billion of net inflows, and is growing significantly faster than the broader Australian funds management market.

This growth can be attributed to the strength of Challenger's retail and institutional distribution teams, a market leading Funds Management business model which focuses on investor alignment, and Australia's superannuation system growth.

Challenger's Fidante Partners' business model demonstrates strong investor alignment and is driving superior long-term investment performance, with 97% of funds outperforming their benchmark[3]. This long-term performance track record is underpinning net flows, with $6.2 billion received in 2017.

Challenger's Fidante Partners business model is being replicated in Europe, providing access to the £7 trillion United Kingdom funds management market[4], while at the same time providing global distribution opportunities for existing investment managers.

Funds Management is expected to continue to benefit from Challenger's distribution capability, superior long-term investment performance, and expansion into Europe. This provides a strong base to continue to grow the business and achieve Challenger's vision of providing our customers with financial security for retirement.

Risks

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

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

[1] Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2015-2035.
[2] Rice Warner 2016 Super Projections – forecasted growth over next 10 years based on existing regulatory environment.
[3] Represents percentage of funds meeting or exceeding performance benchmark over five years.
[4] The Investment Association annual survey 2015–2016.

Operating and financial review

1 Key Performance indicators (KPIs)

1.1 Profitability and growth

KPIs for the year ended 30 June 2017 (with the year to 30 June 2016 being the prior comparative period (PCP), unless otherwise stated) include:

	2017	2016	Change %
Profitability			
Statutory profit attributable to equity holders ($M)	397.6	327.7	21.3
Normalised NPAT ($M)	384.9	361.7	6.4
Statutory EPS (cents)	70.7	58.5	20.9
Normalised EPS (cents)	68.5	64.6	6.0
Total dividend (cents)	34.5	32.5	6.2
Total dividend franking	100%	100%	-
Normalised cost: income ratio	33.4%	34.6%	(1.2)
Statutory RoE after tax	14.4%	12.5%	1.9
Normalised RoE pre tax	18.3%	17.8%	0.5
Normalised RoE after tax	14.0%	13.7%	0.3
Growth			
Total Life annuity sales ($M)	4,011.2	3,351.2	19.7
Life annuity net book growth ($M)	900.4	740.4	21.6
Life annuity net book growth (%)	9.4%	8.5%	0.9
Total FM net flows ($bn)[1]	6.2	(2.5)	(Large)
Total AUM ($bn)	70.0	60.0	16.7

[1] Total FM net flows in 2016 included the derecognition of $5.4 billion as a result of the sale of Kapstream to Janus Capital in July 2015.

Challenger's statutory profit attributable to equity holders was 21.3% higher for the year ended 30 June 2017 primarily as a result of increased income during the period, together with fair value gains on the overall portfolio. Statutory EPS has increased by 20.9% for the year when compared to 2016.

Normalised net profit after tax increased by 6.4% and normalised EPS increased by 6.0% compared to 2016, reflecting higher earnings in both the Life and the Funds Management businesses.

A final dividend of 17.5 cents was announced, franked at 100%, taking the total dividend for 2017 to 34.5 cents franked at 100%, up from 32.5 cents (100% franked).

Challenger's normalised cost to income ratio of 33.4% remains within the targeted range and is lower than the ratio at 30 June 2016 (34.6%). This reflects continued cost discipline throughout the business, particularly Funds Management, and it reflects the benefits of scale. Given the future scale opportunities, Challenger's medium-term expected normalised cost to income ratio target has been revised down from 32–36% to 30–34%.

Challenger targets a normalised return on equity (RoE) of 18%. This was exceeded in the year, with an 18.3% return compared to 17.8% in 2016.

Statutory RoE after tax of 14.4% has also increased (30 June 2016: 12.5%) as a result of higher earnings together with better investment experience after tax than in the prior comparative period.

1.2 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 Process.

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

Capital	2017	2016	Change
Net assets attributable to equity holders ($M)	2,888.1	2,680.9	207.2
CLC excess capital over PCA ($M)	1,225.3	1,010.4	214.9
Group cash ($M)	83.8	84.2	(0.4)
CLC excess capital over PCA + Group cash ($M)	1,309.1	1,094.6	214.5
CLC PCA ratio (times)	1.57	1.57	-
CLC Tier 1 ratio (times)	1.39	1.32	0.07

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.

Challenger completed its second capital notes issue, Challenger Capital Notes 2, during the year, raising $460 million. Proceeds of the notes were used to provide APRA approved Additional Tier 1 capital to CLC. Refer to Note 13 Interest bearing financial liabilities for further details.

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 a Group corporate debt facility of $400 million in order to provide additional financial flexibility. The facility remained undrawn throughout the year.

1 Key Performance indicators (KPIs) (continued)

1.2 Capital management (continued)

Subordinated debt

CLC's total regulatory capital base includes $395.4 million of admissible subordinated debt 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 and will continue to be partially eligible thereafter 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's non-capital conglomerate prudential standards relating to measurement, management, monitoring and reporting aggregate risk exposures and intragroup transactions and exposures came into effect 1 July 2017. 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.

Dividends and dividend reinvestment plan

Dividends	2017	2016	Change	Change %
Interim dividend (cents)[1]	17.0	16.0	1.0	6.3
Final dividend (cents)[2]	17.5	16.5	1.0	6.1
Total dividend (cents)	34.5	32.5	2.0	6.2
Interim dividend franking	100%	100%	-	-
Final dividend franking	100%	100%	-	-

[1] Interim dividend declared on 14 February 2017 and paid on 28 March 2017 in respect of the half year ended 31 December 2016.
[2] Final dividend declared on 14 August 2017 and payable on 27 September 2017 in respect of the half year ended 30 June 2017.

The Board targets a dividend payout ratio range of 45% to 50% of normalised net profit after tax. The dividend payout ratio for the year ended 30 June 2017 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.

The Company continued to operate its dividend reinvestment plan (DRP). The DRP participation rate for the 2016 final dividend was 4% of all issued shares, and 455,140 ordinary shares were issued to satisfy the DRP requirements on 28 September 2016. The participation rate for the 2017 interim dividend was 4%, and 329,428 ordinary shares were issued to satisfy DRP requirements on 28 March 2017.

The DRP will continue in operation for the 2017 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.

1.3 Credit ratings

Challenger Limited and CLC are rated by Standard & Poor's (S&P). In November 2016, 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.

2 Normalised profit and investment experience

Challenger has performed strongly, building on its growth momentum by delivering increased sales in its Life segment, increased funds under management in its FM segment and an overall growth in earnings.

Normalised framework (Non IFRS)

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.

2 Normalised profit and investment experience (continued)

Management analysis – normalised results

	2017 $M	2016 $M	Change $M	Change %
Net income[1]	766.2	721.1	45.1	6.3
Comprising:				
– Life normalised COE	631.4	592.4	39.0	6.6
– FM net income	134.0	127.7	6.3	4.9
– Corporate and other net income	0.8	1.0	(0.2)	(20.0)
Operating expenses[1]	(255.9)	(249.6)	(6.3)	2.5
Normalised EBIT	**510.3**	**471.5**	**38.8**	**8.2**
Comprising:				
– Life normalised EBIT	531.2	499.8	31.4	6.3
– FM normalised EBIT	45.1	37.4	7.7	20.6
– Corporate and other normalised EBIT	(66.0)	(65.7)	(0.3)	(0.5)
Interest and borrowing costs	(5.3)	(4.1)	(1.2)	(29.3)
Tax on normalised profit	(120.1)	(105.7)	(14.4)	(13.6)
Normalised NPAT	**384.9**	**361.7**	**23.2**	**6.4**
Investment experience after tax	12.7	(56.1)	68.8	Large
Significant items after tax	-	22.1	(22.1)	Large
Statutory net profit after tax attributable to equity holders	**397.6**	**327.7**	**69.9**	**21.3**

[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, 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 earnings before interest and tax (EBIT) increased as a result of higher Life investment assets, offset slightly by a declining margin being earned on those assets. Life's average assets under management (AUM) increased by 11.7% as a result of increased net book growth in annuities and valuation movements on those assets.

Funds Management net fee income increased (up $6.3 million) due to both increased Fidante Partners and Challenger Investment Partners income, partially offset by reduced performance fees during the period. Funds Management average FUM increased by 12.1%.

Operating expenses increased modestly (up $6.3 million), with cost discipline maintained in both Life and Funds Management, with Funds Management's expenses falling by $1.4 million from 2016.

In 2017, Challenger's employee numbers increased by 20 (or 3.1%) to 655.

Normalised tax for the year was $120.1 million, up $14.4 million (13.6%) from 2016 due to higher earnings before interest and tax (up 8.2%). The normalised effective tax rate for the period increased to 23.8% (22.6% at 30 June 2016).

Management analysis – investment experience

	2017 $M	2016 $M
Actual capital growth[1]		
– Cash and fixed income	96.7	(139.1)
– Infrastructure	(28.2)	28.5
– Property (net of debt)	55.2	114.9
– Equity and other investments	73.3	(42.8)
Total actual capital growth	**197.0**	**(38.5)**
Normalised capital growth[2]		
– Cash and fixed income	(33.9)	(29.4)
– Infrastructure	21.0	22.0
– Property (net of debt)	65.2	63.7
– Equity and other investments	52.6	44.2
Total normalised capital growth	**104.9**	**100.5**
Investment experience		
– Cash and fixed income	130.6	(109.7)
– Infrastructure	(49.2)	6.5
– Property (net of debt)	(10.0)	51.2
– Equity and other investments	20.7	(87.0)
	92.1	(139.0)
Annuity valuation experience[3]	(70.7)	70.6
Investment experience before tax	21.4	(68.4)
Tax benefit/(expense)	(8.7)	12.3
Investment experience after tax	**12.7**	**(56.1)**

[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.

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.

Investment experience in 2017 comprises a $92.1 million gain in relation to Life's assets and a $70.7 million loss in relation to Life's liabilities. Life's asset portfolio experienced gains across fixed income and equity and alternatives which were partially offset by losses on Life's property and infrastructure assets. The positive fixed income movements, which were primarily due to the contraction in domestic and offshore credit spreads, were partially offset by the increase in the value of Life's liabilities as a result of being fair valued at a lower discount rate.

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 nine 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	2017 $M	2016 $M	Change $M	Change %
Normalised COE	631.4	592.4	39.0	6.6
– Cash earnings	526.4	491.9	34.5	7.0
– Normalised capital growth	105.0	100.5	4.5	4.5
Operating expenses	(100.2)	(92.6)	(7.6)	(8.2)
Normalised EBIT	**531.2**	**499.8**	**31.4**	**6.3**

Life normalised EBIT increased by $31.4 million (up 6.3%) due to higher normalised COE (up $39.0 million or 6.6%), which was partially offset with operating expenses increasing by $7.6 million (or 8.2%). The higher normalised COE was as a result of higher investment assets, with Life average investment assets increasing 11.7%.

Life generated a normalised return on equity (pre-tax) of 21.0%, up by 0.6 percentage points from the prior year.

Life annuity sales increased strongly over the prior period (up 19.7%), with both increased fixed term sales (up 9.2%) and lifetime sales (up 69.8%) 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, relationships with Local Government Super, ClearView Wealth Solutions, CareSuper, legalsuper and Suncorp all went live during the period and are beginning to drive annuity sales. During the period, Life also announced new relationships with AMP, BT and MS Primary. The relationships with AMP and BT are to provide the full range of Life's annuity products through both AMP and BT's investment administration platforms. Both the AMP and BT opportunities are currently in development and are expected to begin delivering sales during the 2018 financial year with AMP expected to come online in the first half of financial year 2018 and BT in the second half of financial year 2018.

In November 2016, Life began issuing Australian dollar fixed-rate annuities with a 20-year term to support its reinsurance agreement with MS Primary. Under the terms of the new product, the customer can choose an annuity payment period of 5, 10 or 20 years, with a benefit payable upon death. 15% of Life's total annuity sales in 2017 are represented by sales with MS Primary.

Life sales	2017 $M	2016 $M	Change $M	Change %
Fixed-term annuities	3,024.3	2,769.8	254.5	9.2
Lifetime annuities	986.9	581.4	405.5	Large
Total Life annuity sales	4,011.2	3,351.2	660.0	19.7
Other Life sales	941.2	998.5	(57.3)	(5.7)
Total Life sales	**4,952.4**	**4,349.7**	**602.7**	**13.9**
Annuity net flows	900.4	740.4	160.0	21.6
Other Life net flows	412.5	327.9	84.6	25.8

Annuity net flows (new annuity sales less capital repayments) increased by 21.6% to $900.4 million. Based on the opening Life annuity book for the 2017 financial year ($9,558.5 million), annuity net book growth for the period was 9.4%, up from 8.5% in the prior period.

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

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 97% of strategies exceeding benchmark over the last five years.

Challenger Investment Partners (CIP) develops and manages assets under Challenger's brand for CLC and third party institutional investors.

FM normalised results	2017 $M	2016 $M	Change $M	Change %
Net income	134.0	127.7	6.3	4.9
– Fidante Partners	80.0	78.2	1.8	2.3
– CIP	54.0	49.5	4.5	9.0
Operating expenses	(88.9)	(90.3)	1.4	(1.6)
Normalised EBIT	**45.1**	**37.4**	**7.7**	**20.6**

Funds Management normalised EBIT increased by 20.6% in 2017, with expenses declining during the period.

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.

[1] Rainmaker – Consolidated FUM for Australian Fund Managers March 2017.

4 Funds Management segment results (continued)

Fidante Partners' net income increased for the period primarily as a result of fees earned by Fidante Partners Europe (up $7.8 million), which was partially offset by lower performance fees than in the prior period (down $4.5 million).

CIP's net income increased due to higher net management fees (up $4.2 million).

Funds Management's normalised RoE (pre-tax) for the year was 24.8%, up by 1.3 percentage points from the prior year. This increase comes largely as a result of Fidante Partners Europe returning to profitability during the year. RoE in Funds Management continues to benefit from FUM growth and capturing the benefits of scale.

FM FUM and flows	2017 $bn	2016 $bn	Change $bn	Change %
Total FUM	66.9	56.7	10.2	18.0
– Fidante Partners	51.0	43.0	8.0	18.6
– CIP	15.9	13.7	2.2	16.1
Net flows	6.2	(2.5)	8.7	Large
– Fidante Partners	4.1	(2.6)	6.7	Large
– CIP	2.1	0.1	2.0	Large

Fidante Partners' FUM increase ($8.0 billion) was driven by net inflows ($4.1 billion) and positive impact from investment markets (up $3.9 billion). Fidante Partners' net outflows in 2016 included the loss of FUM resulting from the sale of Kapstream in July 2015 ($5.4 billion).

CIP FUM growth (up $2.2 billion) is primarily a result of additional fixed income flows (up $1.9 billion) and property flows (up $0.2 billion), from both CLC and third party mandates.

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	2017 $M	2016 $M	Change $M	Change %
Net income	0.8	1.0	(0.2)	(20.0)
Operating expenses	(66.8)	(66.7)	(0.1)	(0.2)
Normalised EBIT	**(66.0)**	**(65.7)**	**(0.3)**	**0.5**
Interest and borrowing costs	(5.3)	(4.1)	(1.2)	29.3
Normalised loss before tax	**(71.3)**	**(69.8)**	**(1.5)**	**2.2**

Normalised EBIT for the Corporate and other segment was lower (down $0.3 million) as a result of higher operating expenses and lower income.

6 Guidance for the 2018 financial year

Challenger is well positioned with strong product offerings, expanding distribution networks and highly efficient operations.

Subsequent to balance date, Challenger announced a strengthening of its strategic relationship with MS&AD Insurance Group Holdings Inc., the parent company of MS Primary (MS&AD), with a $500 million equity placement to MS&AD. Refer to Note 8 of the Directors' report on page 40 for further details.

For 2018, Challenger is targeting normalised net profit before tax of between $545 million and $565 million, representing growth of between 8–12%.

The normalised cost to income ratio is also forecast to decline further to a range of 30–34% over the medium term.

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.

Five-year history

	2017	2016	2015	2014	2013
Earnings ($M)					
Normalised cash operating earnings (COE)	631.4	592.4	543.8	481.3	452.2
Net fee income	134.0	127.7	117.5	110.2	99.4
Other income	0.8	1.0	1.3	1.8	4.9
Total net income	**766.2**	**721.1**	**662.6**	**593.3**	**556.5**
Personnel expenses	(179.3)	(172.8)	(154.8)	(144.4)	(130.3)
Other expenses	(76.6)	(76.8)	(69.4)	(61.0)	(61.4)
Total expenses	**(255.9)**	**(249.6)**	**(224.2)**	**(205.4)**	**(191.7)**
Normalised EBIT	**510.3**	**471.5**	**438.4**	**387.9**	**364.8**
Interest and borrowing costs	(5.3)	(4.1)	(3.8)	(4.1)	(4.6)
Normalised profit before tax	**505.0**	**467.4**	**434.6**	**383.8**	**360.2**
Normalised tax	(120.1)	(105.7)	(100.6)	(55.1)	(51.7)
Normalised profit after tax	**384.9**	**361.7**	**334.0**	**328.7**	**308.5**
Investment experience after tax	12.7	(56.1)	(35.0)	11.9	99.8
Significant items after tax	-	22.1	-	-	8.5
Profit attributable to equity holders	**397.6**	**327.7**	**299.0**	**340.6**	**416.8**
Normalised cost to income ratio (%)	33.4%	34.6%	33.8%	34.6%	34.5%
Normalised effective tax rate (%)	23.8%	22.6%	23.1%	14.4%	14.4%
Earnings per share (EPS) (cents)					
Basic EPS – normalised profit	68.5	64.6	61.2	64.0	58.6
Basic EPS – statutory profit	70.7	58.5	54.8	66.3	79.2
Diluted EPS – normalised profit	65.8	60.9	57.2	60.6	58.0
Diluted EPS – statutory profit	67.8	55.4	51.4	62.8	78.3
Capital management (%)					
Normalised return on equity (RoE) – pre-tax	18.3%	17.8%	18.0%	18.8%	19.6%
Normalised return on equity (RoE) – post-tax	14.0%	13.7%	13.9%	16.1%	16.8%
Statutory return on equity (RoE) – post-tax	14.4%	12.5%	12.4%	16.7%	22.7%
Statement of financial position ($M)					
Total assets	23,011.0	21,256.6	18,531.6	17,323.3	17,788.4
Total liabilities	20,109.7	18,572.6	15,893.0	15,047.2	15,494.2
Net assets[1]	2,901.3	2,684.0	2,638.6	2,276.1	2,294.2
Net assets[2]	2,888.1	2,680.9	2,543.2	2,153.3	1,947.4
Net assets[2] – average[3]	2,753.8	2,630.7	2,410.4	2,044.4	1,835.7
Net tangible assets	2,299.7	2,097.0	1,993.8	1,607.5	1,426.3
Net assets per basic share ($)	5.14	4.80	4.60	4.22	3.78
Net tangible assets per basic share ($)	4.09	3.75	3.60	3.15	2.77

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

Five-year history (continued)

	2017	2016	2015	2014	2013
Underlying operating cash flow ($M)	**299.9**	**297.1**	**287.9**	**321.0**	**321.5**
Dividends per share (cents)					
Dividend – interim[1]	17.0	16.0	14.5	12.5	9.5
Dividend – final[1]	17.5	16.5	15.5	13.5	10.5
Total dividend[1]	**34.5**	**32.5**	**30.0**	**26.0**	**20.0**
Dividend payout ratio – normalised profit (%)	50.4%	50.3%	49.0%	40.6%	34.1%
Dividend payout ratio – statutory profit (%)	48.8%	55.6%	54.7%	39.2%	25.2%
Sales and annuity book net flows ($M)					
Annuity sales	4,011.1	3,351.2	2,753.1	2,798.8	2,179.2
Other Life sales	941.2	998.5	944.0	581.6	951.8
Total Life sales	**4,952.3**	**4,349.7**	**3,697.1**	**3,380.4**	**3,131.0**
Life annuity net flows[2]	900.4	740.4	738.2	887.1	598.1
Life annuity book	10,322.2	9,558.5	8,692.6	7,824.4	7,123.3
Life annuity net book growth[2] (%)	9.4%	8.5%	9.4%	12.5%	9.1%
Funds Management – net flows[3]	6,220.6	(2,517.2)	7,738.9	2,147.4	6,978.6
Assets under management ($M)					
Life	15,677	14,112	12,795	11,087	10,787
Funds Management	66,905	56,662	57,902	47,126	41,103
Elimination of cross-holdings[4]	(12,568)	(10,723)	(10,908)	(7,488)	(7,120)
Total assets under management	**70,014**	**60,051**	**59,789**	**50,725**	**44,770**
Other					
Headcount – closing full time employees	655	635	560	539	487
Weighted average number of ASX-listed basic shares on issue (M)	562.2	560.2	545.7	513.8	526.1
Number of shares on issue – closing (M)	572.0	571.2	569.7	530.9	530.9
Share price – closing ($)	13.34	8.63	6.72	7.44	4.01
Market capitalisation at 30 June ($M)[5]	7,630.5	4,929.5	3,828.4	3,949.9	2,128.9

[1] 2017 final dividend franked at 100% (2017 interim: 100%; 2016 final: 100%; 2016 interim: 100%; 2015 final: 100%, 2015 interim: 70%, 2014 final: 40%, previous periods: unfranked).
[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.

Directors' report

The Directors of Challenger Limited (the Company) submit their report, together with the financial report of the Company and its controlled entities (the Group or Challenger), for the year ended 30 June 2017.

The information appearing on pages 1 to 11 forms part of the Directors' report for the financial year ended 30 June 2017 and is to be read in conjunction with the following information.

1 Directors

The names and details of the Directors of the Company holding office during the financial year ended 30 June 2017 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, including 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) and Myer Holdings Limited (appointed 28 November 2016).

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.

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, 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 Corporate governance summary

3.1 Roles and responsibilities of Board and management

The role of the Board and delegations

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

The Board is responsible for setting the Company's vision, which is to provide our customers with financial security for retirement. This is a long-term vision, and the Board sets the strategic priorities each year to ensure that this vision is achieved over the long term.

Directors are actively involved in setting, approving and regularly monitoring Challenger's strategic initiatives and holding management accountable for progress. This process involves an annual Board strategy offsite, an annual Board risk workshop, and regular Board reporting, discussion and review with management. Similarly, the Board ensures that rigorous governance processes are operating effectively to guide decision-making across the organisation.

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

- establishment, promotion and maintenance of the strategic direction of the Company;
- approval of business plans, budgets and financial policies;
- consideration of management recommendations on strategic business matters;
- establishment, promotion and maintenance of proper processes and controls to maintain the integrity of accounting and financial records and reporting;
- fairly and responsibly rewarding executives, having regard to the interests of shareholders, the performance of executives, market conditions and the Company's performance;
- adoption and oversight of implementation of appropriate corporate governance practices;
- oversight of the establishment, promotion and maintenance of effective risk management policies and processes;
- determination and adoption of the Company's dividend policy;
- review of the Board's composition and performance;

3 Corporate governance summary (continued)

3.1 Roles and responsibilities of Board and management (continued)

- appointment, evaluation and remuneration of the Chief Executive Officer (CEO) and approval of the appointment of the Chief Financial Officer (CFO), the Chief Risk Officer (CRO), the General Counsel and the Company Secretary; and
- determination of the extent of the CEO's delegated authority.

The Board has established committees to assist in carrying out its responsibilities and to consider certain issues and functions in detail. The Board committees are discussed on page 15.

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

Management responsibility

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

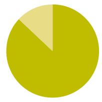
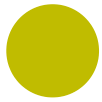
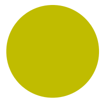
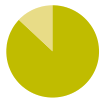
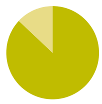
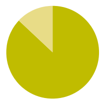
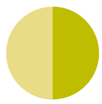
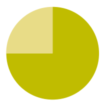
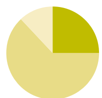
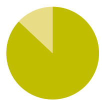
3.2 Directors' skills matrix

The Board considers that its current members have an appropriate collective mix of skills, experience, expertise and diversity to:

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

The Board's competencies are assessed annually. The results of the most recent assessment are shown in the table following.

The Directors generally have a high level of competency across the areas of expertise relevant to the business.

Leadership & Strategy Leadership, effective communication and influencing skills. Strategic thinking capability and transactional expertise.		Advanced competency 87.5% Satisfactory competency 12.5%
Corporate Governance Public company corporate governance literacy.		Advanced competency 100%
Financial Acumen Financial reporting literacy including exposure to accounting standards.		Advanced competency 100%
Risk & Compliance Financial services and fiduciary regulatory awareness. Relevant compliance and risk experience including legal and tax risk management.		Advanced competency 87.5% Satisfactory competency 12.5%
Sectoral Exposure Funds management and life insurance sectors, and market experience in jurisdictions in which Challenger operates.		Advanced competency 87.5% Satisfactory competency 12.5%
Investment & Credit Expertise Credit risk management and investment expertise including asset class literacy and exposure.		Advanced competency 87.5% Satisfactory competency 12.5%
Marketing & Distribution Distribution, marketing and fostering key institutional customer relationships.		Advanced competency 50% Satisfactory competency 50%
Public Policy Relevant public policy areas and key Government and regulator relationships.		Advanced competency 75% Satisfactory competency 25%
Information Technology Understanding of IT strategy, the application of technology in large organisations and innovation.		Advanced competency 25% Satisfactory competency 62.5% Some competency 12.5%
People & Remuneration Building capable and highly engaged teams and understanding of current remuneration regulation, structuring and sectoral conditions.		Advanced competency 87.5% Satisfactory competency 12.5%

3 Corporate governance summary (continued)

3.3 Committees of the Board

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

- The Group Risk Committee;
- The Group Audit Committee;
- The Remuneration Committee; and
- The Nomination Committee.

Each committee has its own charter, copies of which are available on the Company website (www.challenger.com.au).

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 2016 to 30 June 2017 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	10	10	4	3	4	3	5	4	2	2
B Benari[1]	10	10	4	4	4	4	5	5	-	-
G Cubbin	10	10	4	4	4	4	5	5	2	2
S Gregg	10	9	-	-	-	-	5	4	2	2
J Grunzweig	10	7	-	-	-	-	-	-	2	-
B Shanahan	10	10	4	4	4	4	5	5	2	2
J Stephenson	10	10	4	4	4	4	-	-	2	2
L Zwier	10	8	-	-	-	-	-	-	2	2

[1] B Benari attends the Group Risk Committee, Group Audit Committee and Remuneration Committee meetings at the invitation of these committees. There are no management representatives appointed as members of any Board committee.

3.4 Risk management framework

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 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 the GRC, the 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 separate 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 which 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.

3 Corporate governance summary (continued)

3.4 Risk management framework (continued)

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 equity investments, unlisted equity investments and investments in absolute return strategies, where returns are considered to be generally uncorrelated to listed equity market returns; 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 Remuneration report

Letter from the Chair

Dear fellow shareholders,

On behalf of your Board, I am pleased to present Challenger's 2017 Remuneration Report.

The Board considers its role in setting and overseeing executive remuneration policies and practices to be a key responsibility. As always, this year we have reviewed our approach to ensure that it continues to strongly align with shareholder interests. Our framework is designed to:

- provide a clear link between performance and remuneration outcomes;
- ensure that remuneration outcomes are consistent with Challenger's short and long-term objectives, including risk management practices that support sustained performance over the long term; and
- attract and retain key talent.

We remain satisfied that our framework, revised in previous years to lengthen the vesting period of share-based awards and the use of a funding range cap for variable rewards, is achieving these objectives. Therefore, we have made no changes to the structure of our remuneration framework this year.

One aspect that our review did identify for adjustment was our long-term incentive target. The Board believes that linking long-term incentives to total shareholder returns (TSR) strongly aligns rewards with outcomes for our shareholders. For this reason, we view absolute TSR as the appropriate measure for the rewarding of long-term incentives, a measure we have consistently used for many years. The target for TSR is set with reference to market trends. Since Challenger introduced the absolute TSR performance measure in 2010, market conditions, including the global growth and interest rate environment, have changed considerably. For example, in that time the 10-year Australian Government bond rate has reduced from 5.7% to 2.4%. As a result, this year we have adjusted our TSR target for future awards to 7–10% compounded annually (previously 8–12%). The hurdle change applies to awards from 2017 only; no change has been made to pre-existing awards. We believe the new range strikes the appropriate balance, representing a comparatively strong outcome for shareholders. Over the past 10 years, a 7% annual compounding TSR was only achieved by the top quartile of ASX100 companies. More information on the rationale for the TSR hurdle change, including quantitative data reviewed, is provided on page 20.

This year's remuneration report provides additional disclosure on how executive performance was assessed and the relationship between pay outcomes and Challenger's share price. We have also substantially enhanced our sustainability report to provide shareholders with more information about the matters that are material to our business.

Challenger has continued to deliver for shareholders over an extended period. Over five years Challenger's TSR has exceeded 350%, significantly outperforming the ASX100 (which achieved a TSR of 77%). Challenger is one of only seven ASX100 companies to achieve top quartile TSR performance across one, three and five years.

The 2017 financial year has been an outstanding year in terms of key initiatives that position us for sustainable long-term growth, including:

- expansion into the Japanese annuity market via a partnership with MS Primary to provide Australian dollar annuities in Japan;
- the successful implementation of annuities onto three profit-for-member super fund platforms; and
- the announcement of plans to offer Challenger annuities via the AMP and BT platforms, which complement the existing Colonial relationship. On completion, two thirds of all Australian financial advisers will be able to access Challenger annuities via platforms.

The Board is focused on rewarding key executives who have overseen these initiatives and ensuring they are appropriately incentivised to continue to develop and maximise these opportunities which will deliver shareholders long-term growth.

Good governance practices include undertaking regular engagement with stakeholders and reporting clearly and transparently. This year, we have continued our commitment to these practices. I have engaged with shareholders through direct meetings, met with proxy advisers and engaged with retail shareholder representatives. I look forward to further discussions with shareholders at our Annual General Meeting.

Thank you for your continued support for Challenger.

Peter Polson
Chair

4 Remuneration report (continued)

4.1 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 2017. Remuneration components comprise fixed and variable remuneration as summarised in the following table:

	Component	Overview	Link to remuneration 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	In recognition of initiatives undertaken in 2017 focused on long-term value, the Board determined that a portion of 2017 DPSRs 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.	Motivates KMP to pursue Challenger's long-term growth and success within approved risk parameters, thus supporting shareholder alignment.

4 Remuneration report (continued)

4.1 Remuneration strategy and structure (continued)

Fixed remuneration

When determining fixed remuneration for KMP, the Board considers market pay benchmarks for roles with similar responsibilities and complexity and roles requiring similar experience and skills.

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 2017, objectives were set and agreed with KMP in July 2016. In July 2017, the Board assessed the performance of each KMP against these objectives, which determined individual STI awards for KMP, as outlined in Section 4.4 Performance and remuneration snapshot.

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. The Board determined that the pro-rata STI for Mr Paul Rogan, who retired during the year, should be awarded in cash. Excluding Mr Rogan, for 2017, 24% of aggregate variable reward for KMP was delivered as cash, 24% as share awards deferred for up to two years and 52% as share awards deferred for three years or more. Refer to Section 4.5 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 prior to grant date.

Hurdled Performance Share Rights (HPSRs)

HPSRs are awarded annually to KMP and to other employees based on a range of criteria, including current year performance, potential and ability 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 face value and a forecast range of future value delivered at minimum and maximum vesting.

The Board believes it is appropriate to value HPSRs differently from DPSRs in recognition of the range of potential future values.

HPSR awards are allocated based on the fair value, at grant date. 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 only deliver the face value of the share at vesting if absolute TSR is at or above 10% compounded annually (for awards made from 2017 onwards). HPSRs deliver no value at vesting if absolute TSR is below the performance threshold of 7% compounded annually (for awards made from 2017 onwards). Therefore, 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 to Note 27 Employee entitlements for details.

4 Remuneration report (continued)

4.1 Remuneration strategy and structure (continued)

Performance measurement

The Board considers TSR an effective way to incentivise and measure the creation of shareholder value. In August 2010, the Board approved the implementation of absolute TSR as the measure of long-term performance. The Board believes that an absolute rather than 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.

Since the introduction of an absolute TSR performance measure in August 2010, it has been consistently applied to determine long-term performance vesting. Reflecting market practice, 50% of HPSR awards vest at an agreed performance threshold (compounded annually), with full vesting occurring at an agreed higher performance threshold (compounded annually).

Each year the Board reviews the performance threshold set for long-term performance, in order to ensure that it appropriately incentivises KMP, reduces retention risk and ensures alignment between KMP and shareholders. For 2017 HPSR awards, the Board determined that using absolute TSR as the long-term performance threshold remained appropriate for Challenger, however with reduced performance thresholds.

For 2017, 50% of HPSR awards vest at threshold performance of 7% absolute TSR compounded annually (previously 8%) and fully vest when absolute TSR of 10% compounded annually (previously 12%) is achieved.

Absolute TSR Compounded annually		
Awards pre 2017	Awards from 2017	% of HPSRs that vest
Less than 8% p.a.	Less than 7% p.a	0%
8% to 12% p.a.	7% to 10% p.a	Straight-line vesting between 50% and 100%
12% p.a. and above	10% p.a and above	100%

No change has been made to pre-existing awards. HPSR awards made prior to 2017 will continue to be assessed against the higher performance thresholds of 8% to 12% compounded annually.

Over four years, 7% annual compound growth represents an increase of 31% and 10% compound growth represents an increase of 46%. As an example, a share worth $13.00 today and paying a 33 cents per share dividend reinvested each year would need to produce a total return of $6.03 over four years to achieve a 10% per annum compounded return and for all HPSR awards to vest in full.

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 eliminates the potential for short-term price volatility to impact vesting outcomes.

The Board considered the 2017 HPSR performance thresholds based on the following:

- since Challenger introduced the absolute TSR performance measure in 2010, market conditions and the global growth and interest rate environment have changed considerably. In that time, interest rates have reduced by two-thirds and investment market returns have declined materially. In light of the lower growth and lower return environment, the Board considered the previous absolute TSR thresholds to be inappropriate; and
- the potential relationship between long-term performance measures and risk taking.

In setting the 2017 performance thresholds, the Board reviewed a range of quantitative data, including:

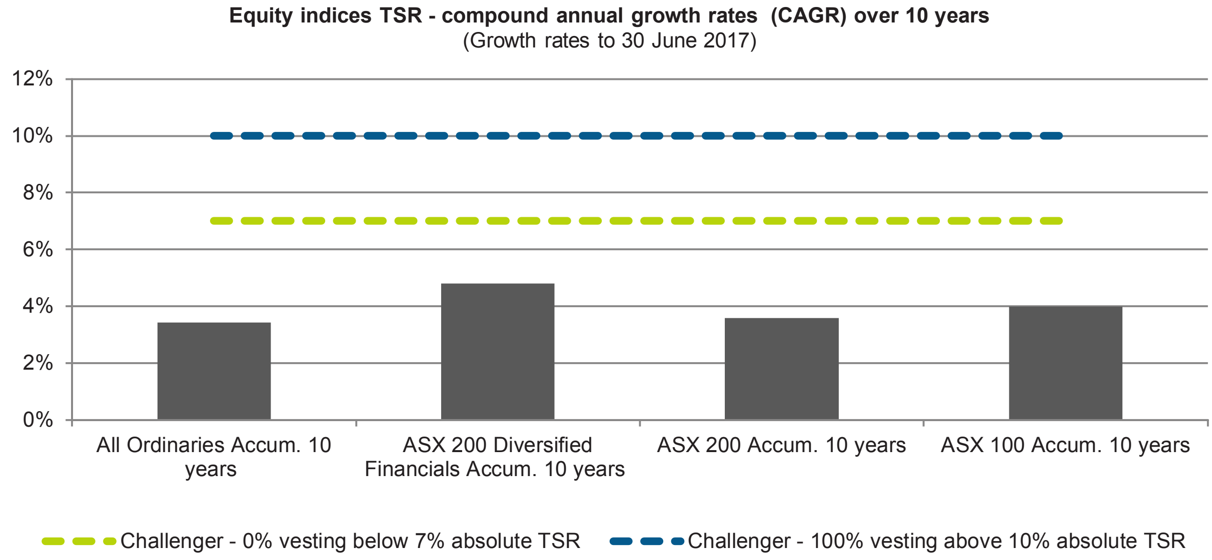
- Market returns over a 10 year period to ensure that the new performance thresholds were sufficiently challenging. The quantitative data confirmed the target of 7% to 10% compounded annually represents high relative performance. Over the last 10 years top quartile TSR performance for the ASX100 commenced at 7.5% compounded annually.
- Average market TSRs over the past five years, which highlighted the extent to which average market TSRs have declined. For example, the average ASX100 10-year compound TSR return in 2013 was 9.6% per annum compound and has fallen to 4.0% in 2017 (with top quartile commencing at 7.5% per annum compound).
- The performance of Australia's leading superannuation and pension funds, revealing that average superannuation returns are tracking well below long-term averages. Reflecting the low growth and low return environment, the Future Fund recently reduced its long term return target by 1%, after achieving a return of 7.7% over the past 10 years; and
- Global interest rates and their impact on equity market returns. For example, the 10 year Australian Government bond rate was 5.7% in 2010 and has reduced to 2.4% in 2017.

4 Remuneration report (continued)

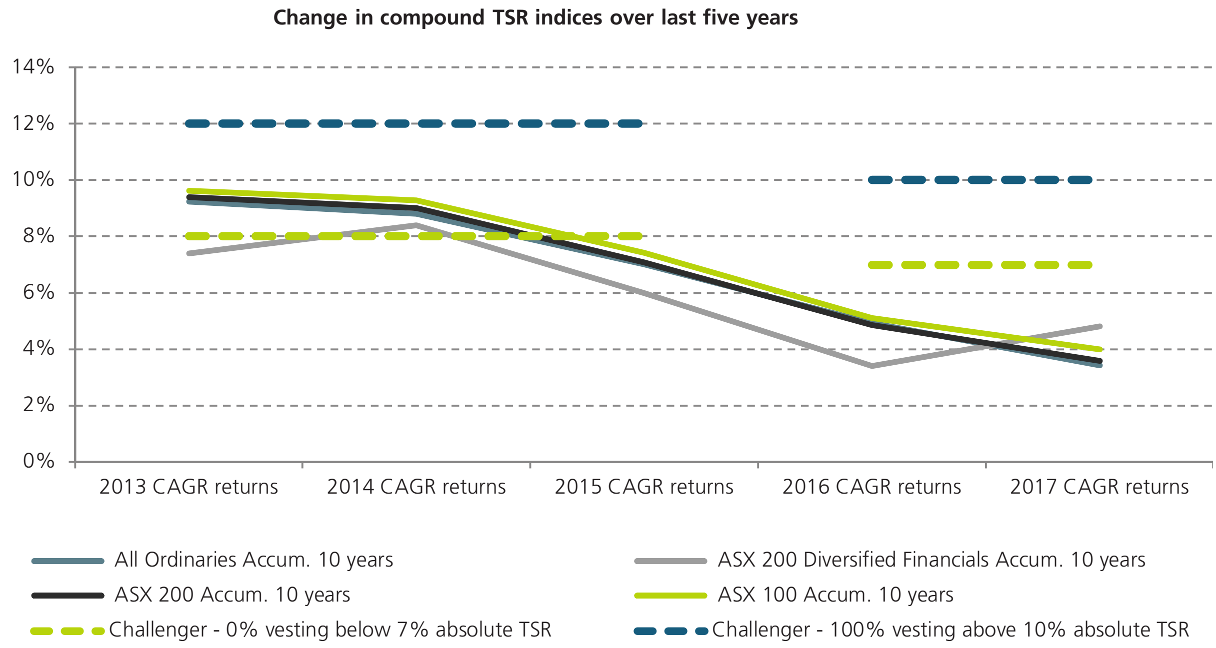
4.1 Remuneration strategy and structure (continued)

The quantitative data reviewed by the Board confirms that the new minimum performance threshold of 7% compounded annually is challenging in the low growth and low interest rate environment and continues to represent a relatively high TSR outcome for shareholders.

For full vesting, the performance outcome of 10% compounded annually is significantly challenging, with only 16 ASX100 companies achieving this over the past 10 years.



As evidenced in the chart above, Challenger's HPSR performance targets are well above the compound average growth rates of Australian equity indices over the past 10 years.



As evidenced in the chart above, 10-year TSRs for Australian equity market indices have reduced significantly over the past five years.

The Board will continue to monitor conditions and adjust the long-term performance thresholds as necessary in order to ensure that they remain commensurate with long-term performance expectations.

4 Remuneration report (continued)

4.1 Remuneration strategy and structure (continued)

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 the Challenger dividend paid per share 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 4.5 Key Management Personnel remuneration arrangements.

Tax Exempt Share Plan

The Board encourages employee share ownership because it believes that 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.

4 Remuneration report (continued)

4.2 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 2017, 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 2017, 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 2017, 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 $40,672 (inclusive of GST). KPMG provided internal audit, tax, accounting, actuarial and transaction services and general remuneration factual information in 2017. Fees paid or payable to KPMG in respect of these activities were $1,494,128 (inclusive of GST). • Mercer was retained in 2017 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 and 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 2017 approved the following peer groups:

1. **Financial Industry Remuneration Group survey:** 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:** Data is 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.
3. **General industry publicly disclosed data:** Data is 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.

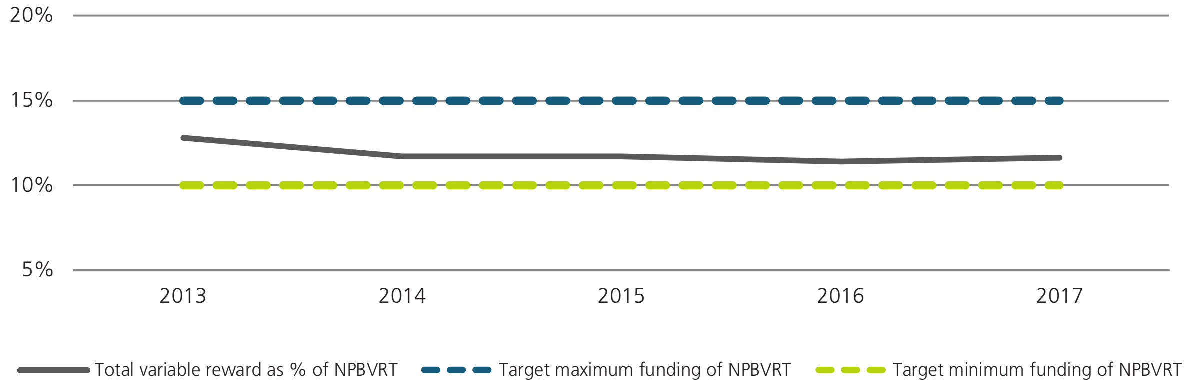
In July 2017, the Board considered remuneration benchmark data as a key input when determining 2017 remuneration outcomes for KMP and is confident that awarded remuneration reflects performance and is positioned and structured at a market-competitive level reflective of the markets in which Challenger competes for talent, and the specialist nature of the skills and experience of Challenger KMP.

4 Remuneration report (continued)

4.2 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 2013 through 2017 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 2017, the Board approved a variable remuneration pool of 11.6% of NPBVRT (total actual variable remuneration was 11.4% in 2016). The Board considers that the 2017 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 2017, 55% (54% in 2016) of the pool was awarded as cash, 18% (19% in 2016) was awarded as equity deferred up to two years and 27% (27% in 2016) 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

The Board reviews KMP and Non-Executive Director minimum shareholding guidelines annually in order to ensure alignment with shareholders and market practice. The 2017 review revealed that a number of companies count unhurdled deferred equity awards towards minimum shareholdings. Deferred equity awards are not subject to performance conditions and provide similar shareholder alignment as fully owned shares. While the Board determined not to amend Challenger's minimum shareholding guidelines, which do not count deferred equity towards minimum holdings, the shareholding disclosures in Sections 4.5 Key Management Personnel remuneration arrangements have been expanded to include holdings inclusive of deferred equity awards.

Minimum shareholding requirements are detailed in the following table:

Group	Requirement	Implied value[1]
Non-Executive Directors (NEDs)	One times base fees	Chair: $525,500 NEDs: $179,000
Managing Director and 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 2017.

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 2017 are set out in Section 4.5 Key Management Personnel remuneration arrangements and 4.6 Non-Executive Director disclosures.

Employee share trading policy

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

4 Remuneration report (continued)

4.2 Remuneration governance (continued)

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

Challenger prohibits KMP and employees from taking out margin loans on Challenger shares, with any exceptions to this rule requiring Board approval. There have been no requests for exceptions to this policy for the year ended 30 June 2017 (no requests in 2016).

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 2017, 77% of permanent employees hold unvested Challenger equity (75% in 2016). This constitutes 2% employee ownership of Challenger (3% in 2016).

4.3 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 4.4 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 2017, this included:

- an assessment of employee responses to risk related questions in Challenger's employee engagement survey; and
- ongoing control assurance through external and internal audits by Ernst & Young and KPMG respectively.

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).

4.4 Performance and remuneration snapshot

Since 2013, Challenger has increased both normalised net profit after tax (NPAT) by 25% and normalised earnings per share (EPS) by 17%, with this sustained strong business performance translating into increased dividends to shareholders by 73% over the period. Performance against key financial metrics and comparison to peer shareholder returns is summarised in the following tables and graphs.

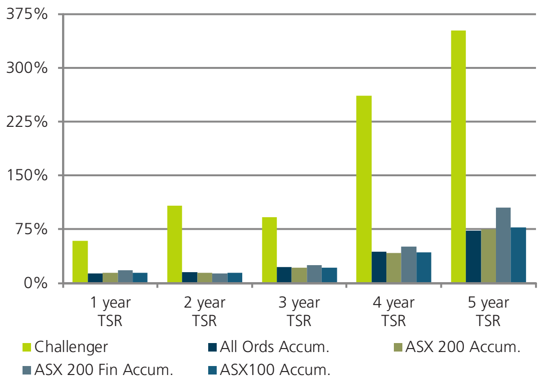
For the year ended	30 June 2013	30 June 2014	30 June 2015	30 June 2016	30 June 2017
Normalised NPAT ($M)	308.5	328.7	334.0	361.7	384.9
Normalised EPS (cents)	58.6	64.0	61.2	64.6	68.5
Closing share price ($)	4.01	7.44	6.72	8.63	13.34
Dividends per share (cents)	20.0	26.0	30.0	32.5	34.5

4 Remuneration report (continued)

4.4 Performance and remuneration snapshot (continued)

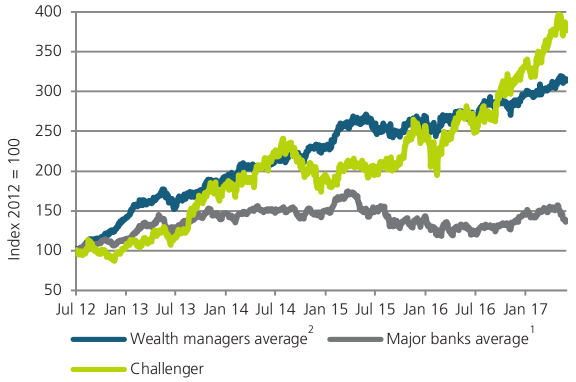
Total shareholder return (TSR)
Source: IRESS and Bloomberg

Challenger's TSR has increased by 352% since 2012 and delivered significant long-term outperformance.



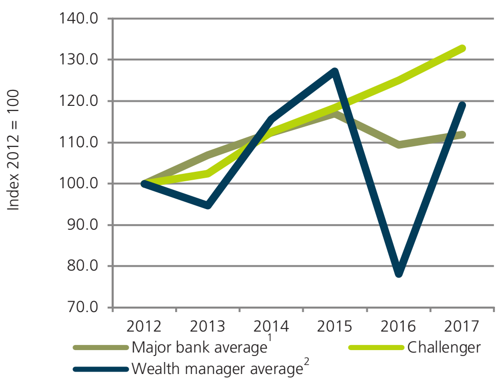
Challenger share price performance versus other Australian financial companies
Source: Bloomberg and Company data

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



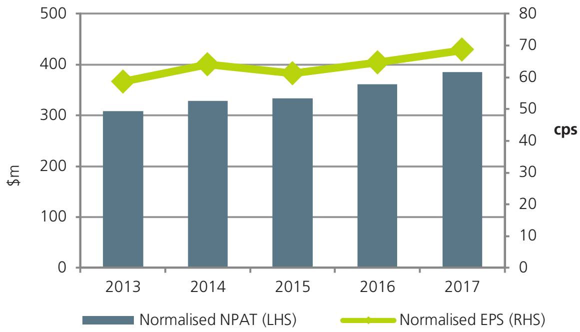
Normalised EPS versus other Australian financial companies
Source: Bloomberg and Company data

Challenger's normalised EPS has increased by 25% since 2012.



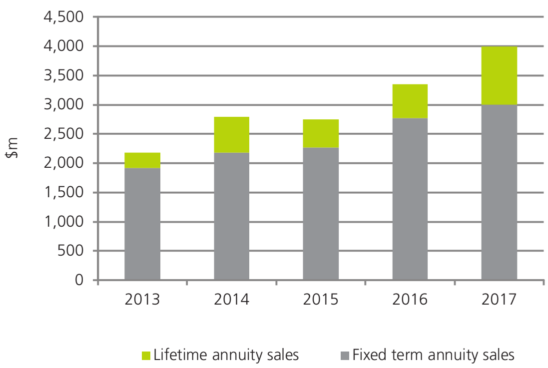
Normalised NPAT and Normalised EPS
Source: Company data

Normalised NPAT and EPS have increased by 25% and 17% respectively since 2013.



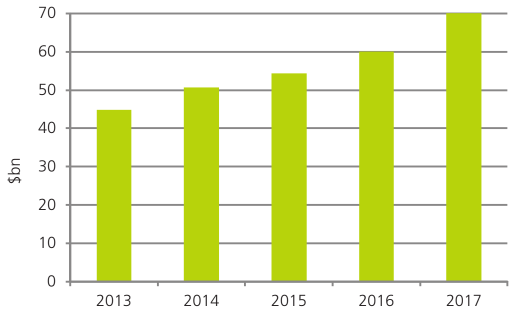
Life – Annuity sales
Source: Company data

Annuity sales have increased by 84% since 2013.



Annual growth in group assets under management[3]
Source: Company data

AUM has grown significantly, increasing by 56% since 2013.



[1] Major bank average – (ANZ, CBA, NAB, WBC)
[2] Wealth manager average – (AMP, IOOF, PPT)

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

4 Remuneration report (continued)

4.4 Performance and remuneration snapshot (continued)

2017 balanced scorecard outcomes

Key Performance Indicators (KPIs) for KMP are aligned to Challenger's strategies to achieve its vision of providing our customers with financial security for retirement. Performance against KPIs is detailed and rated in the table below.

Significant progress towards long-term strategic objectives is underpinned by strong risk management practices and a highly engaged workforce, which enable sustained success. Performance is a primary consideration in determining remuneration outcomes for KMP. The Board are focused on maintaining continuity in the executive team which has overseen these achievements, and ensuring strong alignment to long-term value created for shareholders.

Strategy	2017 priorities and outcomes
Deliver superior returns to shareholders by maintaining a highly engaged, diverse and agile workforce committed to sustainable business practices and a strong risk and compliance culture **Outcome:** Strong	**Deliver superior returns to shareholders by achieving strong financial outcomes** Weighting: CEO 20%; CFO 20%; CE DPM 10%; CE FM 20%; CE Life 25% Performance measures and outcomes: • *Achieve budgeted Normalised NPAT and EPS.* 2017 Normalised NPAT was $384.9 million and EPS was 68.5 cents, exceeding budget. • *Achieve 2017 COE within the guidance range of $620m to $640m*. The Board considers the lower end of guidance as target and the upper end of guidance as strong. 2017 COE was $631 million and above the midpoint of the guidance range. • *Achieve 18% RoE (pre-tax) target*. This measure is used as a performance threshold. The Board does not wish to encourage excessive risk taking by setting performance targets above 18%. The RoE target was achieved for 2017. • *Maintain normalised cost to income ratio between 32% and 36%*. For 2017, a normalised cost to income ratio of 33.4% was achieved, despite significant investment in growth initiatives. Challenger is building a competitive scale advantage, with its cost to income ratio 17 percentage points below the industry average. • *Maintain a strong capital position, including achieving the Prescribed Capital Amount (PCA) target range of 1.3x to 1.6x.* The PCA range is set to balance sustainability and the protection of policy holders with market-competitive returns for shareholders. Challenger successfully completed a $460 million Additional Tier 1 capital raising during the year. The PCA ratio at 30 June 2017 was 1.57 times and at the upper end of Challenger's PCA target range.
Outcome: Outstanding	**Maintain a highly engaged, diverse and agile workforce** Weighting: CEO 15%; CFO 25%; CE DPM 10%; CE FM 10%; CE Life 10% Performance measures and outcomes: • *Maintain Sustainable Engagement at or above the Willis Towers Watson global high performing companies norm.* Challenger's 2017 staff engagement score, in a survey conducted by Willis Towers Watson was 88%. The result was considered outstanding, as it was significantly higher than the global high performing companies norm. All divisions were above the global high performing companies norm, and all categories surveyed were above both Australian companies norms and global financial services norms. • *Encourage a diverse and inclusive workplace*. Outcomes against Challenger's measurable objectives for diversity are detailed under the Our People section of Challenger's Sustainability Report. Challenger exceeded its 2017 gender targets and is tracking well against its 2020 gender targets and maintained equity in gender pay positioning against market benchmarks. Women in all roles increased by 3% to 42.5% (2017 target was 42%) and women in management roles increased by 6.1% to 33.5% (2017 target was 32%). • *Develop future leaders and manage succession risks.* Challenger continues to invest in leadership development to successfully manage succession across the business. In 2017, a number of seamless senior role transitions occurred, including that of the Chief Executive, Life to Chief Executive, Distribution, Product and Marketing and the promotion of Principal Executive Officer and Chief Investment Officer, Life to Chief Executive and Chief Investment Officer, Life. In the 2017 employee engagement survey, 90% of employees reported confidence in the decisions of senior leadership and Challenger's leadership score was 11 percentage points above the global high performing companies norm.

4 Remuneration report (continued)

4.4 Performance and remuneration snapshot (continued)

Strategy	2017 priorities and outcomes
Deliver superior returns to shareholders by maintaining a highly engaged, diverse and agile workforce committed to sustainable businesss practices and a strong risk and compliance culture (continued) **Outcome:** Strong	**Ensure business sustainability through a strong risk and compliance culture and sound risk management practices** Weighting: CEO 20%; CFO 25%; CE DPM 15%; CE FM 25%; CE Life 25% Performance measures and outcomes include: • *Manage risk/reward decisions and ensure compliance with the Board approved Risk Appetite Statement.* Performance was strong, with key outcomes including: adherence to the Internal Capital Adequacy Assessment Process (ICAAP); affirmation of credit ratings; maintenance of liquidity policy ratios; compliance with market risk and credit policy limits; reported incidents and breaches within acceptable tolerance levels; and no significant issues identified through internal audit, external audit or regulatory reviews. • *Instil a culture of compliance and prudent risk taking and maintain relevant regulatory compliance.* The tone regarding compliance and prudent risk-taking is set by senior management. Compliance on mandatory training was high across the year, and no major risk issues were raised by employees. In the anonymous employee engagement survey, more than 90% of employees said that Challenger clearly communicates expectations for ethical behaviour and takes action to learn from risk events and mistakes that occur. Importantly, the same proportion indicated that if they observed unethical behaviour or misconduct, they would raise it. • *Ensure exposures from growth related activities are controlled as part of the risk framework.* Challenger's strong risk culture is reflected in the continual assessment of the risk environment and the controls put in place to manage new and emerging risks. In 2017, Challenger continued to invest in systems and processes to ensure that our infrastructure continues to match our growing business. Despite expansion into new geographies and products, no material incidents or breaches occurred. • *Continue to embed sustainable business practices.* Challenger focused on further developing its Corporate Sustainability Strategy, and has continued to integrate sustainability into business operations. Key activities included completing Principles for Responsible Investment implementation statements, maintaining carbon neutrality, advocating for policy reforms that allow people to use their superannuation savings to create long-term sustainable incomes and undertaking a review of community partnerships.
Increase the Australian retirement savings allocation to secure and stable incomes **Outcome:** Strong	Weighting: CEO 15%; CFO 10%; CE DPM 20%; CE Life 15% • *Sales growth and sales mix.* The ongoing success of initiatives to support an increase in retirement savings allocated to secure and stable incomes is demonstrated in the strong growth in both term annuities (up 9%) and lifetime annuities (up 70%). Importantly, a shift to longer dated annuities saw an increase in the tenor of sales from 6.5 years to 10.8 years. Longer dated annuities represented 40% of sales in 2017, up from 12% five years ago. • *Increase access to secure income stream products via digital platforms.* New partnerships were formed with AMP and BT during 2017, providing access to Challenger products through two of Australia's largest wealth management platforms. During 2017, Challenger annuities were also launched on ClearView and Suncorp's platforms, and were made available by profit-for-member funds CareSuper, legalsuper and Local Government Super. Following the launch of the annuity partnerships with AMP and BT in 2018, Challenger's products will be accessible by two thirds of Australian advisers via digital wealth management platforms. • *Retirement illustrator (demonstrate benefits of partial annuitisation).* During 2017, Challenger launched a new Retirement illustrator tool for financial advisers. The Retirement illustrator demonstrates the benefits of partial annuitisation strategies and how annuities can be combined with account-based-pensions to provide better retirement outcomes for retirees. Adviser feedback has been positive. • *Support superannuation reform through ongoing engagement and advocacy.* The Australian Government is undertaking a range of retirement income regulatory reforms aimed at enhancing the retirement phase of superannuation. As Australia's leading provider of guaranteed retirement incomes, Challenger has a key role to play with both industry and Government.

4 Remuneration report (continued)

4.4 Performance and remuneration snapshot (continued)

Strategy	2017 priorities and outcomes

Be recognised as the leader and partner of choice in retirement income solutions with a broad product offering

Outcome: Outstanding

Weighting: CEO 15%; CFO 15%; CE DPM 20%; CE Life 25%

Performance measures and outcomes:

- *Retain Challenger's strong brand and thought leadership position for retirement income.*
  - Challenger's advertising campaign was successful in maintaining Challenger's brand strength. As reported in the Marketing Pulse Adviser Study, the six-month reverse enquiry rate for annuities increased to 54% from 47%, and 96% of advisers recognised Challenger as a leader in retirement income[1].
  - Challenger received the second highest net promoter score (in a survey conducted by Wealth Insights), with peers including Australia's top 20 fund managers.
  - Challenger continued to demonstrate thought leadership in building community awareness of retirement funding, through relationships with leading universities such as University of New South Wales, University of Adelaide, and Macquarie University.
- *Form new annuity distribution partnerships to create customer access to annuities*. In addition to the new partnerships with AMP and BT, a new annuity relationship was formed with leading Japanese provider MS Primary. This partnership provides Challenger access to Japan's Australian dollar denominated annuity market, which is significantly larger than that of Australia's. In its first year of operation, the annuity relationship with MS Primary generated 15% of Life's total 2017 annuity sales.
- In addition, Challenger's distribution network was expanded through new annuity partnerships with Suncorp and ClearView, and a partnership was formed with Standard Life (refer below).
- *Diversify into new product areas.* In addition to diversifying and expanding Challenger's product offering through expansion into Japan, a Deferred Lifetime Annuity (DLA) product option has been developed and will be launched in 2018. Challenger also formed a new product partnership with Standard Life Investments to distribute the Standard Life Absolute Return Global Bond Strategies Fund under Challenger's brand in Australia. The product aims to provide retirees with capital stability and a steady income stream.
- Challenger's strength in product development and innovation continues to be externally recognised, with Challenger awarded the Retirement Product Innovation award for Liquid Lifetime in the Money Management/Lonsec Fund Manager of the Year Awards and the Best Longevity Fund in the Chant West 2017 Super Funds awards.
- *Deliver fit for purpose and value for money service to customers.* Performance measures included: ongoing development and implementation of the Operations and Technology strategic roadmap; the establishment of a contemporary digital service delivery platform, and client service outcomes as measured by Wealth Insights. Client service outcomes were outstanding; according to the *Wealth Insights Adviser Trends Report* 2017, financial advisers ranked Challenger number one compared to Australia's major wealth management companies across six dimensions including: Business Development Support, Adviser Contact Centre, Technical Services, Client Services, Image and Reputation, and Overall Satisfaction[2].

[1] Marketing Pulse Adviser Study, December 2016.
[2] Wealth Insights Adviser Trends Report 2017. Challenger annuities service level analysis conducted by Wealth Insights and compared to the broader market.

4 Remuneration report (continued)

4.4 Performance and remuneration snapshot (continued)

Strategy	Outcome achieved
Provide customers with relevant investment strategies exhibiting consistently superior performance **Outcome**: Sound to strong	Weighting: CEO 15%; CFO 5%; CE DPM 25%; CE FM 45% Performance measures and outcomes: • *Funds Management flows.* Domestic net flows were outstanding for the Funds Management business compared to industry benchmarks, and exceeded budget by 59%. • *Fidante investment performance compared to benchmark.* Performance was maintained, with 97% of Fidante Partners' FUM outperforming benchmarks over the past five years. • *Add new Fidante managers and promote new strategies for existing managers.* Performance was on target with the launch of two new boutique fund managers, Lennox Capital Partners and Avenir Capital in 2017. Structured business planning and product development for existing boutiques resulted in: the establishment of a retail product strategy for Ardea; repositioning Merlon for growth in the popular equity income strategy; expanding Greencape's global exposure mandate; launching Fidante Partners' global equities offering including Avenir Capital, the establishment of the Challenger ARGBS Fund (partnering with Standard Life Investments) and the Challenger Index Plus Fund. • *Restore European listed transaction volumes and build out European boutique business.* Transaction volumes and income in Fidante Capital's listed funds business recovered, and Fidante Partners Europe is well positioned to add additional managers to the platform. Fidante Partners Europe's progress in 2017 included the design and launch of the Whitehelm Core Listed Infrastructure Fund, the development of Whitehelm's Infrastructure Debt Fund, and a successful capital raising for Resonance. Reflecting the turnaround in Fidante Partners Europe, it generated a pre-tax profit of $3 million in 2017 following a $10 million loss in 2016. Overall performance was below target.

4 Remuneration report (continued)

4.5 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 2017 are detailed in the table below:

Name	Role	Term as KMP in 2017
Brian Benari	Managing Director & CEO	Full year
Richard Howes	Chief Executive, Life	Until 13 February 2017
	Chief Executive, Distribution, Product & Marketing	From 13 February 2017
Chris Plater	Chief Executive & Chief Investment Officer, Life	From 13 February 2017
Paul Rogan	Chief Executive, Distribution, Marketing & Research	Until 13 February 2017
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, distributions from the CPP Trust, long service leave entitlements and insurance.

		Short-term employee benefits			Long-term employee benefits		
KMP	Year	Salary[1] $	Super-annuation $	Cash STI $	Other[2] $	Share-based payments[3] $	Total $
B Benari	**2017**	**1,236,855**	**19,616**	**900,000**	**216,976**	**2,904,140**	**5,277,587**
	2016	1,236,380	19,308	800,000	223,995	2,880,964	5,160,647
R Howes	**2017**	**715,028**	**19,616**	**775,000**	**142,808**	**1,833,537**	**3,485,989**
	2016	632,124	19,308	700,000	131,903	1,805,404	3,288,739
C Plater[4]	**2017**	**238,889**	**7,416**	**255,205**	**31,904**	**446,379**	**979,793**
	2016	-	-	-	-	-	-
P Rogan[5]	**2017**	**400,012**	**12,199**	**800,000**	**70,309**	**935,610**	**2,218,130**
	2016	641,926	19,308	675,000	120,306	1,597,214	3,053,754
I Saines	**2017**	**842,984**	**19,616**	**425,000**	**67,815**	**1,020,388**	**2,375,803**
	2016	841,258	19,308	325,000	41,462	652,427	1,879,455
A Tobin	**2017**	**637,035**	**19,616**	**475,000**	**102,781**	**1,166,525**	**2,400,957**
	2016	636,524	19,308	450,000	90,651	1,098,340	2,294,823
Total	**2017**	**4,070,803**	**98,079**	**3,630,205**	**632,593**	**8,306,579**	**16,738,259**
	2016	3,988,212	96,540	2,950,000	608,317	8,034,349	15,677,418

1 Includes the cost of death, total permanent disability and salary continuance insurances.
2 Values represent distributions from the CPP Trust and long service leave accruals.
3 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.
4 Mr Plater transferred to a KMP role on 13 February 2017.
5 Mr Rogan transferred to a non-KMP role on 13 February 2017 as transition to retirement. The Board determined that his 2017 STI would be awarded in cash.

4 Remuneration report (continued)

4.5 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	**2017**	**24%**	**17%**	**55%**	**4%**	**100%**
	2016	24%	16%	56%	4%	100%
R Howes	**2017**	**21%**	**22%**	**53%**	**4%**	**100%**
	2016	20%	21%	55%	4%	100%
C Plater[1]	**2017**	**25%**	**26%**	**46%**	**3%**	**100%**
	2016	-	-	-	-	-
P Rogan[2]	**2017**	**19%**	**36%**	**42%**	**3%**	**100%**
	2016	22%	22%	52%	4%	100%
I Saines	**2017**	**36%**	**18%**	**43%**	**3%**	**100%**
	2016	46%	17%	35%	2%	100%
A Tobin	**2017**	**27%**	**20%**	**49%**	**4%**	**100%**
	2016	28%	20%	48%	4%	100%

[1] Mr Plater transferred to a KMP role on 13 February 2017.
[2] Mr Rogan transferred to a non-KMP role on 13 February 2017 as transition to retirement. The Board determined that his 2017 STI would be awarded in cash.

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. In 2017, significant progress towards long-term strategic objectives has positioned Challenger for further growth. The Board is focused on rewarding key executives who have overseen these initiatives and ensuring they are appropriately incentivised to continue to develop and maximise these opportunities which will deliver shareholders long-term growth. Reflecting this, the Board has increased remuneration for KMP, with the majority of the increase in equity deferred for three years or more.

		Short-term employee benefits			**Share-based payments**				
KMP	Year	Salary[1] $	Super-annuation $	Cash STI $	1&2 year DPSRs[2] $	3 year DPSRs[3] $	HPSRs[4] $	Other[5] $	Total $
B Benari	**2017**	**1,236,855**	**19,616**	**900,000**	**900,000**	**810,000**	**1,890,000**	**194,807**	**5,951,278**
	2016	1,236,380	19,308	800,000	800,000	600,000	1,800,000	203,676	5,459,364
R Howes	**2017**	**715,028**	**19,616**	**775,000**	**775,000**	**405,000**	**945,000**	**126,091**	**3,760,735**
	2016	632,124	19,308	700,000	700,000	312,500	937,500	121,458	3,422,890
C Plater[6]	**2017**	**238,889**	**7,416**	**255,205**	**255,205**	**113,425**	**264,658**	**28,098**	**1,162,896**
	2016	-	-	-	-	-	-	-	-
P Rogan[7]	**2017**	**400,012**	**12,199**	**800,000**	**-**	**-**	**-**	**65,665**	**1,277,876**
	2016	641,926	19,308	675,000	675,000	125,000	375,000	106,597	2,617,831
I Saines	**2017**	**842,984**	**19,616**	**425,000**	**425,000**	**255,000**	**595,000**	**61,107**	**2,623,707**
	2016	841,258	19,308	325,000	325,000	162,500	487,500	37,390	2,197,956
A Tobin	**2017**	**637,035**	**19,616**	**475,000**	**475,000**	**270,000**	**630,000**	**79,680**	**2,586,331**
	2016	636,524	19,308	450,000	450,000	200,000	600,000	73,474	2,429,306

[1] Includes the cost of death, total permanent disability and salary continuance insurances.
[2] DPSRs will be formally granted in September 2017 and vest 50% one year after grant and 50% two years after grant.
[3] DPSRs will be formally granted in September 2017 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 2017 with reference to the fair value at the time of grant.
[5] Values represent distributions from the CPP Trust.
[6] Mr Plater transferred to a KMP role on 13 February 2017.
[7] Mr Rogan transferred to a non-KMP role on 13 February 2017 as transition to retirement. The Board determined that his 2017 STI would be awarded in cash.

4 Remuneration report (continued)

4.5 Key Management Personnel remuneration arrangements (continued)

Share Rights granted

Deferred Performance Share Rights

The number of DPSRs granted is determined based on the five day volume weighted average price (VWAP) of shares prior to grant date. This is the face value allocation price that determines the number of DPSRs granted.

DPSRs granted to KMP during the year ended 30 June 2017 are detailed below:

					Vesting		
KMP	Awarded DPSR value from 2016 $	Face value allocation price $	Total number of DPSRs granted	Date of grant	Tranche 1 1 September 2017 Number[1]	Tranche 2 1 September 2018 Number[1]	Tranche 3 1 September 2019 Number[1]
B Benari	1,400,000	9.2101	152,005	12/9/16	43,430	43,430	65,145
R Howes	1,012,500	9.2101	109,932	12/9/16	38,001	38,001	33,930
P Rogan[2]	800,000	9.2101	86,860	12/9/16	36,644	36,644	13,572
I Saines	487,500	9.2101	52,929	12/9/16	17,643	17,643	17,643
A Tobin	650,000	9.2101	70,573	12/9/16	24,429	24,429	21,715

[1] The number of DPSRs granted is determined by dividing the dollar value of the award by the allocation price which is determined based on the VWAP in the five days prior to grant. The fair value of each tranche was $8.59 for Tranche 1, $8.26 for Tranche 2 and $7.95 for Tranche 3. The fair value is independently calculated and is used to determine the accounting value which is amortised over future vesting periods. The fair value differs to the face value allocation price as the DPSRs do not carry a dividend entitlement and reflects the deferred nature of the award.

[2] Mr Rogan transferred to a non-KMP role on 13 February 2017.

Mr Plater transferred to a KMP role on 13 February 2017; grant and vesting disclosures prior to that are not required to be disclosed.

Hurdled Performance Share Rights

In allocating HPSR awards for KMP, the Board considers face value and a range of forecast future values delivered at minimum and maximum vesting. Whereas DPSRs deliver the face value of a share at vesting (subject to continued employment), HPSRs only deliver the face value of a share at vesting if absolute TSR is at or above 10% compounded annually. HPSRs deliver no value at vesting if absolute TSR is below the performance threshold of 7% compounded annually.

The Board believes it is appropriate to value HPSRs differently from DPSRs when determining the number of HPSRs granted in recognition of the uncertain vesting outcomes and range of potential future values. HPSR awards are therefore allocated based on the fair value at grant date which reflects the best estimate of the awarded financial value at grant date. HPSR fair values are independently calculated based on a market accepted calculation methodology which values the expected HPSR vesting outcome relative to the TSR hurdles and market conditions at the grant date.

HPSRs granted to KMP during the year ended 30 June 2017 are detailed below:

				Vesting				
				Tranche 1 1 September 2019		Tranche 2 1 September 2020		
KMP	Awarded HPSR value from 2016 $	TSR start price[1] $	Grant date	Fair value allocation price $	Number vesting[2]	Fair value allocation price $	Number vesting[2]	Total number of HPSRs granted
B Benari	1,800,000	9.0167	12/9/16	4.33	277,136	3.80	157,894	435,030
R Howes	937,500	9.0167	12/9/16	4.33	144,341	3.80	82,236	226,577
P Rogan[3]	375,000	9.0167	12/9/16	4.33	57,736	3.80	32,894	90,630
I Saines	487,500	9.0167	12/9/16	4.33	75,057	3.80	42,763	117,820
A Tobin	600,000	9.0167	12/9/16	4.33	92,378	3.80	52,631	145,009

[1] The TSR start price is the VWAP of shares traded in the 90 calendar days immediately preceding the grant date.

[2] The number of HPSRs granted is determined by dividing the dollar value of the award by the fair value of the relevant tranche. The fair value is independently calculated and has been determined by the Board as the best estimate of the awarded financial value at the grant date. The fair value is also used to determine the accounting value which is amortised over future vesting periods. The fair value differs to the TSR start price as the HPSR vesting events are subject to achieving future TSR hurdles, do not carry a dividend entitlement and reflects the deferred nature of the award.

[3] Mr Rogan transferred to a non KMP role on 13 February 2017.

Mr Plater transferred to a KMP role on 13 February 2017; grant and vesting disclosures prior to that are not required to be disclosed.

4 Remuneration report (continued)

4.5 Key Management Personnel remuneration arrangements (continued)

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 2017 are detailed below:

KMP	Date of grant	Number	Face value at grant $	Vesting date
B Benari	17/9/13	122,372	648,572	1/9/16
	16/9/14	66,079	504,183	1/9/16
	13/9/15	64,383	450,037	1/9/16
R Howes	16/9/14	45,888	350,125	1/9/16
	13/9/15	50,075	350,024	1/9/16
P Rogan	16/9/14	42,217	322,116	1/9/16
	13/9/15	36,662	256,267	1/9/16
I Saines	13/9/15	12,161	85,005	1/9/16
A Tobin	16/9/14	29,368	224,078	1/9/16
	13/9/15	30,403	212,517	1/9/16

Mr Plater transferred to a KMP role on 13 February 2017; grant and vesting disclosures prior to that are not required to be disclosed.

Hurdled Performance Share Rights

HPSR grants awarded and considered by shareholders in prior periods and which vested to KMP during the year ended 30 June 2017 are detailed below, together with TSR performance and vesting outcomes.

Total shareholder return outcomes for all HPSRs vested during the year range between 33% and 36% per annum and are significantly above external market performance. As a result of this TSR performance, all eligible HPSRs vested during the year. The Board considers that these outcomes reflect the strong value delivered to shareholders.

	Grant details			Vesting details				
KMP	Date	Number	Fair value at grant[1] $	Date	Number vested	TSR outcome per annum	Number vested or lapsed in prior years	Number yet to vest or lapse
B Benari	17/9/13	850,000	2,751,166	1/9/16	283,333	36%	283,333	283,334
R Howes	12/9/12	850,000	1,207,000	1/9/16	283,334	33%	566,666	-
	17/9/13	525,000	1,699,250	1/9/16	175,000	36%	175,000	175,000
P Rogan[2]	12/9/12	700,000	994,000	1/9/16	233,334	33%	466,666	-
	17/9/13	500,000	1,618,332	1/9/16	166,666	36%	166,666	166,668
A Tobin	12/9/12	400,000	568,000	1/9/16	133,334	33%	266,666	-
	17/9/13	300,000	971,000	1/9/16	100,000	36%	100,000	100,000

[1] The fair value is independently calculated and has been determined by the Board as the best estimate of the awarded financial value at the grant date. Refer to Page 19 for further discussion on the value for HPSRs.

[2] Mr Rogan transferred to a non-KMP role on 13 February 2017.

Mr Plater transferred to a KMP role on 13 February 2017; grant and vesting disclosures prior to that are not required to be disclosed.

4 Remuneration report (continued)

4.5 Key Management Personnel remuneration arrangements (continued)

Share Rights held

Performance Share Rights held

Details of KMP DPSRs and HPSRs held as at 30 June 2017 are set out below:

KMP	Instrument	Number held at 1 July 2016	Number granted as remuneration	Number vested	Number held at 30 June 2017
B Benari	DPSRs	472,359	152,005	(252,834)	371,530
	HPSRs	1,515,809	435,030	(283,333)	1,667,506
R Howes	DPSRs	248,333	109,932	(95,963)	262,302
	HPSRs	1,135,473	226,577	(458,334)	903,716
C Plater[1]	DPSRs	-	-	-	166,559
	HPSRs	-	-	-	446,665
I Saines	DPSRs	65,455	52,929	(12,161)	106,223
	HPSRs	481,456	117,820	-	599,276
A Tobin	DPSRs	153,191	70,573	(59,771)	163,993
	HPSRs	673,537	145,009	(233,334)	585,212

[1] Mr Plater transferred to a KMP role on 13 February 2017; grant and vesting disclosures prior to that are not required to be disclosed.

Key Management Personnel and their affiliates' shareholdings in Challenger Limited

Details of KMP and their affiliates' shareholdings in Challenger Limited as at 30 June 2017 are detailed below, along with the number of unvested DPSRs. The CEO and other KMP are required to have a minimum shareholding equal to two times, and one times, their fixed remuneration respectively. From the date of appointment, KMP have a five year transition period to reach the minimum shareholding. With the exception of Mr Plater and Mr Saines, who remain within their transition period, all of the KMP hold substantially more than the minimum requirement as at 30 June 2017.

							Shareholding as a multiple of fixed remuneration[1]	
KMP	Year	Opening balance	Number of vested DPSRs and HPSRs	Number of shares sold	Closing balance of shares	Number of unvested DPSRs	Fully-owned shares	Shares and DPSRs
B Benari	**2017**	**1,000,000**	**536,167**	**(536,167)**	**1,000,000**	**371,530**	**10.6**	**14.6**
	2016	1,000,000	1,073,695	(1,073,695)	1,000,000	472,359	6.9	10.1
R Howes	**2017**	**100,000**	**554,297**	**(554,297)**	**100,000**	**262,302**	**1.8**	**6.6**
	2016	179,693	780,483	(860,176)	100,000	248,333	1.3	4.6
C Plater[2]	**2017**	**-**	**-**	**-**	**3,385**	**166,559**	**0.1**	**3.5**
	2016	-	-	-	-	-	-	-
P Rogan[3]	**2017**	**150,000**	**478,879**	**(628,879)**	**-**	**-**	**-**	**-**
	2016	100,000	686,816	(636,816)	150,000	214,259	2.0	4.8
I Saines[4]	**2017**	**-**	**12,161**	**-**	**12,161**	**106,223**	**0.2**	**1.8**
	2016	-	-	-	-	65,455	-	0.7
A Tobin	**2017**	**230,236**	**293,105**	**(225,000)**	**298,341**	**163,993**	**6.1**	**9.4**
	2016	195,851	358,727	(324,342)	230,236	153,191	3.0	5.0
Total	**2017**	**1,480,236**	**1,874,609**	**(1,944,343)**	**1,413,887**	**1,070,607**		
	2016	1,475,544	2,899,721	(2,895,029)	1,480,236	1,153,597		

[1] Shareholding multiple based on 30 June 2017 closing share price of $13.34 (30 June 2016: $8.63).
[2] Mr Plater transferred to a KMP role on 13 February 2017 and has a five-year transitional period in which to acquire the required shareholding. Prior period disclosures are not required.
[3] Mr Rogan transferred to a non-KMP role on 13 February 2017. The number of shares sold reflects shares sold whilst a KMP and an adjustment to bring the closing balance to nil, as his holding is not required to be disclosed post 13 February 2017.
[4] Mr Saines became a KMP on 2 March 2015 and has a five-year transition period in which to acquire the required shareholding.

4 Remuneration report (continued)

4.5 Key Management Personnel remuneration arrangements (continued)

Brian Benari – Managing Director & CEO

Mr Benari was appointed Managing Director & CEO effective 17 February 2012. The terms of his appointment and termination arrangements were approved at an extraordinary general meeting on 28 February 2012. All equity awards for the Managing Director & CEO are satisfied by the purchase of shares on market. The following table summarises the notice periods and payments which apply to Mr Benari upon termination.

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

[1] HPSRs continue to be held by Mr Benari subject to the original vesting conditions.
[2] Represents a substantial diminution of Mr Benari's duties, status, responsibilities and/or authority without his agreement.
[3] The Board may in its absolute discretion determine the extent to which Mr Benari's unvested HPSRs will vest.

Key Management Personnel (excluding Managing Director & CEO) employment agreements and notice periods

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

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

4.6 Non-Executive Director disclosures

Composition

Challenger's Non-Executive Directors for 2017 are detailed in the table below:

Name	Term as Non-Executive Director in 2017
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 $2,500,000 was approved by shareholders in 2016.

Fee framework and review

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

The Board is committed to periodically reviewing the fee framework in order to ensure that fees remain appropriate against the external market and support the attraction and retention of high quality Non-Executive

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4 Remuneration report (continued)

4.6 Non-Executive Director disclosures (continued)

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 the 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 2017. Fee increases were effective from 1 September 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 2017. All amounts are inclusive of superannuation; where applicable.

	2016 fee structure		2017 fee structure	
	Chair fee[2]	Member fee	Chair fee[2]	Member fee
Board/Committee	$	$	$	$
Board[1]	464,500	173,000	525,500	179,000
Group Risk	23,500	11,750	30,000	11,750
Group Audit	23,500	11,750	30,000	11,750
Remuneration	41,500	21,000	44,000	22,000

[1] Board fees include Nomination Committee fees.
[2] The Board Chair fees reported in the table are inclusive of committee fees paid to the Board Chair.

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

Non-Executive Director fees for the year ended 30 June 2017

The following table summarises Non-Executive Director fees for the year ended 30 June 2017.

Non-Executive Director	Year	Director fees $	Superannuation $	Total $
P Polson	**2017**	**495,717**	**19,616**	**515,333**
	2016	438,775	19,308	458,083
G Cubbin[1]	**2017**	**260,083**	**-**	**260,083**
	2016	235,333	-	235,333
S Gregg	**2017**	**182,496**	**17,337**	**199,833**
	2016	175,495	16,672	192,167
J Grunzweig[1]	**2017**	**178,000**	**-**	**178,000**
	2016	171,667	-	171,667
B Shanahan	**2017**	**203,957**	**19,376**	**223,333**
	2016	196,880	18,704	215,584
J Stephenson	**2017**	**236,218**	**19,616**	**255,834**
	2016	199,025	19,308	218,333
L Zwier[1]	**2017**	**178,000**	**-**	**178,000**
	2016	171,667	-	171,667
Total	**2017**	**1,734,471**	**75,945**	**1,810,416**
	2016	1,588,842	73,992	1,662,834

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

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.

4 Remuneration report (continued)

4.6 Non-Executive Director disclosures (continued)

Non-Executive Director shareholdings in Challenger Limited at 30 June 2017

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	**2017**	**122,000**	**-**	**122,000**
	2016	122,000	-	122,000
G Cubbin	**2017**	**97,702**	**95**	**97,797**
	2016	97,702	-	97,702
S Gregg	**2017**	**10,000**	**-**	**10,000**
	2016	10,000	-	10,000
J Grunzweig	**2017**	**250**	**-**	**250**
	2016	250	-	250
B Shanahan	**2017**	**252,112**	**-**	**252,112**
	2016	252,112	-	252,112
J Stephenson	**2017**	**13,000**	**-**	**13,000**
	2016	7,000	6,000	13,000
L Zwier	**2017**	**2,360**	**5,000**	**7,360**
	2016	2,360	-	2,360
Total	**2017**	**497,424**	**5,095**	**502,519**
	2016	491,424	6,000	497,424

Total remuneration of KMP 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						
2017	**1,734,471**	**75,945**	**-**	**-**	**-**	**1,810,416**
2016	1,588,842	73,992	-	-	-	1,662,834
KMP						
2017	**7,701,008**	**98,079**	**8,306,579**	**632,593**	**-**	**16,738,259**
2016	6,938,212	96,540	8,034,349	608,317	-	15,677,418
All KMP and Non-Executive Directors						
2017	**9,435,479**	**174,024**	**8,306,579**	**632,593**	**-**	**18,548,675**
2016	8,527,054	170,532	8,034,349	608,317	-	17,340,252

4 Remuneration report (continued)

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

Key term	Description
Awarded remuneration	Represents the value of remuneration that has been awarded for the financial year. This includes fixed remuneration, cash STI and deferred share awards.
Board	The Board of Directors of Challenger Limited and the main body responsible for the implementation of effective remuneration governance and related risk management practices at Challenger.
CPP	*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 CPP Trust.
Face value	The number of DPSRs granted to KMP and employees is determined based on the face value of the shares using a five day Volume Weighted Average Price (VWAP) to the grant date.
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 Operating and financial review 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 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, distributions from the CPP Trust, long service leave entitlements and insurance.
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 5-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) for HPSR awards.

5 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.

6 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 it 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 its own negligence or wrongful or wilful acts or omissions. No payment has been made to indemnify Ernst & Young during or since the financial year.

7 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.

8 Significant events after the balance date

MS&AD Insurance Group Holdings Inc. (MS&AD) is the parent of MS Primary, a key Challenger distributor. In order to broaden Challenger's relationship with the MS&AD group and fund future growth, Challenger is undertaking a $500 million equity placement to MS&AD.

On 23 August 2017, Challenger will issue 38,295,689 new ordinary shares to MS&AD at a price of $13.0563 per share. The new shares will be issued at a 2% premium to Challenger's 14 August 2017 30 business day volume weighted average share price of $12.9719, adjusted for the final 2017 dividend of 17.5 cents per share. The shares issued to MS&AD are not eligible for Challenger's final 2017 dividend.

The equity placement to MS&AD represents 6.27% of Challenger's issued capital following the placement. MS&AD intends to be a supportive Challenger shareholder and plans to increase its investment to 10% of issued capital over the next 12 months via market acquisitions, subject to market conditions, any necessary or desirable regulatory approvals and Challenger circumstances. MS&AD reserves the right to change its intentions and to acquire and dispose of Challenger shares as they see fit.

The proceeds from the placement will be used to increase CLC's Common Equity Tier 1 capital. After allowing for the equity placement, and assuming the same capital intensity as at balance date, CLC's pro forma capital ratios at 30 June 2017 are as follows:

- PCA ratio of 1.75 times (from 1.57 times); and
- Total Tier 1 ratio of 1.57 times (from 1.39 times); and
- Common Equity Tier 1 (CET1) ratio of 1.21 times (from 1.01 times).

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

9 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.

10 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 2017 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 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; and
- no non-audit services were carried out which were specifically excluded by the Auditor Independence Policy.

For details of fees for non-audit services paid to the auditors, refer to Note 28 Remuneration of auditor of the financial report.

11 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 2017, 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

S J Ferguson
Partner

Sydney
14 August 2017

L Burns
Partner

Sydney
14 August 2017

Liability limited by a scheme approved under Professional Standards Legislation.

12 Authorisation

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

G A Cubbin
Director

Sydney
14 August 2017

B R Benari
Managing Director & Chief Executive Officer

Sydney
14 August 2017

Sustainability

Challenger's approach to sustainability links directly to our vision – to provide our customers with financial security for retirement.

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

This year, we have refreshed our approach to corporate sustainability, which is reflected in our 2017 Sustainability Report, which is available from the Company website (www.challenger.com.au). The purpose of this report is to inform stakeholders about how we manage and anticipate current and future economic, social and environmental risks and opportunities.

In terms of sustainability, we have identified 16 areas of importance to our business. Of these, six key themes have emerged as being of high importance to our business and stakeholders – our material matters.

We also recognise that our employees are key to our success. A continuing focus on employee engagement, diversity and flexibility; risk management; and community engagement ensures that we provide a great place to work for employees.

Challenger is also committed to reducing our impact on the environment by raising employee awareness; occupying sustainable places of work; and offsetting our greenhouse gas emissions for our business operations.

Our material matters

Ethical conduct

How we conduct our business is a top priority for our stakeholders and for us. This means doing the right thing by all our stakeholders and, in particular, our customers. It incorporates the values and behaviours of our people, as well as our standards, policies and procedures.

Sustainable retirement incomes

Around 700 Australians reach retirement age every day, and providing reliable and sustainable income for this growing cohort is a key concern for Government, businesses and the community. As a leader in providing retirement income solutions, Challenger is particularly focused on this matter.

Regulatory change

Regulatory change has the potential to create opportunities and challenges for our business. In recent years, the Government has embarked on a series of superannuation reforms intended to create a world class retirement income system, which are broadly positive for Challenger. How these and other regulatory changes progress has the potential to impact our customers, our business and other stakeholders.

Long-term risk management

How we manage risk in the long term is central to our promise to provide secure and stable incomes to our customers. We invest in a high proportion of long-dated investments to match the long-dated annuities we sell. How we manage these investments, from origination through to divestment, requires us to take a long-term view of risk including issues such as demographic change, competition, innovation and disruption, and climate change.

Demographic shifts

As a retirement income provider, our business is supported by the substantial growth in the ageing demographic. Our business is also dependent on accurate life expectancy assumptions. Each of these factors is also key to decisions being made by Government and other stakeholders and presents both opportunities and challenges.

Corporate governance

Stakeholders have expressed a strong demand for greater transparency from businesses and good governance. This includes demonstrating that our leadership has an appropriate and diverse mix of capability, capacity and independence to support long-term value creation. Our approach to risk and compliance is a key focus area.

Our people and workplace

Employee engagement

At Challenger, we are committed to creating a great place to work and have a goal for Challenger to be a top quartile company. We understand that a better employee experience directly translates to a better customer experience and has an impact on business performance.

We track employee engagement and give our employees the opportunity to provide feedback about working at Challenger through our annual 'Your Voice' survey. The results and insights are used as an input into refining our strategy and priority areas of focus.

In 2017, Challenger's overall sustainable engagement score was 88%, placing us well above the Australian National norm, Global Financial Services norm and Global High Performing Companies norm.

Diversity

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

Challenger seeks to create an inclusive workforce and values the capability and experience that 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.

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

As we seek to achieve diversity within our workforce, a key focus continues to be on improving the gender balance in our business.

Sustainability (continued)

Our people and workplace (continued)

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.

In May 2017, the Board approved the introduction of a 30% target for female Non-Executive Directors on the Challenger Board by 30 June 2020, further demonstrating our commitment to gender balance.

Supporting flexible working

We offer flexible work to support employees to balance work and personal commitments.

In December 2016, we rolled out a flexible work toolkit to all employees. This toolkit provides information for employees and managers to successfully implement and manage flexible work in ways that work for the employee, the broader team and Challenger.

At Challenger, flexible work arrangements are available for all employees, regardless of gender.

Employees who are new parents are supported through our parental leave policy, with primary care givers receiving 12 weeks' paid leave and secondary care givers receiving two weeks' paid leave. In addition, Superannuation Guarantee payments are paid for both men and women whilst on parental leave, further supporting our vision to provide Australians with financial security for retirement.

Risk management

At Challenger, risk is everyone's business. Culturally, it filters through 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, 88% of employees had a positive view towards Challenger's risk culture (this is 9 points above the Australian National norm).

Community engagement

Challenger aims to contribute to the prosperity of the communities in which we operate.

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 National Seniors Australia.

We are also a silver sponsor of the Sohn Hearts & Minds Investment Leaders' conference, which raises funds to support Australian medical research.

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.

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.

Taking into account all donations made to our community partners and other charitable organisations, together with volunteering costs, Challenger donated an average of $297 per full-time employee during 2017.

Environmental management

Challenger is committed to reducing our impact on the environment.

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.

Improvements in energy efficiency, enhanced waste management, recycling processes and improved printer ratios have also 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 (now known as South Pole Group) and introduced a program of offsetting our electricity 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.

Since 2015, Challenger has offset all relevant greenhouse gas emissions for all offices, making our business operations carbon neutral.

Our full commitment to sustainability is outlined in our 2017 Sustainability Report and can be viewed at:

challenger.com.au/sustainabilityreport2017

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

Statement of comprehensive income

For the year ended 30 June

	Note	2017 $M	2016 $M
Revenue	1	1,972.3	1,813.3
Expenses	2	(1,310.4)	(1,188.6)
Finance costs	15	(160.8)	(229.6)
Share of profits of associates	23	18.1	16.6
Profit before income tax		**519.2**	**411.7**
Income tax expense	4	(121.0)	(81.8)
Profit for the year		**398.2**	**329.9**
Profit attributable to shareholders of Challenger Limited		397.6	327.7
Profit attributable to non-controlling interests		0.6	2.2
Profit for the year		**398.2**	**329.9**
Other comprehensive income			
Items that may be reclassified to profit and loss, net of tax			
Translation of foreign entities	14	(23.9)	35.0
Hedge of net investment in foreign operations	14	25.8	(35.5)
Cash flow hedges – SPV[1]	14	(0.2)	(1.4)
Other comprehensive income for the year		1.7	(1.9)
Total comprehensive income for the year		**399.9**	**328.0**
Comprehensive income attributable to shareholders of Challenger Limited		399.3	325.8
Comprehensive income attributable to non-controlling interests		0.6	2.2
Total comprehensive income for the year		**399.9**	**328.0**
Earnings per share attributable to ordinary shareholders of Challenger Limited		Cents	Cents
Basic	17	70.7	58.5
Diluted	17	67.8	55.4

[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	2017 $M	2016 $M
Assets			
Cash and cash equivalents	11	514.7	526.9
Cash and cash equivalents – SPV	7	122.4	146.9
Receivables		573.0	536.1
Mortgage assets – SPV	7	1,300.1	1,677.6
Derivative assets	10	541.4	788.3
Financial assets – fair value through profit and loss	5	15,479.1	13,104.3
Investment property held for sale	6	96.0	70.6
Investment and development property	6	3,532.9	3,499.3
Finance leases		51.3	57.8
Current tax assets	4	-	13.1
Property, plant and equipment		109.2	145.4
Investment in associates	23	53.5	51.5
Other assets		49.0	54.9
Goodwill	25	571.6	571.6
Other intangible assets	25	16.8	12.3
Total assets of shareholders of Challenger Limited and non-controlling interests		**23,011.0**	**21,256.6**
Liabilities			
Payables		988.0	885.3
Derivative liabilities	10	477.6	843.6
Interest bearing financial liabilities	13	5,208.6	4,148.8
Interest bearing financial liabilities – SPV	7	1,213.0	1,628.4
External unit holders' liabilities	9	1,687.8	1,315.5
Provisions		13.5	12.5
Current tax liability	4	107.6	-
Deferred tax liabilities	4	91.4	180.0
Life contract liabilities	8	10,322.2	9,558.5
Total liabilities of shareholders of Challenger Limited and non-controlling interests		**20,109.7**	**18,572.6**
Net assets of shareholders of Challenger Limited and non-controlling interests		**2,901.3**	**2,684.0**
Equity			
Contributed equity	12	1,554.5	1,546.7
Reserves	14	(16.5)	(7.9)
Retained earnings	14	1,350.1	1,142.1
Total equity of shareholders of Challenger Limited		**2,888.1**	**2,680.9**
Non-controlling interests		13.2	3.1
Total equity of shareholders of Challenger Limited and non-controlling interests		**2,901.3**	**2,684.0**

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 2016	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 2015		1,527.2	10.0	1.4	(6.6)	18.9	992.3	2,543.2	95.4	2,638.6
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	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	(34.1)	-	-	-	-	-	(34.1)	-	(34.1)
Settled forward purchases	12	30.0	-	-	-	-	-	30.0	-	30.0
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 and 1 July 2016		**1,546.7**	**(12.9)**	**-**	**(7.1)**	**12.1**	**1,142.1**	**2,680.9**	**3.1**	**2,684.0**
For the year ended 30 June 2017										
Profit for the year	14	-	-	-	-	-	397.6	397.6	0.6	398.2
Other comprehensive income for the year		-	-	(0.2)	1.9	-	-	1.7	-	1.7
Total comprehensive income for the year		**-**	**-**	**(0.2)**	**1.9**	**-**	**397.6**	**399.3**	**0.6**	**399.9**
Other equity movements										
Ordinary shares issued[1]	12	8.0	-	-	-	-	-	8.0	-	8.0
Shares purchased in the CPP Trust	12	(43.8)	-	-	-	-	-	(43.8)	-	(43.8)
Vested shares released from the CPP Trust	12	40.6	-	-	-	-	-	40.6	-	40.6
CPP deferred share purchases	12	(30.3)	-	-	-	-	-	(30.3)	-	(30.3)
Settled forward purchases	12	33.3	-	-	-	-	-	33.3	-	33.3
Share-based payment expense less releases	14	-	(10.3)	-	-	-	-	(10.3)	-	(10.3)
Dividends paid	16	-	-	-	-	-	(189.6)	(189.6)	-	(189.6)
Other movements		-	-	-	-	-	-	-	9.5	9.5
Balance at 30 June 2017		**1,554.5**	**(23.2)**	**(0.2)**	**(5.2)**	**12.1**	**1,350.1**	**2,888.1**	**13.2**	**2,901.3**

[1] The Company issued 455,140 ordinary shares on 28 September 2016 (14 October 2015: 890,868 shares) and 329,428 ordinary shares on 28 March 2017 (29 March 2016: 600,598 shares) 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	2017 $M	2016 $M
Operating activities			
Receipts from customers		666.3	636.2
Annuity and premium receipts	8	4,041.6	3,367.8
Annuity and claim payments	8	(3,464.7)	(2,955.1)
Payments to reinsurer	8	(5.6)	(5.2)
Receipts from external unit holders		941.2	998.5
Payments to external unit holders		(581.7)	(706.1)
Payments to vendors and employees		(571.7)	(563.2)
Dividends received		66.6	56.4
Interest received		687.0	611.0
Interest paid		(103.9)	(93.4)
Income tax paid		(77.9)	(64.5)
Net cash inflows from operating activities	11	**1,597.2**	**1,282.4**
Investing activities			
Payments on net purchases of investments		(2,423.4)	(2,054.1)
Net mortgage loan repayments		332.3	505.6
Payments for net purchases of property, plant and equipment		(19.0)	(19.1)
Payments for purchase of associate interest		(1.0)	(17.4)
Payments for purchase of controlled entities		-	(36.5)
Proceeds from sale of associate		-	45.0
Net cash outflows from investing activities		**(2,111.1)**	**(1,576.5)**
Financing activities			
Net proceeds from borrowings – interest bearing financial liabilities[1]	13	249.5	590.0
Payments for Treasury shares		(39.5)	(49.0)
Net dividends paid		(181.6)	(166.7)
Proceeds from issue of Challenger Capital Notes 2		460.0	-
Costs associated with issue of Challenger Capital Notes 2		(11.2)	-
Net cash inflows from financing activities		**477.2**	**374.3**
Net increase/(decrease) in cash and cash equivalents		**(36.7)**	**80.2**
Cash and cash equivalents at the beginning of the year		673.8	593.6
Cash and cash equivalents at the end of the year		**637.1**	**673.8**
Cash and cash equivalents	11	514.7	526.9
Cash and cash equivalents – SPV	7	122.4	146.9
Cash and cash equivalents at the end of the year		**637.1**	**673.8**

[1] Includes $841.4 million (30 June 2016: $569.9 million) outflow relating to SPVs.

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 2017 was authorised for issue in accordance with a resolution of the Directors of the Company on 14 August 2017.

(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 (IASB). 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.

New accounting standards and amendments that are effective in the current financial year

There were a number of new accounting standards and amendments to existing accounting standards that were effective from 1 July 2016 but do not have a material impact on the financial statements.

Accounting standards and interpretations issued but not yet effective

AASB 9 *Financial Instruments*

AASB 9 *Financial Instruments* replaces AASB 139 *Financial Instruments: Recognition and Measurement* and is effective for the Group from 1 July 2018. The Group does not intend to early adopt the standard.

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. The standard replaces the incurred loss model of AASB 139 with a new expected loss model which can result in the acceleration of impairment recognition on financial instruments.

The standard requires entities to account for expected credit losses on financial instruments at the point at which the financial instruments are first recognised and to estimate the expected loss applicable to those financial instruments over the period for which they are held. This requirement can result in expected losses on financial instruments being recognised in full much earlier than would have been the case under AASB 139. In addition, there are also significant changes to hedge accounting requirements, including changes to hedge effectiveness testing, treatment of hedging costs, risk components that can be hedged and associated disclosures.

The Group has performed an initial assessment and does not expect any material impact as a result of complying with the new requirements. This is because the majority of the Group's assets are already measured at fair value through profit and loss as required by AASB 1038 *Life Insurance* and as permitted under both AASB 139 and AASB 9. A new impairment model will be developed but the impact of any assumption changes with regard to credit losses is not expected to result in a material change to equity. Amendments to hedge documentation will be required but quantitative impacts from these changes are not expected.

AASB 15 *Revenue from Contracts with Customers*

The new revenue standard establishes a single, comprehensive framework for revenue recognition and will be effective for the Group from 1 July 2018 and replaces the previous revenue standards AASB 118 *Revenue* and AASB 111 *Construction Contracts*. The standard does not apply to leases, financial instruments or insurance contracts. The core principle of AASB 15 is that an entity recognises revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services.

The Group has performed an initial assessment on existing revenue streams and does not expect any material impact as a result of complying with the new requirements. The majority of Funds Management fee revenue is accrued when earned and the impact assessment indicates minimal change in the current revenue recognition methods. Life revenue is mainly derived from income on financial instruments and life insurance contract premiums which are not part of the scope of the standard.

AASB 16 *Leases*

This standard amends the accounting for leases and replaces AASB 117 *Leases*. The standard removes the distinction between operating and finance leases and requires lessees to bring all leases on to the statement of financial position. The standard will be effective for the Group from 1 July 2019 and the Group does not intend to early adopt the standard.

The majority of leases from the lessee perspective within the scope of AASB 16 are expected to be recognised as a 'right-of-use' asset on the Group's statement of financial position together with a related lease liability being recognised subject to the relevant contracts remaining in force at transition. Lessor accounting remains largely unchanged.

The Group is in the process of considering its transition approach to the standard.

AASB 17 *Insurance Contracts*

On 20 July 2017, AASB 17 *Insurance Contracts* was released to align with the new IFRS 17 *Insurance Contracts*. The effective dates are the same and will be applicable to the Group from 1 July 2021. The proposed approach for the measurement of insurance contract liabilities is based on the following building blocks:

- Expected present value of future cash flows;
- A risk adjustment related to the expected present value of cash flows; and
- A contractual service margin (CSM) that would eliminate any gain at inception of the contract. The CSM would be adjusted subsequently for changes in estimates of future cash flows and the risk adjustment to the extent these changes relate to future coverage or other future services.

A full review of the impact on the Group will be performed over the coming year.

(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 fair 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, which approximates fair value.

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, which approximates fair value.

(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 the 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 2017 $M	30 June 2016 $M
Investment revenue		
Fixed income securities and cash		
Interest revenue	786.1	711.9
Net realised and unrealised (losses)/gains on fixed income securities[1]	(207.8)	149.8
Investment property and property securities		
Property rental revenue	328.5	334.1
Dividend revenue	20.4	19.2
Net realised and unrealised gains on investment property and property securities	56.3	132.1
Revenue from sale of development properties	16.6	30.2
Equity and infrastructure investments		
Dividend revenue	34.7	22.9
Net realised and unrealised gains/(losses) on equity investments	65.5	(8.7)
Net realised and unrealised gains on infrastructure investments	4.5	69.6
Other		
Net realised and unrealised gains on foreign exchange translation and hedges	23.1	41.3
Net realised and unrealised gains/(losses) on interest rate derivatives	59.4	(85.5)
Net realised and unrealised gains on equity swap derivatives	37.8	25.2
Management fee revenue	187.8	172.3
Other revenue		
Life insurance contract premiums and related revenue	1,624.0	598.0
Gain on sale of associate	-	40.0
Change in life insurance contract liabilities	(1,141.5)	(395.6)
Change in life investment contract liabilities	72.3	(4.9)
Change in reinsurance contract liabilities	4.6	(38.6)
Total revenue	**1,972.3**	**1,813.3**

[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 2017 $M	30 June 2016 $M
Life insurance contract claims and expenses	339.3	226.6
Cost of life insurance contract liabilities	188.7	146.4
Cost of life investment contract liabilities	221.3	242.2
Reinsurance contracts	2.5	1.7
Investment property related expenses[1]	102.8	100.7
Development properties cost of sales	17.3	37.6
Management fee expense	87.1	83.1
Distribution expenses	41.5	37.7
Employee expenses	152.7	147.7
Employee share-based payments	22.9	24.0
Superannuation	7.6	7.0
Occupancy expense – operating lease	10.8	14.0
Depreciation and amortisation expense	14.5	16.1
Technology and communications	20.8	24.4
Professional fees	20.6	18.4
Impairment loss on equity accounted associates	-	10.6
Other expenses	60.0	50.4
Total expenses	**1,310.4**	**1,188.6**

[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	
	2017 $M	2016 $M	2017 $M	2016 $M	2017 $M	2016 $M	2017 $M	2016 $M	2017 $M	2016 $M
Net income	631.4	592.4	134.0	127.7	765.4	720.1	0.8	1.0	766.2	721.1
Operating expenses	(100.2)	(92.6)	(88.9)	(90.3)	(189.1)	(182.9)	(66.8)	(66.7)	(255.9)	(249.6)
Normalised EBIT	**531.2**	**499.8**	**45.1**	**37.4**	**576.3**	**537.2**	**(66.0)**	**(65.7)**	**510.3**	**471.5**
Interest and borrowing costs	-	-	-	-	-	-	(5.3)	(4.1)	(5.3)	(4.1)
Normalised net profit/(loss) before tax	**531.2**	**499.8**	**45.1**	**37.4**	**576.3**	**537.2**	**(71.3)**	**(69.8)**	**505.0**	**467.4**
Tax on normalised profit									(120.1)	(105.7)
Normalised net profit after tax									**384.9**	**361.7**
Investment experience after tax									12.7	(56.1)
Significant items after tax									-	22.1
Profit attributable to the shareholders of Challenger Ltd									**397.6**	**327.7**
Other statutory segment information										
Revenue from external customers	1,028.2	955.8	157.5	144.9	1,185.7	1,100.7	0.5	0.7	1,186.2	1,101.4
Interest revenue	784.0	689.4	-	-	784.0	689.4	2.1	22.5	786.1	711.9
Interest expense	(136.0)	(209.7)	(0.8)	(0.5)	(136.8)	(210.2)	(24.0)	(19.4)	(160.8)	(229.6)
Intersegment revenue	(41.6)	(33.7)	41.6	33.7	-	-	-	-	-	-
Depreciation and amortisation	(5.7)	(7.2)	(0.3)	(0.4)	(6.0)	(7.6)	(8.5)	(8.5)	(14.5)	(16.1)
As at 30 June										
Segment assets	16,157.0	14,627.7	236.0	219.3	16,393.0	14,847.0	6,627.5	6,128.2	23,020.5	20,975.2
Segment liabilities	(13,486.0)	(12,138.3)	(49.3)	(43.6)	(13,535.3)	(12,181.9)	(6,597.1)	(6,112.4)	(20,132.4)	(18,294.3)
Net assets attributable to shareholders	**2,671.0**	**2,489.4**	**186.7**	**175.7**	**2,857.7**	**2,665.1**	**30.4**	**15.8**	**2,888.1**	**2,680.9**

[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 reliable income. 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 and are unchanged since 30 June 2016. 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.

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 prior period ending 30 June 2016 in accordance with the definition.

There have been no significant items reported for the year ended 30 June 2017.

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 2017 $M	30 June 2016 $M
Reconciliation of management to statutory view of after-tax profit		
Operating segments normalised net profit before tax	576.3	537.2
Corporate and other normalised net loss before tax	(71.3)	(69.8)
Normalised net profit before tax (management view of pre-tax profit)	**505.0**	**467.4**
Tax on normalised profit	(120.1)	(105.7)
Normalised net profit after tax	**384.9**	**361.7**
Investment experience after tax	12.7	(56.1)
Significant items after tax	-	22.1
Profit attributable to the shareholders of Challenger Limited	**397.6**	**327.7**
Profit attributable to non-controlling interests excluded from management view	0.6	2.2
Statutory view of profit after tax	**398.2**	**329.9**
Reconciliation of management view of revenue to statutory revenue		
Operating segments	765.4	720.1
Corporate and other	0.8	1.0
Net income (management view of revenue)	**766.2**	**721.1**
Expenses and finance costs offset against revenue		
SPV expenses and finance costs offset against SPV income	35.0	53.3
Distribution expenses offset against related income	41.5	37.7
Change in life contract liabilities and reinsurance contracts recognised in expenses	751.8	616.9
Property related expenses offset against property income	102.8	103.0
Interest and loan amortisation costs	101.0	156.3
Fee expenses	87.1	83.1
Gain on sale of associate	-	40.0
Adjustment for non-controlling interests and other items	65.5	70.3
Difference between management view of investment experience and statutory recognition		
Actual capital growth	197.0	(38.5)
Normalised capital growth	(104.9)	(100.5)
Annuity valuation experience	(70.7)	70.6
Statutory revenue (refer Note 1 Revenue)	**1,972.3**	**1,813.3**

Note 4 Income tax

Analysis of income tax expense	30 June 2017 $M	30 June 2016 $M
Current income tax expense for the year	(209.6)	(47.2)
Current income tax (expense)/benefit prior year adjustment	(0.9)	8.7
Deferred income tax benefit/(expense)	86.9	(38.3)
Deferred income tax benefit/(expense) prior year adjustment	2.6	(5.0)
Income tax expense	**(121.0)**	**(81.8)**
Income tax benefit/(expense) on translation of foreign entities	11.2	(15.4)
Income tax (expense)/benefit on hedge of net investment in foreign operations	(11.0)	15.2
Income tax benefit/(expense) from other comprehensive income	**0.2**	**(0.2)**
Reconciliation of income tax expense		
Profit before income tax	519.2	411.7
Prima facie income tax based on the Australian company tax rate of 30%	(155.8)	(123.5)
Tax effect of amounts not assessable/deductible in calculating taxable income:		
– non-assessable and non-deductible items[1]	25.2	24.6
– rate differential on offshore income	10.4	16.3
– tax adjustment in respect of non-controlling interests	0.2	0.7
– other items	(1.0)	0.1
Income tax expense	**(121.0)**	**(81.8)**
Underlying effective tax rate[2]	**23.3%**	**20.0%**

[1] The 30 June 2017 amount includes a reduction in tax expense for previously unbooked capital losses in respect of property disposals. 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 $0.6 million (30 June 2016: $2.2 million).

	Statement of financial position		Statement of comprehensive income	
Analysis of deferred tax	30 June 2017 $M	30 June 2016 $M	30 June 2017 $M	30 June 2016 $M
Deferred tax assets				
Accruals and provisions	28.6	32.1	(3.5)	1.3
Employee entitlements	3.7	3.5	0.2	0.2
Losses	21.4	23.7	3.7	7.4
Other	23.2	28.0	(8.1)	14.7
Total deferred tax assets	**76.9**	**87.3**	**(7.7)**	**23.6**
Deferred tax liabilities				
Deferred acquisition and origination costs	-	-	-	1.4
Unrealised foreign exchange movements	(14.4)	(22.3)	6.1	(4.7)
Unrealised gains on investments	(139.8)	(167.5)	27.7	(51.1)
Other	(14.1)	(77.5)	63.4	(12.5)
Total deferred tax liabilities	**(168.3)**	**(267.3)**	**97.2**	**(66.9)**
Net deferred tax liabilities (statement of financial position)	**(91.4)**	**(180.0)**		
Deferred income tax benefit/(expense) (statement of comprehensive income)			**89.5**	**(43.3)**

Note 4 Income tax (continued)

Tax Transparency Code Disclosures

Domestic and foreign tax (expense)/benefit	30 June 2017 $M	30 June 2016 $M	Change $M
Domestic operations	(119.3)	(84.9)	(34.4)
Foreign operations	(1.7)	3.1	(4.8)
Income tax expense	**(121.0)**	**(81.8)**	(39.2)

Analysis of current tax liability/(asset)	30 June 2017 $M	30 June 2016 $M
Opening balance	(13.1)	23.6
Current tax expense for the year	209.6	47.2
Current tax prior year adjustment	0.9	(8.7)
Tax in equity	(5.4)	(7.6)
Revenue losses utilised	-	(1.7)
Income tax paid	(77.9)	(64.5)
Other	(6.5)	(1.4)
Closing balance	**107.6**	**(13.1)**

The income tax paid in 2017 was $77.9 million (2016: $64.5 million) and was lower than the current year income tax expense for the period as known amounts payable to the ATO are not due and payable until August 2017. The difference also arises due to using a lower 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 is 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

Note 4 Income tax (continued)

Recognition and measurement (continued)

assets against current tax liabilities and the deferred tax assets and liabilities relate to the same taxable entity or tax consolidated group and the same taxation authority.

Tax consolidation

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

Tax effect accounting by members of the tax 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

There are no Challenger tax consolidated group revenue losses at 30 June 2017. A deferred tax asset in relation to $21.4 million (30 June 2016: $23.4 million) of revenue losses (net) has been recognised in respect of non-tax consolidated group entities. A further deferred tax asset of $18.5 million (30 June 2016: $17.5 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 $282.9 million (30 June 2016: $422.3 million) of gross unused capital losses for which no deferred tax asset has been recognised. The decrease in the period is largely attributable to a capital gain arising from the sale of property assets.

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 2017 $M	30 June 2016 $M
Domestic sovereign bonds and semi-government bonds	5,948.0	4,364.4
Floating rate notes and corporate bonds	5,123.1	4,788.0
Residential mortgage and asset-backed securities	2,538.0	2,065.2
Non-SPV mortgage assets	200.7	245.9
Fixed income securities	**13,809.8**	**11,463.5**
Shares in listed and unlisted corporations	66.7	54.8
Unit trusts, managed funds and other	664.1	545.4
Equity securities	**730.8**	**600.2**
Units in listed and unlisted infrastructure trusts	336.7	369.4
Other infrastructure investments	305.5	331.7
Infrastructure investments	**642.2**	**701.1**
Indirect property investments in listed and unlisted trusts	296.3	339.5
Property securities	**296.3**	**339.5**
Total financial assets – fair value through profit and loss	**15,479.1**	**13,104.3**
Current	6,298.1	5,744.1
Non-current	9,181.0	7,360.2
	15,479.1	**13,104.3**

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

Recognition and measurement

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

Purchases and sales of financial assets are recognised on the date on which the Group commits to purchase or sell the asset 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 2017 $M	30 June 2016 $M
Investment property held for sale[1]	96.0	70.6
Investment property in use	3,359.4	3,378.7
Investment property under development	144.1	83.3
Total investment property	**3,599.5**	**3,532.6**
Development property held for resale[2]	29.4	37.3
Total investment and development property[3]	**3,628.9**	**3,569.9**

[1] Held for sale properties: 12-30 Toll, 2-10 Toll, City Century Walk, Gennevilliers, Parcay-Meslay and Villeneuve les Beziers (30 June 2016: Elder House and Innaloo Cinema).
[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 held for resale 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 2017 $M	Investment property in use 30 June 2016 $M	Investment property under development 30 June 2017 $M	Investment property under development 30 June 2016 $M	Development property held for resale 30 June 2017 $M	Development property held for resale 30 June 2016 $M
Balance at the beginning of the year	3,378.7	2,736.6	83.3	19.2	37.3	70.6
Movements for the year						
– acquisitions[1]	63.3	558.1	10.7	12.0	-	-
– disposals	(45.5)	(84.7)	-	-	(16.3)	(35.3)
– net transfers to investment property held for sale	(73.0)	(25.8)	-	-	-	-
– transfers from investment property under development	23.5	-	(23.5)	-	-	-
– capital expenditure	34.6	16.9	73.6	50.2	13.2	16.8
– net revaluation gain/(loss)	48.5	64.8	-	1.9	(4.8)	(14.8)
– foreign exchange (loss)/gain	(70.7)	112.8	-	-	-	-
Balance at the end of the year	**3,359.4**	**3,378.7**	**144.1**	**83.3**	**29.4**	**37.3**

[1] Investment property acquisitions: 839 Collins Street, VIC $10.7 million; 82 Northbourne Avenue, ACT $60.4 million; Aeon Kushiro, Japan (additional land parcel) $2.7 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 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 2017 $M	Cap rate 2017[3] %	Last external valuation date	Carrying value 2016 $M	Cap rate 2016[3] %
Investment property in use and held for sale							
Australia							
1-9 Toll Drive, Altona North, VIC	31-Dec-08	-	-	-	-	4.0	7.50
2-10 Toll Drive, Altona North, VIC	31-Dec-08	6.3	7.0	7.00	31-Dec-16	7.1	7.00
12-30 Toll Drive, Altona North, VIC	31-Dec-08	13.9	13.6	7.50	31-Dec-16	13.3	7.50
Spotlight, Laverton North, VIC	31-Dec-08	-	-	-	-	20.6	7.00
Cosgrave Industrial Park, Enfield, NSW	31-Dec-08	91.9	105.8	6.25	31-Dec-16	69.5	6.84
21 O'Sullivan Circuit, NT	27-Jan-16	47.6	42.3	7.75	31-Dec-16	47.6	7.75
31 O'Sullivan Circuit, NT	27-Jan-16	28.6	27.3	8.00	31-Dec-16	28.6	8.25
31 Queen Street, VIC	31-Mar-11	97.4	136.8	5.75	31-Dec-16	118.4	6.50
35 Clarence Street, NSW	15-Jan-15	145.3	180.0	5.75	30-Jun-17	149.0	6.50
53 Albert Street, QLD	12-Dec-14	222.9	216.0	6.50	30-Jun-17	217.5	6.63
82 Northbourne Avenue, ACT	01-Jun-17	60.4	60.4	6.25	-	-	-
565 Bourke Street, VIC	28-Jan-15	88.1	90.1	6.00	31-Dec-16	88.6	6.50
ABS Building, ACT	01-Jan-00	120.1	124.0	7.00	30-Jun-17	126.5	7.50
215 Adelaide Street, QLD	31-Jul-15	242.6	230.0	6.75	30-Jun-17	230.0	6.75
County Court, VIC	30-Jun-00	215.1	301.0	6.25	31-Dec-16	290.6	6.50
DIBP (formerly DIAC) Building, ACT	01-Dec-01	103.3	122.5	6.75	30-Jun-17	121.0	7.50
Discovery House, ACT	28-Apr-98	88.2	105.1	7.50	31-Dec-16	104.2	7.75
Elder House, SA	21-Jun-02	48.3	23.0	9.00	30-Jun-17	25.8	8.75
Executive Building, TAS	30-Mar-01	33.6	40.9	7.50	31-Dec-16	38.2	7.75
Makerston House, QLD	14-Dec-00	67.7	68.3	8.00	31-Dec-16	65.4	8.50
Bunbury Forum, WA	03-Oct-13	152.8	151.0	6.25	30-Jun-17	151.0	6.50
Century City Walk, VIC	16-Oct-06	30.2	45.0	7.00	31-Dec-16	41.2	7.25
Channel Court, TAS	21-Aug-15	80.9	82.5	7.25	30-Jun-17	80.0	7.50
Golden Grove, SA	31-Jul-14	141.1	146.4	6.00	30-Jun-17	142.3	6.50
Innaloo Cinema, WA	17-Dec-01	-	-	-	-	44.8	7.25
Karratha, WA	28-Jun-13	54.2	54.3	7.00	30-Jun-17	62.3	7.00
Kings Langley, NSW	29-Jul-01	15.9	23.0	6.25	30-Jun-17	21.0	6.50
Lennox, NSW	27-Jul-13	28.2	35.5	6.25	30-Jun-17	33.5	6.50
Next Hotel, QLD	25-Mar-15	142.0	130.9	6.84	31-Dec-16	136.5	6.85
North Rocks, NSW	18-Sep-15	137.6	128.0	6.50	30-Jun-17	127.5	6.75
The Barracks, QLD	31-Oct-14	153.8	150.7	6.50	30-Jun-17	149.5	7.50
Total Australia		**2,658.0**	**2,841.4**			**2,755.5**	

[1] Acquisition date represents the date of 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 rate is the rate at which net market income is capitalised to determine the value of the property. The rate is determined with regard to market evidence.

Note 6 Investment and development property (continued)

Analysis of investment property as at 30 June (continued)	Acquisition date[1]	Total cost $M[2]	Carrying value 2017 $M	Cap rate 2017[3] %	Last external valuation date	Carrying value 2016 $M	Cap rate 2016[3] %
Europe							
Rozalia Park	12-Apr-07	-	-	-	-	20.4	9.25
Rue Charles Nicolle, Villeneuve les Beziers	31-Dec-08	18.4	12.9	7.25	30-Jun-17	12.5	8.75
Avenue de Savigny, Aulnay sous Bois	31-Dec-08	20.3	12.0	6.25	30-Jun-17	14.0	7.00
105 Route d'Orleans, Sully sur Loire	31-Dec-08	27.1	9.1	8.00	30-Jun-17	10.0	10.00
140 Rue Marcel Paul, Gennevilliers	31-Dec-08	14.1	10.2	7.25	30-Jun-17	10.1	9.75
ZAC Papillon, Parcay-Meslay	31-Dec-08	10.1	7.3	7.50	30-Jun-17	7.2	9.25
Japan							
Aeon Kushiro	31-Jan-10	30.5	32.5	5.50	30-Jun-17	33.0	5.50
Carino Chitosedai	31-Jan-10	118.4	118.4	4.70	31-Dec-16	131.2	4.80
Carino Tokiwadai	31-Jan-10	77.0	76.4	4.70	30-Jun-17	84.3	4.80
DeoDeo Kure	31-Jan-10	31.9	28.8	5.60	30-Jun-17	31.8	5.80
Fitta Natalie Hatsukaichi	28-Aug-15	11.4	13.0	5.90	31-Dec-16	14.5	6.00
Izumiya Hakubaicho	31-Jan-10	68.9	66.9	5.00	31-Dec-16	74.4	5.10
Kansai Super Saigo	31-Jan-10	13.1	12.6	5.50	30-Jun-17	14.1	5.50
Kojima Nishiarai	31-Jan-10	12.2	13.3	4.60	30-Jun-17	14.1	4.90
Life Asakusa	31-Jan-10	27.8	31.3	4.60	30-Jun-17	34.8	4.70
Life Higashi Nakano	31-Jan-10	32.9	33.6	4.70	31-Dec-16	37.3	4.80
Life Nagata	31-Jan-10	25.2	26.2	5.00	30-Jun-17	28.5	5.00
MaxValu Tarumi	28-Aug-15	16.9	18.0	5.70	31-Dec-16	20.2	5.80
Seiyu Miyagino	31-Jan-10	9.7	9.7	5.70	30-Jun-17	10.9	5.70
Valor Takinomizu	31-Jan-10	26.8	23.3	5.70	31-Dec-16	26.3	6.10
Valor Toda	31-Jan-10	42.5	41.4	5.50	30-Jun-17	45.2	5.70
Yaoko Sakato Chiyoda	31-Jan-10	18.8	17.1	5.00	31-Dec-16	19.0	5.10
Total international		**654.0**	**614.0**			**693.8**	
Total investment property in use and held for sale[4]		**3,312.0**	**3,455.4**			**3,449.3**	
Investment property under development							
Australia							
839 Collins Street, VIC	22-Dec-16	34.6	34.6	-	n/a	-	-
Enfield, NSW	31-Dec-08	-	-	-	n/a	18.7	-
Gateway, NT	01-Jul-15	95.7	96.4	-	n/a	51.8	-
TRE Data Centre, ACT	14-Apr-10	13.1	13.1	-	n/a	12.8	-
Total investment property under development		**143.4**	**144.1**			**83.3**	
Development property held for resale							
Australia							
Maitland	6-Dec-06	49.1	29.4	-	-	37.3	-
Total development property		**49.1**	**29.4**	**-**	**-**	**37.3**	**-**

[1] Acquisition date represents the date of 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 rate is the rate at which net market income is capitalised to determine the value of the property. The rate is determined with regard to market evidence.
[4] At 30 June 2017, the investment property portfolio occupancy rate for Australia was 93.8% (30 June 2016: 94.7%) with a weighted average lease expiry of 4.3 years (30 June 2016: 4.1 years), Europe 100.0% (30 June 2016: 95.0%) with a weighted average lease expiry of 1.4 years (30 June 2016: 1.7 years) and Japan 100% (30 June 2016: 100%) with a weighted average lease expiry of 8.7 years (30 June 2016: 8.4 years).

Note 7 Special Purpose Vehicles

Consolidated	30 June 2017 $M	30 June 2016 $M
Cash and cash equivalents	122.4	146.9
Mortgage assets[1]	1,300.1	1,677.6
Derivative assets	0.3	0.7
Total assets	**1,422.8**	**1,825.2**
Payables	209.5	196.1
Derivative liabilities	0.5	0.7
Interest bearing financial liabilities[1]	1,213.0	1,628.4
Total liabilities	**1,423.0**	**1,825.2**
Net assets	**(0.2)**	**-**
Cash flow hedge reserve	(0.2)	-
Total equity attributable to residual income unit (RIU) holders	**(0.2)**	**-**

[1] $315.4 million (30 June 2016: $381.8 million) of the Mortgage assets balance is considered current, and $294.3 million (30 June 2016: $370.7 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 2017 $M	30 June 2016 $M
Balance at the beginning of the year	40.4	40.8
Additional provisions and adjustments to estimates	1.3	1.6
Utilisation of provision against incurred losses	(11.6)	(2.0)
Balance at the end of the year	**30.1**	**40.4**

Note 8 Life contract liabilities

Fair value of life contract liabilities	30 June 2017 $M	30 June 2016 $M
Life investment contract liabilities – at fair value	6,356.5	6,915.3
Life insurance contract liabilities – at margin on services value	3,885.5	2,555.3
Reinsurance contract liabilities – at margin on services value	80.2	87.9
Total life contract liabilities	**10,322.2**	**9,558.5**

	Life investment contract liabilities		Life insurance contract liabilities		Outward reinsurance contract liabilities		Total life contract liabilities	
Movement in life contract liabilities	30 June 2017 $M	30 June 2016 $M	30 June 2017 $M	30 June 2016 $M	30 June 2017 $M	30 June 2016 $M	30 June 2017 $M	30 June 2016 $M
Balance at the beginning 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
Deposits and premium receipts	2,417.6	2,769.8	1,624.0	598.0	-	-	4,041.6	3,367.8
Payments and withdrawals	(3,125.4)	(2,728.5)	(339.3)	(226.6)	(5.6)	(5.2)	(3,470.3)	(2,960.3)
Revenue per Note 1	(72.3)	4.9	(482.5)	(202.4)	(4.6)	38.6	(559.4)	(158.9)
Expense per Note 2	221.3	242.2	528.0	373.0	2.5	1.7	751.8	616.9
Balance at the end of the year	**6,356.5**	**6,915.3**	**3,885.5**	**2,555.3**	**80.2**	**87.9**	**10,322.2**	**9,558.5**

Analysis of life insurance and reinsurance contract liability and expenses	30 June 2017 $M	30 June 2016 $M
Best estimate liability		
Value of future life insurance contract benefits	3,783.1	2,564.4
Value of future expenses	207.2	102.8
Value of future premiums	(287.7)	(267.4)
Total best estimate liability	**3,702.6**	**2,399.8**
Value of future profit margins	263.1	243.4
Net life insurance and reinsurance contract liability	**3,965.7**	**2,643.2**
Life insurance and reinsurance contract operating expenses		
Maintenance expenses	27.7	10.0
Total life insurance and reinsurance contract operating expenses	**27.7**	**10.0**
Analysis of life contract profit		
Profit margin release on life insurance contracts	27.3	14.5
Loss recognition in respect of life insurance contracts[1]	(140.5)	(103.7)
Loss recognition in respect of life investment contracts	(94.0)	(106.2)
Difference in actual and assumed experience in respect of life insurance contracts	154.9	102.2
Difference in actual and assumed experience in respect of life investment contracts	289.1	266.7
Profit arising from difference between actual and assumed experience	**236.8**	**173.5**
Investment earnings on assets in excess of life contract liabilities	208.4	164.9
Life contract profit after tax	**445.2**	**338.4**

[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.

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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 in the statement of comprehensive income in the period in which they occur. 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.

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, wholesale mortality, wholesale morbidity and longevity reinsurance. Annuity payments are used as the profit carrier for individual lifetime annuities and premium receipts or best estimate claim payments are used as the profit carrier for wholesale mortality, 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 2016. Discount rates applied for Australian liabilities were between 2.2-4.2% per annum (30 June 2016: 2.3-3.3%).

Expenses

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, 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 1.4% for short-term inflation and 2.4% for long-term per annum (30 June 2016: 0.9% short-term, 1.8% long-term).

Surrenders

For life investment contracts, no surrenders or voluntary discontinuances are assumed. For inwards reinsurance of Japanese business, a rate of surrenders is assumed in line with local experience in relation to similar contracts, currently 3.5% per annum.

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 0.0-2.3% per annum (30 June 2016: 0.0-2.8%).

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 Vita Curves (proprietary mortality curves developed by Hymans Robertson where mortality rates vary by several rating factors) 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 0.0-2.8% per annum (30 June 2016: 0.0-4.0%). Base mortality rates for retrocession of Japanese business are determined as a multiple of Japanese population mortality rates.

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 four 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. Funds 2 and 4 are the principal operating funds of the Group. Fund 2 contains non-investment-linked contracts, including the Group's term annuity business, lifetime annuity policies and the related reinsurance, plus the wholesale mortality, wholesale morbidity and longevity reinsurance. Fund 4 was established on 7 March 2017 and contains retrocession of fixed term business written in Japan.

Life contract liabilities for Funds 1, 2, 3 and 4 are $2.8 million, $9,746.6 million, $3.0 million and $569.8 million respectively (2016: $3.3 million, $9,551.9 million, $3.3 million, nil).

Current/non-current split for total life contracts

There is a fixed settlement date for the majority of life contract liabilities. Approximately $1,903.2 million (on a discounted basis) (2016: $2,481.6 million) of life contract liabilities have a contractual maturity within 12 months of the reporting date. Based on assumptions applied for the 30 June 2017 valuation of life contract liabilities, $2,318.3 million of principal payments on fixed term and lifetime business are expected in the year to 30 June 2018 (expected in the year to 30 June 2017: $2,781.7 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 and retrocession of fixed term business written in Japan. 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.

Note 8 Life contract liabilities (continued)

Life insurance risk (continued)

The Group manages the mortality and morbidity risk by regular reviews of the portfolio to ensure that mortality and morbidity assumptions remain appropriate.

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 2017 $M	30 June 2016 $M	30 June 2017 $M	30 June 2016 $M	30 June 2017 $M	30 June 2016 $M	30 June 2017 $M	30 June 2016 $M
50% increase in the rate of mortality improvement	43.0	42.0	26.0	21.5	(30.1)	(29.4)	(18.2)	(15.1)
10% increase in maintenance expenses	12.4	9.0	12.4	9.0	(8.7)	(6.3)	(8.7)	(6.3)

Liquidity risk for insurance contracts

The following table summarises the undiscounted maturity profile of the Group's life insurance contract liabilities. 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
2017	405.1	713.1	580.2	3,310.9	5,009.3
2016	228.5	399.3	344.5	2,310.1	3,282.4

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 2017 $M	30 June 2016 $M
Current	1,225.2	750.0
Non-current	462.6	565.5
Total liabilities to external unit holders	**1,687.8**	**1,315.5**

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 2017 Notional value $M	Net fair value assets $M	Net fair value liabilities $M	30 June 2016 Notional value $M	Net fair value assets $M	Net fair value liabilities $M
Non-SPV						
Interest rate swaps						
Less than one year	4,764.0	10.7	(3.3)	3,094.8	42.2	(3.4)
One to three years	7,330.5	43.1	(29.4)	6,730.5	53.9	(29.7)
Three to five years	2,769.6	37.0	(15.8)	2,640.9	68.1	(42.6)
Greater than five years	14,854.8	261.2	(188.6)	11,834.3	457.9	(410.3)
Total interest rate swaps	**29,718.9**	**352.0**	**(237.1)**	**24,300.5**	**622.1**	**(486.0)**
Inflation-linked swaps						
Less than one year	867.1	3.3	(5.8)	297.0	9.4	(0.1)
One to three years	430.0	9.3	-	664.0	16.5	(6.0)
Three to five years	111.1	3.0	-	162.0	6.2	-
Greater than five years	479.0	22.2	(10.0)	499.0	31.7	(13.2)
Total inflation-linked swaps	**1,887.2**	**37.8**	**(15.8)**	**1,622.0**	**63.8**	**(19.3)**
Futures contracts						
Less than one year	8,967.6	-	(0.5)	3,963.1	-	(0.5)
Total futures contracts	**8,967.6**	**-**	**(0.5)**	**3,963.1**	**-**	**(0.5)**
Forward currency contracts						
Less than one year	2,769.2	34.8	(26.6)	2,415.2	46.9	(16.8)
One to three years	-	-	-	3.7	-	-
Total forward currency contracts	**2,769.2**	**34.8**	**(26.6)**	**2,418.9**	**46.9**	**(16.8)**
Cross-currency swaps						
Less than one year	904.0	7.4	(67.8)	246.0	-	(47.7)
One to three years	1,184.1	28.5	(78.3)	788.4	9.5	(98.7)
Three to five years	897.6	16.4	(36.2)	639.4	22.3	(117.9)
Greater than five years	27.7	-	(6.8)	83.5	-	(23.7)
Total cross-currency swaps	**3,013.4**	**52.3**	**(189.1)**	**1,757.3**	**31.8**	**(288.0)**
Equity swaps						
Less than one year	1,178.4	22.5	(6.7)	1,053.2	16.1	(22.1)
One to three years	320.7	1.1	(1.1)	261.4	6.0	(5.5)
Total equity swaps	**1,499.1**	**23.6**	**(7.8)**	**1,314.6**	**22.1**	**(27.6)**
Credit default swaps						
Less than one year	131.7	0.3	(0.1)	134.3	0.8	-
One to three years	49.1	0.3	-	175.9	0.1	(3.9)
Three to five years	726.1	40.0	(0.1)	10.0	-	(0.1)
Greater than five years	-	-	-	9.4	-	(0.7)
Total credit default swaps	**906.9**	**40.6**	**(0.2)**	**329.6**	**0.9**	**(4.7)**
Options						
One to three years	2.1	-	-	0.3	-	-
Total options	**2.1**	**-**	**-**	**0.3**	**-**	**-**
Total non-SPV	**48,764.4**	**541.1**	**(477.1)**	**35,706.3**	**787.6**	**(842.9)**

Note 10 Derivative financial instruments (continued)

Analysis of derivative financial instruments (continued)	30 June 2017 Notional value $M	30 June 2017 Net fair value assets $M	30 June 2017 Net fair value liabilities $M	30 June 2016 Notional value $M	30 June 2016 Net fair value assets $M	30 June 2016 Net fair value liabilities $M
SPV						
Interest rate swaps – SPV						
Less than one year	8.7	-	(0.1)	11.1	-	(0.1)
One to three years	12.0	-	(0.1)	13.2	-	(0.2)
Three to five years	1.6	-	0.0	2.5	-	(0.1)
Total interest rate swaps – SPV	**22.3**	**-**	**(0.2)**	**26.8**	**-**	**(0.4)**
Cross-currency swaps – SPV						
Greater than five years	471.1	0.3	(0.3)	727.6	0.7	(0.3)
Total cross-currency swaps – SPV	**471.1**	**0.3**	**(0.3)**	**727.6**	**0.7**	**(0.3)**
Total – SPV	**493.4**	**0.3**	**(0.5)**	**754.4**	**0.7**	**(0.7)**
Total derivative financial instruments[1]		**541.4**	**(477.6)**		**788.3**	**(843.6)**

[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 $275.9 million (30 June 2016: $453.5 million) and the derivative liabilities would reduce by $275.9 million (30 June 2016: $453.5 million).

Recognition and measurement

The Group uses derivative financial instruments predominantly to hedge its risks associated with interest rate and foreign currency fluctuations and to gain exposure to different markets. 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 2017, a post-tax gain of $25.8 million (30 June 2016: post-tax loss of $35.5 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 transactions, with the fair value change on the effective portion of the derivative being recognised in equity.

For the year ended 30 June 2017, a post-tax loss of $0.2 million (30 June 2016: post-tax loss of $1.4 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 2017 $M	30 June 2016 $M
Profit for the year	**398.2**	**329.9**
Adjusted for		
Net realised and unrealised gains on investment assets	(55.4)	(354.0)
Share of associates' net profit	(18.1)	(16.6)
Change in life contract liabilities[1]	192.4	458.0
Depreciation and amortisation expense	14.5	16.1
Impairment in associates and other investments	30.8	22.7
Share-based payments	22.9	24.0
Dividends from associates	18.0	16.5
Change in operating assets and liabilities		
Decrease in receivables	5.6	17.7
Decrease in other assets	2.1	9.6
Increase/(decrease) in payables	9.5	(33.2)
Increase/(decrease) in provisions	1.0	(11.3)
Increase in life contract liabilities	571.3	407.5
Increase in external unit holders' liabilities	372.3	370.8
Increase in net tax liabilities	32.1	24.7
Net cash flows from operating activities	**1,597.2**	**1,282.4**

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

Reconciliation of cash	30 June 2017 $M	30 June 2016 $M
Cash at bank and on hand	514.7	516.2
Cash at bank and on hand – SPV	122.4	146.9
Other cash equivalents	-	10.7
Total cash and cash equivalents[2]	**637.1**	**673.8**

[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 2017		30 June 2016	
	No. of shares M	Value of shares $M	No. of shares M	Value of shares $M
Analysis of contributed equity				
Ordinary shares issued	572.0	1,641.9	571.2	1,633.9
CPP Trust shares treated as Treasury shares	(5.3)	(39.5)	(6.1)	(36.3)
CPP deferred share purchases treated as Treasury shares	(4.8)	(47.9)	(6.3)	(50.9)
Total contributed equity	**561.9**	**1,554.5**	**558.8**	**1,546.7**
Movements in contributed equity				
Ordinary shares				
Balance at the beginning of the year	571.2	1,633.9	569.7	1,622.7
Issued under dividend reinvestment plan	0.8	8.0	1.5	11.2
Balance at the end of the year	**572.0**	**1,641.9**	**571.2**	**1,633.9**
CPP Trust				
Balance at the beginning of the year	6.1	36.3	8.7	48.7
Shares purchased (including settled forwards)	5.3	43.8	6.9	41.3
Vested shares released to employees	(6.1)	(40.6)	(9.5)	(53.7)
Balance at the end of the year	**5.3**	**39.5**	**6.1**	**36.3**
CPP deferred share purchases				
Balance at the beginning of the year	6.3	50.9	7.6	46.8
CPP deferred share purchases	2.8	30.3	4.0	34.1
Settled forward purchases	(4.3)	(33.3)	(5.3)	(30.0)
Balance at the end of the year	**4.8**	**47.9**	**6.3**	**50.9**

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.

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

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 more than one APRA-regulated industry and/or in one or more non-APRA regulated industries. APRA's non-capital conglomerate prudential standards relating to measurement, management, monitoring and reporting aggregate risk exposures and intragroup transactions and exposures came into effect on 1 July 2017.

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

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

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.

The Company has continued to offer the DRP. On 28 September 2016, the Company issued 455,140 ordinary shares to shareholders under the DRP. The DRP issue price per share for the 2016 final dividend was $9.2505 and represents the volume weighted average share price over ten trading days from 6 to 19 September 2016. The DRP participation rate was 4% of all issued shares, resulting in proceeds of $4.1 million.

For the interim 2017 dividend, the Company issued 329,428 ordinary shares on 28 March 2017. The DRP issue price per share for the interim 2017 dividend was $11.9690 and represents the volume weighted average share price over the 10 trading days from 3 to 16 March 2017. The interim DRP participation rate was 4% of all issued shares, resulting in proceeds of $3.9 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.

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 2017 was 1.57 times (1.57 times at 30 June 2016) reflecting changes in asset allocation, net AUM growth, changes in retained earnings, increased Additional Tier 1 capital and repayment of Tier 2 regulatory capital.

Note 12 Contributed equity (continued)

Capital management (continued)

Prescribed capital amount (PCA) (continued)

On 7 April 2017, the Company completed its second capital notes issue, Challenger Capital Notes 2, raising $460 million. The proceeds of the issue were used to subscribe for Additional Tier 1 capital issued by CLC to support the forecast growth of its annuity business.

Subordinated debt

CLC's total regulatory capital base includes $395.4 million (30 June 2016: $445.5 million) of admissible subordinated debt 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 thereafter partially eligible until November 2021.

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 2017 $M	30 June 2016 $M
CLC's excess capital under LAGIC		
Common Equity Tier 1 regulatory capital	2,169.0	2,003.6
Additional Tier 1 regulatory capital	805.0	345.0
Tier 2 regulatory capital – subordinated debt[1]	395.4	445.5
CLC total regulatory capital base	**3,369.4**	**2,794.1**
Prescribed capital amount		
Asset risk charge[2]	2,067.1	1,712.0
Insurance risk charge	157.5	168.3
Operational risk charge	38.7	28.7
Aggregation benefit	(119.2)	(125.3)
CLC prescribed capital amount	**2,144.1**	**1,783.7**
CLC excess over prescribed capital amount	**1,225.3**	**1,010.4**
Capital adequacy ratio (times)	**1.57**	**1.57**

[1] Differs from $393.6 million disclosed in Note 13 Interest bearing financial liabilities due to $1.8 million (30 June 2016: $2.3 million) of accrued interest and nil million (30 June 2016: $133.5 million) of inadmissible Tier 2 regulatory capital.
[2] The asset risk charge includes the combined stress test scenarios and default stress adjustments.

Note 13 Interest bearing financial liabilities

	30 June 2016		Cash flows	Non-cash movements			30 June 2017	
	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	-	-	-	-	-	-	400.0
Controlled property trusts[1]	568.5	556.3	4.4	(42.9)	0.9	1.3	520.0	537.0
Controlled infrastructure trusts	204.3	204.3	(3.2)	-	-	-	201.1	201.1
Repurchase agreements	2,454.2	2,454.2	833.3	-	-	-	3,287.5	3,287.5
Total bank loans	**3,577.0**	**3,214.8**	**834.5**	**(42.9)**	**0.9**	**1.3**	**4,008.6**	**4,425.6**
Non-bank loans								
Subordinated debt issuance	576.7	576.7	(190.3)	(11.3)	18.5	-	393.6	393.6
Challenger Capital Notes 1	338.5	338.5	-	-	-	1.7	340.2	340.2
Challenger Capital Notes 2	-	-	448.8	-	-	0.4	449.2	449.2
Other finance	18.8	18.8	(2.1)	(2.7)	3.0	-	17.0	17.0
Total non-bank loans	**934.0**	**934.0**	**256.4**	**(14.0)**	**21.5**	**2.1**	**1,200.0**	**1,200.0**
Total interest bearing financial liabilities	**4,511.0**	**4,148.8**	**1,090.9**	**(56.9)**	**22.4**	**3.4**	**5,208.6**	**5,625.6**
Current		2,733.9					3,336.1	
Non-current		1,414.9					1,872.5	
		4,148.8					**5,208.6**	

[1] Total facility limit consists of redraw loan facilities limits totalling $101.0 million (30 June 2016: $121.0 million) and non-redraw loan facility limits totalling $436.0 million (30 June 2016: $447.5 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 31 August 2016 with amended terms. The amount was increased to $400.0 million in two tranches with three ($150 million) and five ($250 million) 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 2017 balance includes $333.3 million (30 June 2016: $377.2 million) of (Australian dollar equivalent) Yen denominated loans in the Japanese property trusts. Other controlled property trusts loans total $186.7 million (30 June 2016: $179.1 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 2017 are current and all except $630 million matured in July 2017. The remaining agreements mature in August 2017 ($595 million) and September 2017 ($35 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 were fully repaid during the period. The November 2007 issuance matures 30 years from the issue date with a non-call period of 10 years and carries a floating rate of interest. The proceeds of this issuance were made available to Statutory Fund 2 of CLC (SF2) and ranks 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 (if applicable).

The notes were issued under APRA approved Instruments of Issue and are counted as Approved Subordinated Debt for regulatory capital purposes. At 30 June 2017, all subordinated debt is fully eligible as Tier 2 regulatory capital.

Challenger Capital Notes – 1 and 2 (Notes 1 and Notes 2)

On 7 April 2017, the Company completed its second capital notes issue, Challenger Capital Notes 2 (Notes 2), raising $460.0 million of new debt funding. The Notes 2 issue features similar structural characteristics to the Company's first $345.0 million debt issue completed on 9 October 2014, Challenger Capital Notes 1 (Notes 1), including:

- quarterly, floating, discretionary, non-cumulative distributions based on a margin over 3 month BBSW;
- optional exchange whereby notes may be redeemed or resold for cash or converted to ordinary shares in the Company, at the Company's option, on the relevant Optional Exchange Date (or on an earlier date in certain circumstances), subject to APRA's prior written approval; and
- mandatory conversion to ordinary shares in the Company on the relevant Mandatory Conversion Date, subject to certain conditions being satisfied. If the conditions to mandatory conversion are not met on the relevant Mandatory Conversion Date, conversion will be deferred to a later date when the conditions are retested.

	Notes 1	Notes 2
Issue date	9 October 2014	7 April 2017
Issue amount	$345.0 million	$460.0 million
Optional Exchange Date	25 May 2020	22 May 2023
Mandatory Conversion Date	25 May 2022	22 May 2025

The costs associated with the issue of both Notes 1 and Notes 2 have been capitalised against the relevant liability and will be expensed to the statement of comprehensive income over the respective lives of Notes 1 and Notes 2. Neither the Notes 1 issue nor the Notes 2 issue constitute regulatory capital of the Company. The proceeds from the issue of both Notes 1 and Notes 2 were used to fund a subscription for notes issued by CLC. Both issues of notes by CLC were approved by APRA and constitute Additional Tier 1 capital of CLC.

Other finance

Other finance includes a limited recourse non-bank loan for the financing of equipment totalling $17.0 million. The loan has a maturity date of November 2020.

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 Notes 1 and Notes 2, adjusted to allow for both issues' higher ranking in the capital structure (using market comparable instruments) and illiquidity.

The change in the statement of comprehensive income in respect of valuation changes for the year ended 30 June 2017 was a loss of $18.5 million (30 June 2016: $3.9 million).

Note 14 Reserves and retained earnings

	30 June 2017 $M	30 June 2016 $M
Share-based payments reserve		
Balance at the beginning of the year	(12.9)	10.0
Share-based payments for the period	22.9	24.0
Releases from share-based payments reserve	(40.6)	(53.7)
Tax on equity	7.4	6.8
Balance at the end of the year	**(23.2)**	**(12.9)**
Cash flow hedge reserve – SPV[1]		
Balance at the beginning of the year	-	1.4
Loss on cash flow hedges	(0.2)	(1.4)
Balance at the end of the year	**(0.2)**	**-**
Foreign currency translation reserve[1]		
Balance at the beginning of the year	(7.1)	(6.6)
(Loss)/gain on translation of foreign entities[2]	(23.9)	35.0
Gain/(loss) on hedge of net investment in foreign entities[2]	25.8	(35.5)
Balance at the end of the year	**(5.2)**	**(7.1)**
Adjusted controlling interests reserve[1]		
Balance at the beginning of the year	12.1	18.9
Change in holdings in controlled entities	-	(6.8)
Balance at the end of the year	**12.1**	**12.1**
Total reserves	**(16.5)**	**(7.9)**
Retained earnings		
Balance at the beginning of the year	1,142.1	992.3
Profit attributable to equity holders	397.6	327.7
Dividends paid	(189.6)	(177.9)
Total retained earnings	**1,350.1**	**1,142.1**

[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.

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 2017 $M	30 June 2016 $M
Interest expense	89.4	141.2
Interest expense – SPV	35.0	53.3
Interest expense – property trusts	11.5	15.1
Other finance costs	24.9	20.0
Total finance costs	**160.8**	**229.6**

Recognition and measurement

Finance costs represent interest incurred on interest bearing financial liabilities (primarily repurchase agreements and the securitised residential mortgage-backed securities (RMBS) issued by the consolidated Special Purpose Vehicles (SPV), 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 2017 $M	30 June 2016 $M
Dividends declared and paid during the year		
Final 30 June 2016 100% franked dividend: 16.5 cents (30 June 2015: 15.5 cents 100% franked dividend)	93.3	87.5
Interim 30 June 2017 100% franked dividend: 17.0 cents (30 June 2016: 16.0 cents 100% franked dividend)	96.3	90.4
Total dividends paid	**189.6**	**177.9**
Dividend proposed (not recognised as a liability at 30 June)		
Final 30 June 2017 100% franked dividend: 17.5 cents (30 June 2016: 100% franked 16.5 cents)	99.2	93.3

Refer to Note 12 Contributed equity for details of the dividend policy. A dividend reinvestment plan will be in operation for the 30 June 2017 final dividend.

Group franking credits account	30 June 2017 $M	30 June 2016 $M
Franking account balance at the beginning of the year	46.7	57.1
Franking credits from the payment of income tax during the year[1]	71.5	64.0
Franking credits from dividends received during the year	8.1	8.1
Franking debits applied to dividend payments to shareholders	(82.1)	(76.8)
Franking debits applied to Challenger Capital Notes 1 and 2	(5.3)	(5.7)
Franking credits balance	**38.9**	**46.7**

[1] Tax paid in respect of the Complying Superannuation Class and non Tax Consolidated entities for 30 June 2017 was $6.4 million (30 June 2016: $0.5 million) and does not give rise to a franking credit in Challenger's franking account.

Note 17 Earnings per share

	30 June 2017 cents	30 June 2016 cents
Basic earnings per share	70.7	58.5
Diluted earnings per share	67.8	55.4

	$M	$M
Profit attributable to ordinary shareholders	397.6	327.7
Add back interest expense on Challenger Capital Notes 1 and 2	17.1	13.5
Total earnings used in the calculation of dilutive earnings per share	**414.7**	**341.2**

Number of shares	Number	Number
Weighted average of ordinary shares issued	571,647,189	570,515,364
Weighted average of Treasury shares	(9,457,927)	(10,330,749)
Weighted average ordinary shares for basic earnings per share	562,189,262	560,184,615
Adjusted for potential ordinary shares:		
Weighted average effect of Challenger Performance Plan	14,401,151	16,791,573
Weighted average effect of Challenger Capital Notes 1 and 2	34,835,255	39,060,802
Weighted average ordinary shares for diluted earnings per share	611,425,668	616,036,990

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 9,457,927 (2016: 10,330,749).

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 1 and 2 (Notes) of 34.8 million shares (2016: 39.1 million) and shares granted under the CPP of 14.4 million shares (2016: 16.8 million). The profit attributable to ordinary shareholders is adjusted by $17.1 million interest on the Notes (2016: $13.5 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.

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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 2017 $M	Change in equity 30 June 2017 $M	Profit/(loss) 30 June 2016 $M	Change in equity 30 June 2016 $M
Non-SPV	+100bps	2.6	2.6	5.6	5.6
	-100bps	(2.6)	(2.6)	(5.6)	(5.6)
SPV	+100bps	(1.2)	(1.2)	(1.5)	(1.5)
	-100bps	1.2	1.2	1.5	1.5
Total	**+100bps**	**1.4**	**1.4**	**4.1**	**4.1**
	-100bps	**(1.4)**	**(1.4)**	**(4.1)**	**(4.1)**

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. The Group is exposed to equity price risk on its holdings in equity securities, which include a range of investments in absolute return strategies where returns are considered to be generally uncorrelated to listed equity market returns, 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 2017 $M	Change in equity 30 June 2017 $M	Profit/(loss) 30 June 2016 $M	Change in equity 30 June 2016 $M
Property securities	+10%	20.7	20.7	23.8	23.8
	-10%	(20.7)	(20.7)	(23.8)	(23.8)
Infrastructure investments	+10%	23.6	23.6	25.9	25.9
	-10%	(23.6)	(23.6)	(25.9)	(25.9)
Other assets	+10%	43.0	43.0	30.3	30.3
	-10%	(43.0)	(43.0)	(30.3)	(30.3)
Total assets	**+10%**	**87.3**	**87.3**	**80.0**	**80.0**
	-10%	**(87.3)**	**(87.3)**	**(80.0)**	**(80.0)**

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 2017, 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 $98.9 million (30 June 2016: $71.3 million).

Currency risk

It is the Group's policy to minimise 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 2017					
Financial assets	668.8	1,878.3	608.6	260.6	388.6
Financial liabilities	(18.4)	(3.0)	(16.0)	-	-
Foreign currency contracts and cross currency swaps	(649.8)	(1,876.5)	(593.1)	(258.3)	(389.6)
Net exposure in Australian dollars	**0.6**	**(1.2)**	**(0.5)**	**2.3**	**(1.0)**
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**

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 2017 $M	Change in equity 30 June 2017 $M	Profit/(loss) 30 June 2016 $M	Change in equity 30 June 2016 $M
British Pound (GBP)	+10%	0.1	0.1	0.7	0.7
	-10%	(0.1)	(0.1)	(0.7)	(0.7)
US Dollar (USD)	+10%	(0.1)	(0.1)	7.0	7.0
	-10%	0.1	0.1	(7.0)	(7.0)
Euro (EUR)	+10%	(0.1)	(0.1)	(0.3)	(0.3)
	-10%	0.1	0.1	0.3	0.3
Japanese Yen (JPY)	+10%	-	0.2	-	0.8
	-10%	-	(0.2)	-	(0.8)
Other	+10%	(0.1)	(0.1)	0.4	0.4
	-10%	0.1	0.1	(0.4)	(0.4)

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 2017							
Cash and cash equivalents	512.7	2.0	-	-	-	-	514.7
Cash and cash equivalents – SPV	122.4	-	-	-	-	-	122.4
Receivables	29.8	13.7	161.0	24.9	6.0	337.6	573.0
Mortgage assets – SPV	709.5	323.3	262.2	-	5.1	-	1,300.1
Fixed income securities	6,797.4	933.8	1,350.1	2,716.0	1,935.0	77.5	13,809.8
Derivative assets	-	483.6	42.2	(21.4)	37.0	-	541.4
Total assets with credit exposures	**8,171.8**	**1,756.4**	**1,815.5**	**2,719.5**	**1,983.1**	**415.1**	**16,861.4**
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	307.3	24.5	6.6	162.6	536.1
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**	**2,194.8**	**2,091.8**	**1,711.6**	**264.7**	**15,139.3**

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:

Amortised cost financial assets	Not past due/not impaired $M	Past due but not impaired 0-1 months $M	1-3 months $M	3-6 months $M	Past due and impaired $M	Total $M
30 June 2017						
Receivables	571.0	1.9	0.1	-	-	573.0
Mortgage assets – SPV	1,159.4	56.7	44.1	36.1	3.8	1,300.1
Total receivables	**1,730.4**	**58.6**	**44.2**	**36.1**	**3.8**	**1,873.1**
30 June 2016						
Receivables	534.7	0.4	0.6	0.4	-	536.1
Mortgage assets – SPV	1,538.4	75.6	41.5	12.1	10.0	1,677.6
Total receivables	**2,073.1**	**76.0**	**42.1**	**12.5**	**10.0**	**2,213.7**

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.

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 on the following page 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 2017					
Payables	944.6	12.8	4.2	23.5	985.1
Payables – SPV	2.9	-	-	-	2.9
Interest bearing financial liabilities	3,379.3	222.2	1,273.5	650.7	5,525.7
Interest bearing financial liabilities – SPV	366.6	493.7	285.3	365.1	1,510.7
External unit holders' liabilities	1,225.2	462.6	-	-	1,687.8
Life investment contract liabilities	2,359.2	2,716.7	1,051.6	612.8	6,740.3
Life insurance contract liabilities[1]	405.1	713.1	580.2	3,310.9	5,009.3
Derivative liabilities	111.1	108.9	52.0	205.6	477.6
Total undiscounted financial liabilities[1]	**8,794.0**	**4,730.0**	**3,246.8**	**5,168.6**	**21,939.4**
30 June 2016					
Payables	835.5	12.1	27.7	5.6	880.9
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]	**8,145.9**	**4,396.2**	**2,848.3**	**4,680.7**	**20,071.1**

[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 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 1 and 2, 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 mortgage SPVs have total equity attributable to RIU holders at amortised cost of ($0.2 million) (2016: nil). The fair value of this RIU holders' asset is $94.9 million (2016: $104.9 million) and would be classified as Level 3 in the fair value hierarchy.

Challenger Capital Notes 1 and 2 have carrying values of $345.0 million and $460.0 million. The fair value of these notes is $350.2 million and $476.2 million respectively and they would be 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 2017				
Derivative assets	-	541.3	0.1	541.4
Fixed income securities[1]	-	11,724.0	2,085.8	13,809.8
Equity securities	136.0	333.4	261.4	730.8
Infrastructure investments[1]	122.4	110.6	409.2	642.2
Property securities	152.7	-	143.6	296.3
Investment and development property[2]	-	96.0	3,503.5	3,599.5
Total assets	**411.1**	**12,805.3**	**6,403.6**	**19,620.0**
Derivative liabilities	0.5	477.1	-	477.6
Interest bearing financial liabilities	-	61.0	410.6	471.6
External unit holders' liabilities	-	1,687.8	-	1,687.8
Life investment contract liabilities	-	75.9	6,280.6	6,356.5
Total liabilities	**0.5**	**2,301.8**	**6,691.2**	**8,993.5**
30 June 2016				
Derivative assets	-	788.3	-	788.3
Fixed income securities	-	9,455.2	2,008.3	11,463.5
Equity securities	40.6	291.2	268.4	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	3,462.0	3,532.6
Total assets	**319.5**	**10,714.7**	**6,391.0**	**17,425.2**
Derivative liabilities	-	843.5	0.1	843.6
Interest bearing financial liabilities	-	70.9	595.5	666.4
External unit holders' liabilities	-	1,315.5	-	1,315.5
Life investment contract liabilities	-	80.1	6,835.2	6,915.3
Total liabilities	**-**	**2,310.0**	**7,430.8**	**9,740.8**

[1] The Group has exposures to structured entities (entities designed so that voting or similar rights are not the dominant factor in determining who controls the entity; for example when any voting rights relate purely to administrative tasks) via investments in asset-backed finance vehicles (where it may act as a lender or purchaser of notes and/or residual income units) and securitisations (such as mortgages, finance leases and other types of collateralised vehicles). The maximum exposure to loss is limited to the reported fair value of the underlying securities plus any guaranteed undrawn commitments to the counterparties. At 30 June 2017 the carrying value of asset-backed financing assets was $32.0 million (30 June 2016: $8.4 million) with zero undrawn commitments (30 June 2016: none) and securitisations was $2,347.4 million (30 June 2016: $2,815.9 million) plus $71.8 million undrawn commitments (30 June 2016: $142.1 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 2017		30 June 2016	
	Assets $M	Liabilities $M	Assets $M	Liabilities $M
Balance at the beginning of the year	2,929.0	7,430.8	2,988.5	7,107.2
Fair value gains/(losses)	12.6	133.2	58.2	259.8
Acquisitions	1,664.7	2,329.7	1,373.7	2,695.4
Maturities and disposals	(1,759.3)	(3,202.5)	(1,413.8)	(2,631.6)
Transfers to other categories[1, 2]	53.1	-	(77.6)	-
Balance at the end of the year[3]	**2,900.1**	**6,691.2**	**2,929.0**	**7,430.8**
Unrealised gains/(losses) included in the statement of comprehensive income for assets and liabilities held at the statement of financial position date	38.5	(16.1)	68.3	260.1

[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.

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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 2017					
Derivative assets	0.1	0.8	(0.3)	Discounted cash flow	Primarily credit spreads
Fixed income securities	2,085.8	36.0	(32.9)	Discounted cash flow	Primarily credit spreads
Interest bearing financial liabilities	(410.6)	(7.7)	7.9	Discounted cash flow	Primarily credit spreads
Equity, infrastructure, property assets	814.2	33.6	(35.1)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Investment contract liabilities	(6,280.6)	4.8	(4.8)	Discounted cash flow	Primarily expense assumptions
Total Level 3[4]	**(3,791.1)**	**67.5**	**(65.2)**		
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
Equity, infrastructure, property assets	920.7	49.3	(50.7)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Investment contract liabilities	(6,835.2)	3.8	(3.8)	Discounted cash flow	Primarily expense assumptions
Derivative liabilities	(0.1)	0.2	(0.1)	Discounted cash flow	Primarily credit spreads
Total Level 3	**(4,501.8)**	**70.7**	**(88.2)**		

[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%.
[4] Does not include Investment Property.

Note 20 Collateral arrangements

Recognition and measurement

CLC receives collateral, where it is considered necessary, when entering into certain financial arrangements. The amount of collateral required is subject to management's credit evaluation of the counterparty which is performed on a case-by-case basis. $268.0 million (30 June 2016: $278.3 million) cash received from third parties as collateral is recorded in payables. CLC is not permitted to sell or repledge financial or non-financial assets held as collateral in the absence of default by the owner of the collateral.

CLC is required to pledge collateral, as part of the standard terms of transactions, when entering into certain financial arrangements. Cash paid to third parties as collateral is recorded in receivables. Other financial assets transferred as collateral are not derecognised from the statements of financial position as the risks and rewards of ownership remain with CLC. At the balance sheet date the fair value of cash and financial assets pledged are as follows:

Collateral pledged as security	30 June 2017 $M	30 June 2016 $M
Cash	176.3	303.3
Other financial assets[1]	4,375.6	2,700.0
Total collateral pledged	**4,551.9**	**3,003.3**

[1] Includes assets sold under repurchase agreements. Please refer Note 13 Interest bearing financial liabilities for more information.

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 21 Parent entity

Company	30 June 2017 $M	30 June 2016 $M
Statement of comprehensive income for the year ended		
Revenue	303.1	238.9
Finance costs	(19.3)	(15.2)
Profit before income tax	283.8	223.7
Income tax benefit	3.5	15.0
Profit and total comprehensive income for the year	**287.3**	**238.7**
Statement of financial position as at		
Assets		
Cash and cash equivalents	2.1	1.8
Receivables	1,480.6	1,097.1
Financial asset – fixed income securities[1]	805.0	345.0
Current tax asset	-	14.3
Deferred tax assets	2.0	0.9
Investment in controlled entities	1,543.8	1,528.1
Total assets	**3,833.5**	**2,987.2**
Liabilities		
Payables	646.9	443.9
Interest bearing financial liability	789.4	338.5
Current tax liability	105.9	-
Total liabilities	**1,542.2**	**782.4**
Net assets	**2,291.3**	**2,204.8**
Equity		
Contributed equity	1,641.8	1,633.8
Share-based payments reserve	(67.5)	(49.9)
Retained earnings	717.0	620.9
Total equity	**2,291.3**	**2,204.8**

[1] Financial asset – fixed income securities 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 22 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 2017:

Entity name
Challenger Limited
Challenger Group Holdings Limited
Challenger Group Services Pty Limited
Challenger Treasury Limited
Challenger Japan 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 $13.2 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 23 Investment in associates

Name of company	Principal activity	Country of domicile	30 June 2017 %[1]	30 June 2016 %[1]	30 June 2017 $M	30 June 2016 $M
Agricultural Asset Management Ltd	Funds Management	UK	50	50	0.1	-
Alphinity Investment Management Pty Ltd	Funds Management	Australia	30	30	1.4	1.7
Ardea Investment Management Pty Ltd	Funds Management	Australia	30	30	3.1	3.1
Avenir Capital Pty Ltd	Funds Management	Australia	40	-	0.4	-
Bentham Asset Management Pty Ltd	Funds Management	Australia	49	49	0.8	0.6
Greencape Capital Pty Ltd	Funds Management	Australia	50	50	33.3	33.7
Kinetic Investment Partners Pty Ltd	Funds Management	Australia	20	20	0.6	0.5
Lennox Capital Partners Pty Ltd	Funds Management	Australia	40	-	0.9	-
Merlon Capital Partners Pty Ltd	Funds Management	Australia	30	30	1.0	0.6
Novaport Capital Pty Ltd	Funds Management	Australia	49	49	0.5	0.7
Resonance Asset Management Ltd[2]	Funds Management	UK	-	-	0.9	1.0
Structured Credit Research LLP	Funds Management	UK	50	50	0.7	0.7
Tempo Asset Management Pty Ltd	Funds Management	Australia	40	40	1.5	1.1
Wavestone Capital Pty Ltd	Funds Management	Australia	33	33	2.2	2.1
Whitehelm Capital Pty Ltd	Funds Management	Australia	30	30	5.1	5.0
Wyetree Asset Management Pty Ltd	Funds Management	UK	49	50	1.0	0.7
Total investment in associates[3]					**53.5**	**51.5**

[1] Represents ownership and voting rights percentages.
[2] Challenger is deemed to have significant influence.
[3] Investment in associates is all considered non-current.

Note 23 Investment in associates (continued)

	30 June 2017 $M	30 June 2016 $M
Movements in carrying amount of investment in associates		
Opening balance	51.5	43.4
Acquisition of investment in associates	1.4	21.2
Share of associates' net profit	18.1	16.6
Dividend and net capital redemptions	(17.5)	(19.1)
Impairment of investment in associates	-	(10.6)
Carrying amount at the end of the year	**53.5**	**51.5**
Share of associates' profit or loss		
Profit before tax	18.1	16.6
Profit after tax for the year	**18.1**	**16.6**
Share of the associates' statement of financial position		
Current assets	30.3	25.8
Non-current assets	1.5	1.2
Total assets	**31.8**	**27.0**
Current liabilities	14.5	12.4
Non-current liabilities	0.5	0.4
Total liabilities	**15.0**	**12.8**
Net assets	**16.8**	**14.2**

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 24 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 (from 13 February 2017)	Chief Executive, Distribution, Product and Marketing
Chris Plater (from 13 February 2017)	Chief Executive & Chief Investment Officer, Life
Paul Rogan (up to 13 February 2017)	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 22 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 23 Investment in associates) for the provision of distribution and administration services. The Group earned fee income during the year of $38.5 million (2016: $40.3 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 2017 (30 June 2016: 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						
2017	**1,734,471**	**75,945**	**-**	**-**	**-**	**1,810,416**
2016	1,588,842	73,992	-	-	-	1,662,834
KMP						
2017	**7,701,008**	**98,079**	**8,306,579**	**632,593**	**-**	**16,738,259**
2016	6,938,212	96,540	8,034,349	608,317	-	15,677,418
All KMP and Non-Executive Directors						
2017	**9,435,479**	**174,024**	**8,306,579**	**632,593**	**-**	**18,548,675**
2016	8,527,054	170,532	8,034,349	608,317	-	17,340,252

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 25 Goodwill and other intangible assets

	30 June 2017 $M	30 June 2016 $M
Goodwill	**571.6**	**571.6**
Other intangible assets		
Software at cost	30.4	20.8
Less: accumulated amortisation	(13.6)	(8.6)
	16.8	**12.2**
Customer list at cost	0.1	0.2
Less: accumulated amortisation	(0.1)	(0.1)
	-	**0.1**
Total other intangible assets	**16.8**	**12.3**

	Goodwill		Customer list		Software		Operating lease	
	30 June 2017 $M	30 June 2016 $M	30 June 2017 $M	30 June 2016 $M	30 June 2017 $M	30 June 2016 $M	30 June 2017 $M	30 June 2016 $M
Balance at the beginning of the year	571.6	531.0	0.1	0.2	12.2	4.9	-	13.3
Additions	-	40.6	-	-	9.6	9.6	-	-
Impairment	-	-	-	-	-	-	-	(12.1)
Amortisation expense	-	-	(0.1)	(0.1)	(5.0)	(2.3)	-	(1.2)
Balance at the end of the year	**571.6**	**571.6**	**-**	**0.1**	**16.8**	**12.2**	**-**	**-**

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 (CGU), or groups of CGUs, 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 CGU (or group of CGUs) to which the goodwill relates. When the recoverable amount of the CGU (or group of CGUs) 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 CGU, 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.

CGUs within the Group are predominantly business operations.

Note 25 Goodwill and other intangible assets (continued)

Recognition and measurement (continued)

Goodwill (continued)

When goodwill forms part of a CGU (or group of CGUs) 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 its accounting policy. These value in use calculations involve an estimation of the recoverable amount of the CGUs 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 CGU 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 2017. 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 2017 $M	30 June 2016 $M	30 June 2017 Discount rate %	30 June 2016 Discount rate %	Cash flow horizon (years)
Life	444.0	444.0	10.5	10.5	5
Funds Management	127.6	127.6	10.5	10.5	5
Total	**571.6**	**571.6**			

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 2017. 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 2017 there are potential future commitments totalling $301.3 million (30 June 2016: $242.4 million) in relation to these opportunities. The Group has made capital commitments to associates to subscribe for up to $9.5 million (30 June 2016: nil) non-redeemable preference shares to enable them to meet their working capital requirements.

Subsidiary guarantees

CLC has provided a guarantee to a third party regarding the performance of a CLC subsidiary in respect of certain reinsurance arrangements.

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 2017 $M	30 June 2016 $M
Non-cancellable operating leases – Group as lessee		
Amounts due in less than one year	9.5	13.5
Amounts due between one and two years	7.4	12.8
Amounts due between two and five years	20.8	38.8
Amounts due in greater than five years	43.8	124.1
Total operating leases – Group as lessee	**81.5**	**189.2**
Contracted capital expenditure		
Amounts due in less than one year	182.8	65.3
Amounts due between one and two years	173.4	4.0
Amounts due between two and five years	5.8	5.2
Amounts due in greater than five years	-	2.6
Total capital expenditure commitments	**362.0**	**77.1**
Non-cancellable operating leases – Group as lessor		
Amounts due in less than one year	(218.1)	(237.6)
Amounts due between one and two years	(200.1)	(209.3)
Amounts due between two and five years	(457.9)	(471.3)
Amounts due in greater than five years	(293.2)	(318.2)
Total operating leases – Group as lessor	**(1,169.3)**	**(1,236.4)**
Other contracted commitments		
Amounts due in less than one year	2.0	2.0
Total other contracted commitments	**2.0**	**2.0**
Net commitments owed to Group	**(723.8)**	**(968.1)**

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 terms ranging between one and 16 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 and property, plant and equipment.

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 2017 $M	30 June 2016 $M
Employee[1] entitlements provision	**12.3**	**11.9**

[1] The total number of employees of the Group at 30 June 2017 was 655 (30 June 2016: 635).

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 share 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 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 (continued)

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 broadly 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 2017 and movements on previous issues.

Grant date	Latest date for vesting[1]	Reference price $	Fair value at grant $	Outstanding at 1 July 2016	Granted during the year	Vested during the year	Expired during the year	Outstanding at 30 June 2017
09 Jun 17	01 Sep 19	12.596	11.79	-	9,758	-	-	9,758
12 Sep 16	01 Sep 19	9.210	7.95	-	463,996	-	(10,857)	453,139
12 Sep 16	01 Sep 18	9.210	8.26	-	590,725	-	(31,075)	559,650
12 Sep 16	01 Sep 17	9.210	8.59	-	590,725	-	(31,075)	559,650
13 Sep 15	01 Sep 18	6.989	6.16	696,194	-	-	(57,226)	638,968
13 Sep 15	01 Sep 17	6.989	6.44	773,117	-	(42,443)	(24,763)	705,911
13 Sep 15	01 Sep 16	6.989	6.73	769,254	-	(769,254)	-	-
16 Sep 14	01 Sep 17	7.698	6.54	780,554	-	-	(40,365)	740,189
16 Sep 14	01 Sep 16	7.698	6.81	678,295	-	(678,295)	-	-
17 Sep 13	01 Sep 16	4.086	4.46	122,372	-	(122,372)	-	-
Total				**3,819,786**	**1,655,204**	**(1,612,364)**	**(195,361)**	**3,667,265**

[1] At the date of vesting, fully-paid shares 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. 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. 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 2017 and movements on previous issues:

Grant date	Expected date for vesting[1]	Reference price $	Fair value at grant $	Outstanding at 1 July 2016	Granted during the year	Vested during the year	Expired during the year	Outstanding at 30 June 2017
09 Jun 17	01 Sep 20	9.017	8.55	-	14,376	-	-	14,376
09 Jun 17	01 Sep 19	9.017	9.71	-	25,317	-	-	25,317
12 Sep 16	01 Sep 20	9.017	3.80	-	906,550	-	(8,223)	898,327
12 Sep 16	01 Sep 19	9.017	4.33	-	1,591,197	-	(14,434)	1,576,763
13 Sep 15	01 Sep 19	7.013	2.84	1,256,318	-	-	(61,621)	1,194,697
13 Sep 15	01 Sep 18	7.013	3.27	2,182,191	-	-	(107,032)	2,075,159
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	793,997	-	-	(49,257)	744,740
16 Sep 14	01 Sep 17	7.698	3.37	1,587,963	-	-	(55,049)	1,532,914
17 Sep 13	01 Sep 17	4.086	2.69	2,035,382	-	-	(118,338)	1,917,044
17 Sep 13	01 Sep 16	4.086	3.23	2,035,309	-	(2,035,309)	-	-
11 Jun 13	01 Jun 17	3.928	1.33	66,668	-	(33,334)	-	33,334[2]
12 Sep 12	01 Sep 16	3.448	1.42	2,361,020	-	(2,361,020)	-	-
Total				**12,523,231**	**2,537,440**	**(4,429,663)**	**(413,954)**	**10,217,054**

[1] At the date of vesting, fully-paid shares are transferred to the individual and released from the CPP Trust.
[2] The 11 June 2013 tranche met the vesting requirements on 1 June 2017. However, 33,334 HPSRs remain unvested as at 30 June 2017 due to vesting restrictions in accordance with Challenger's internal share trading policy.

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 share rights 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	12 Sep 16 PSR[1]	12 Sep 16 HPSR[1]	09 Jun 17 PSR	09 Jun 17 HPSR[1]
Dividend yield (%)	3.90	3.90	3.40	3.40
Risk-free rate (%)	1.59–1.58	1.59–1.73	1.63–1.73	1.63–1.96
Volatility[2] (%)	28	28	27	27
Valuation ($)	8.59–7.95	4.33–3.80	11.79	9.71–8.55

[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 2017 $	30 June 2016 $
Full year audit and half year review of the Group financial report	1,595,262	1,271,000
Other audit services – audit and review of trusts and funds	598,864	602,933
Other services in relation to the Group		
– taxation services	441,380	413,642
– other assurance services	503,089	632,850
Total auditor remuneration[1]	**3,138,595**	**2,920,425**

[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

MS&AD Insurance Group Holdings Inc. (MS&AD) is the parent of MS Primary, a key Challenger distributor. In order to broaden Challenger's relationship with the MS&AD group and fund future growth, Challenger is undertaking a $500 million equity placement to MS&AD.

On 23 August 2017, Challenger will issue 38,295,689 new ordinary shares to MS&AD at a price of $13.0563 per share. The new shares will be issued at a 2% premium to Challenger's 14 August 2017 30 business day volume weighted average share price of $12.9719, adjusted for the final 2017 dividend of 17.5 cents per share. The shares issued to MS&AD are not eligible for Challenger's final 2017 dividend.

The equity placement to MS&AD represents 6.27% of Challenger's issued capital following the placement. MS&AD intends to be a supportive Challenger shareholder and plans to increase its investment to 10% of issued capital over the next 12 months via market acquisitions, subject to market conditions, any necessary or desirable regulatory approvals and Challenger circumstances. MS&AD reserves the right to change its intentions and to acquire and dispose of Challenger shares as they see fit.

The proceeds from the placement will be used to increase CLC's Common Equity Tier 1 capital. After allowing for the equity placement, and assuming the same capital intensity as at balance date, CLC's pro forma capital ratios at 30 June 2017 are as follows:

- PCA ratio of 1.75 times (from 1.57 times); and
- Total Tier 1 ratio of 1.57 times (from 1.39 times); and
- Common Equity Tier 1 (CET1) ratio of 1.21 times (from 1.01 times).

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

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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 2017 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 2017.

On behalf of the Board

G A Cubbin
Director

Sydney
14 August 2017

B R Benari
Managing Director and Chief Executive Officer

Sydney
14 August 2017

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Independent auditor's report

Independent auditor's report to the members of Challenger Limited

Opinion

We have audited the financial report of Challenger Limited (the Company) and its subsidiaries (collectively the Group), which comprises the consolidated statement of financial position as at 30 June 2017, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, notes to the financial statements, including a summary of significant accounting policies, and the directors' declaration.

In our opinion, the accompanying financial report of the Group is in accordance with the *Corporations Act 2001*, including:

a) giving a true and fair view of the consolidated financial position of the Group as at 30 June 2017 and of its consolidated financial performance for the year ended on that date; and
b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

Basis for Opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Report section of our report. We are independent of the Group in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial report of the current year. These matters were addressed in the context of our audit of the financial report as a whole, and in forming our opinion thereon, but we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the Auditor's Responsibilities for the Audit of the Financial Report section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial report. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial report.

1 Valuation of Life Contract Liabilities

30 June 2017 Financial report reference: **Note 8**

Why significant

A provision is recognised for future claims associated with sold insurance policies. The valuation methodology adopted by the Group involves complex and subjective judgments about future events.

Key assumptions involved in the valuation of the policy liabilities include:

- Discount rates
- Inflation
- Future claims administration expenses
- Mortality and redemptions

These assumptions are incorporated into an internal model, which is used to generate the valuation.

This was a key audit matter due to the size of the balance (30 June 2017: $10,322.2 million), and the degree of judgment and estimation uncertainty associated with the valuation.

How our audit addressed the key audit matter

Our audit of the valuation of the life contract liabilities involved an assessment of the design and operating effectiveness of relevant controls over data inputs into the valuation process. This also extended to the involvement of our IT specialists testing the completeness and accuracy of data extracted from the underlying administration system into the valuation process.

We involved our actuarial specialists to assist in assessing the appropriateness of the valuation methodology, key assumptions and models deriving the life contract liabilities. In doing so, we:

- Evaluated the governance process in place to determine the methodology and assumptions.
- Assessed the results of the experience investigations carried out by the Group to determine whether they supported the assumptions used by the Group.
- Assessed the movements in modelled profit margins and best estimate liabilities for insurance risk transactions.
- Performed a recalculation of a sample of the life contract liability valuations.

We assessed the adequacy and completeness of policy liability disclosures against the requirements of Australian Accounting Standards – AASB 1038 *Life Insurance Contract Liabilities.*

2 Valuation Level 3 Financial Assets

30 June 2017 Financial report reference: **Note 19**

Why significant	**How our audit addressed the key audit matter**
The Group holds a portfolio of financial assets for which an observable market value is not readily available. These assets are classified as Level 3 within the fair value hierarchy of the financial report and include: • Unlisted debt instruments, e.g. residential mortgage and asset backed securities • Infrastructure assets • Unlisted indirect property holdings • Mortgage loans • Unlisted equities • Unlisted unit trusts • Direct properties Level 3 assets require judgment to be applied in determining their fair value as the valuation inputs for these assets are not based on observable market data. In determining the fair value of these assets the Group utilises a range of methodologies, models and assumptions. Accordingly there are a number of risks associated with the valuation and modelling methodologies adopted. This was a key audit matter due to the size of the balance (30 June 2017: $6,403.6 million), and the degree of judgment and estimation uncertainty associated with the valuation.	For the Level 3 assets we assessed both the methodology and assumptions in the calculation of the year end value as well as assessed the design and operating effectiveness of governance controls the Group has in place to monitor these investments. In obtaining sufficient audit evidence, we: • Checked the mathematical accuracy of the valuation models and consistency with the Group's documented methodology and assumptions. • Involved our valuation specialists to assess the appropriateness of valuation and modelling methodologies and assessed the key assumptions used in the year end valuations, specifically the discount rate and terminal value. • Assessed the independence and competence of the external property valuation experts used by the Group, and assessed the internal property models and appropriateness of the methodologies and assumptions used in the year end property valuations. • Involved our credit and valuation specialists to assess the adequacy of the internal credit rating process. • Obtained valuation statements provided by external investment managers in respect of controlled unit trusts and hedge funds. We assessed the valuations of investments as provided by external investment managers, including an assessment of the reliability of the information provided by the investment manager, such as key assumptions, multiples and discounts applied.

3 Valuation of Goodwill

30 June 2017 Financial report reference: **Note 25**

Why significant	How our audit addressed the key audit matter
Goodwill has been recognised as a result of the Group's historical acquisitions, representing the excess of the purchase consideration over the fair value of assets and liabilities acquired. On acquisition this goodwill has been allocated to the applicable Cash Generating Units (CGUs). An impairment assessment is performed at each reporting period, comparing the carrying value of the CGU with its recoverable amount. The recoverable amount of each CGU is determined using a value in use calculation. This calculation incorporates a range of assumptions, including future cash flows, discount rates and terminal growth rates. This was a key audit matter due to the size of Goodwill held on the consolidated statement of financial position (30 June 2017: $571.6 million), and the degree of judgment and estimation uncertainty associated with the impairment assessment.	Our audit of the impairment assessment of each CGU required valuation expertise to assist in the testing of the underlying models and key assumptions. Accordingly we involved our valuation specialists and: • Assessed the valuation methodology and appropriateness of the impairment models used to calculate the recoverable amount of each CGU. • Agreed the projected cash flows used in the impairment models to the Board approved Challenger Limited five year plan. We compared the Group's implied growth rate assumption to comparable companies for reasonableness. • Assessed the methodology and assumptions used in the calculation of the discount rate, including comparison of the rate to market benchmarks. • Assessed the methodology and assumptions used in the calculation of the terminal growth rates. • Assessed the mathematical accuracy of the impairment models. • Assessed the Group's sensitivity analysis and evaluated whether any reasonable foreseeable change in assumptions could lead to an impairment. We assessed the Group's determination of the CGUs to which goodwill is allocated and the adequacy of the disclosures in the financial report for compliance with applicable Australian Accounting Standards.

Information Other than the Financial Report and Auditor's Report Thereon

The Directors are responsible for the other information. The other information comprises the information included in the Company's 2017 Annual Report, but does not include the financial report and our auditor's report thereon.

Our opinion on the financial report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors 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 control as the Directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the financial report, the Directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Report

Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report.

As part of an audit in accordance with the Australian Auditing Standards, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.
- Conclude on the appropriateness of the Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial report or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the financial report. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated to the Directors, we determine those matters that were of most significance in the audit of the financial report of the current year and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on the Audit of the Financial Report

Opinion on the Remuneration Report

We have audited the Remuneration Report included in pages 17 to 39 of the Directors' Report for the year ended 30 June 2017.

In our opinion, the Remuneration Report of Challenger Limited for the year ended 30 June 2017 complies with section 300A of the *Corporations Act 2001*.

Responsibilities

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.

Ernst & Young

S J Ferguson
Partner

Sydney
14 August 2017

L Burns
Partner

Sydney
14 August 2017

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 2017	Number of shares	% of issued capital
UBS Group AG	42,361,760	7.41
Caledonia (Private) Investments Pty Ltd	41,274,437	7.24
BlackRock Group	29,096,438	5.08
20 largest individual shareholders as at 31 July 2017		
1. HSBC Custody Nominees (Australia) Limited	180,492,314	31.55
2. J P Morgan Nominees Australia Limited	89,897,933	15.72
3. Citicorp Nominees Pty Limited	57,025,960	9.97
4. National Nominees Limited	27,771,819	4.86
5. BNP Paribas Nominees Pty Ltd <Agency Lending Collateral>	10,570,400	1.85
6. BNP Paribas Nominees Pty Ltd <Agency Lending DRP A/C>	8,246,522	1.44
7. Citicorp Nominees Pty Limited <Colonial First State INV A/C>	6,475,755	1.13
8. BNP Paribas Nominees Pty Ltd <DRP>	5,862,062	1.02
9. CPU Share Plans Pty Ltd <CGF Performance Plan A/C>	5,326,638	0.93
10. Argo Investments Limited	4,190,311	0.73
11. HSBC Custody Nominees (Australia) Limited <NT – Comnwlth Super Corp A/C>	3,949,853	0.69
12. HSBC Custody Nominees (Australia) Limited – GSCO ECA	3,512,336	0.61
13. RBC Investor Services Australia Pty Limited <VFA A/C>	3,101,918	0.54
14. National Nominees Limited <N A/C>	2,991,063	0.52
15. Australian Foundation Investment Company Limited	2,941,556	0.51
16. HSBC Custody Nominees (Australia) Limited – A/C 2	2,830,463	0.49
17. AMP Life Limited	2,019,907	0.35
18. CS Third Nominees Pty Limited <HSBC Cust Nom AU Ltd 13 A/C>	1,934,931	0.34
19. UBS Nominees Pty Ltd	1,867,536	0.33
20. National Nominees Limited <DB A/C>	1,589,795	0.28
Total 20 largest individual shareholders – issued capital	**422,599,072**	**73.88**
Total remaining shareholders balance	**149,402,783**	**26.12**

Distribution of shares (as at 31 July 2017)

Range	Number of shareholders	Number of shares	% of issued capital
1 – 1,000	15,149	7,492,946	1.31
1,001 – 5,000	17,110	41,230,768	7.21
5,001 – 10,000	3,398	24,526,703	4.29
10,001 – 100,000	1,996	43,382,152	7.58
100,001 and over	118	455,369,286	79.61
Total	37,771	572,001,855	100.00

Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum $500.00 parcel at $12.85 per unit	39	490	4,162

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 2017

5.3 million Challenger Limited ordinary shares were purchased on market to satisfy entitlements under Challenger's employee incentive schemes at an average price per share of $8.26.

Top 20 noteholders of Challenger Capital Notes 1 as at 31 July 2017

20 largest individual noteholders as at 31 July 2017	Number of notes	% of issued notes
1. HSBC Custody Nominees (Australia) Limited	245,657	7.12
2. J P Morgan Nominees Australia Limited	111,785	3.24
3. IOOF Investment Management Limited <IPS Super A/C>	111,073	3.22
4. National Nominees Limited	68,260	1.98
5. Navigator Australia Ltd <MLC Investment Settlement A/C>	66,475	1.93
6. Sandhurst Trustees Ltd <DMP Asset Management A/C>	55,922	1.62
7. Eastcote Pty Ltd <Van Lieshout Family A/C>	40,000	1.16
8. IOOF Investment Management Limited <IPS IDPS A/C>	34,662	1.00
9. Netwealth Investments Limited <Wrap Services A/C>	31,293	0.91
10. JDB Services Pty Ltd <RAC & JD Brice Invest A/C>	30,400	0.88
11. BNP Paribas Nominees Pty Ltd HUB24 Custodial Serv Ltd DRP	28,104	0.81
12. Taverners No 11 Pty Ltd <Stoneyville Invest Unit A/C>	27,652	0.80
13. Taverners No 11 Pty Ltd <Brencorp No 11 Unit A/C>	25,000	0.72
14. Willimbury Pty Ltd	22,000	0.64
15. Australia Executor Trustees Limited <No 1 A/C>	20,898	0.61
16. Catholic Church Insurance Limited	20,400	0.59
17. GCF Investments Pty Ltd	20,000	0.58
18. Nulis Nominees (Australia) Limited <Navigator Mast Plan Sett A/C>	19,565	0.57
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	**1,014,127**	**29.39**
Total remaining noteholders balance	**2,435,873**	**70.61**

Distribution of notes (as at 31 July 2017)

Range	Number of holders	Number of notes	% of notes
1 – 1,000	3,238	1,150,447	33.35
1,001 – 5,000	377	826,976	23.97
5,001 – 10,000	41	309,824	8.98
10,001 – 100,000	28	694,238	20.12
100,001 and over	3	468,515	13.58
Total	3,687	3,450,000	100.00

Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum $500.00 parcel at $101.60 per unit	5	-	-

Investor information (continued)

Top 20 noteholders of Challenger Capital Notes 2 as at 31 July 2017

20 largest individual noteholders as at 31 July 2017	Number of notes	% of issued notes
1. HSBC Custody Nominees (Australia) Limited	632,433	13.75
2. National Nominees Limited	95,756	2.08
3. Sandhurst Trustees Ltd <DMP Asset Management A/C>	82,826	1.80
4. J P Morgan Nominees Australia Limited	74,008	1.61
5. Citicorp Nominees Pty Ltd	70,000	1.52
6. BNP Paribas Nominees Pty Ltd HUB24 Custodial Serv Ltd DRP	48,374	1.05
7. Navigator Australia Ltd <MLC Investment Settlement A/C>	32,782	0.71
8. McCorkell Properties Pty Ltd	30,000	0.65
9. BT Portfolio Services Limited <The A L N All A/C>	26,000	0.57
10. Springway Corporate Pty Ltd <Springway Holding Family A/C>	25,100	0.55
11. LBL Investment Pty Ltd <L&B Family A/C>	25,000	0.54
12. G C F Investments Pty Ltd	20,000	0.43
13. Taverners No 11 Pty Ltd <Brencorp No 11 Unit A/C>	19,811	0.43
14. Mr Judd Anthony Willows	18,500	0.40
15. Netwealth Investments Limited <Wrap Services A/C>	16,832	0.37
16. Taverners No 11 Pty Ltd <Scanlon Foundation RC A/C>	15,000	0.33
17. Taverners No 11 Pty Ltd <Stoneyville No 11 Unit A/C>	15,000	0.33
18. D F D Rhodes Pty Ltd	13,745	0.30
19. Aust Executor Trustees Ltd <Charitable Foundation>	13,320	0.29
20. Nulis Nominees (Australia) Limited <Navigator Mast Plan Sett A/C>	13,154	0.28
Total 20 largest individual noteholders – issued notes	**1,287,641**	**27.99**
Total remaining noteholders balance	**3,312,359**	**72.01**

Distribution of notes (as at 31 July 2017)

Range	Number of holders	Number of notes	% of notes
1 – 1,000	4,374	1,575,833	34.26
1,001 – 5,000	592	1,284,731	27.93
5,001 – 10,000	46	330,059	7.17
10,001 – 100,000	30	776,944	16.89
100,001 and over	1	632,433	13.75
Total	5,043	4,600,000	100.00

Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum $500.00 parcel at $104.40 per unit	5	1	1

ASX listing

Challenger Capital Notes 1 are listed on the ASX under the trade symbol CGFPA. Challenger Capital Notes 2 are listed on the ASX under the trade symbol CGFPB. Note price details can be accessed via the ASX website www.asx.com.au.

Voting rights

Challenger Capital Notes 1 and 2 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.

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.

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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

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 2017 Annual Report is available at:

challenger.com.au/annualreport2017

challenger

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