2019 Annual Report

Providing our customers with financial security for retirement

challenger.com.au
Challenger Limited ACN 106 842 371

challenger

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Key dates

25 September 2019
Final dividend payment date

31 October 2019
2019 Annual General Meeting

11 February 2020
Half year financial results

24 March 2020
Interim dividend payment date

11 August 2020
Full year financial results

23 September 2020
Final dividend payment date

29 October 2020
2020 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 2019 Annual Report, including the financial report for the year ended 30 June 2019, can be downloaded from Challenger's online Shareholder Centre at:

› challenger.com.au/annualreport2019

2019 Annual Review

The 2019 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/annualreview2019

2019 Corporate Governance Report

The 2019 Corporate Governance Report can be viewed online at:

› challenger.com.au/corporategovernance2019

2019 Sustainability Report

The 2019 Sustainability Report can be viewed online at:

› challenger.com.au/sustainabilityreport2019

2019 Annual General Meeting

Location
Wesley Centre, 220 Pitt Street, Sydney NSW

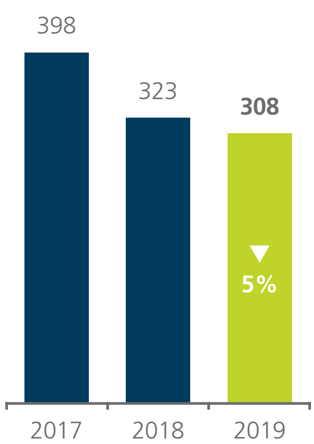
Date
31 October 2019

Time
9.30am (Sydney time)

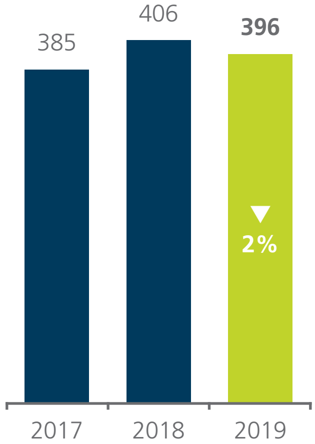
Full details of the meeting will be included in your Notice of Annual General Meeting, which will be sent to shareholders in September 2019.

Group performance highlights

Statutory net profit after tax ($m)



Normalised net profit after tax ($m)



Full year dividend

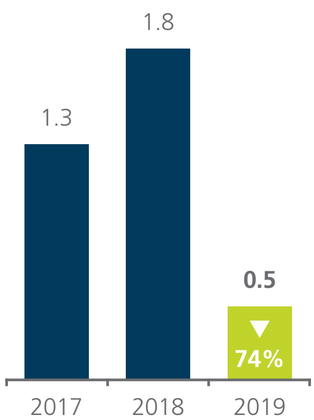
35.5

cents per share fully franked

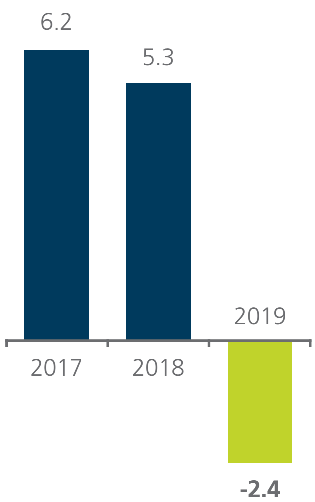
Total Group assets under management

$82bn

Life book growth ($bn)



Funds Management net flows ($bn)



MS&AD

EXPANDED STRATEGIC RELATIONSHIP

#1 RETIREMENT INCOME BRAND[1]

84% SUSTAINABLE EMPLOYEE ENGAGEMENT[2]

EMPLOYER OF CHOICE FOR GENDER EQUALITY[3]

1 Adviser – Marketing Pulse Adviser Study April 2011 to December 2018. Peers include major Australian wealth managers.
2 Willis Towers Watson – March 2019.
3 Workplace Gender Equality Agency (WGEA) 2017-18 WGEA Employer of Choice for Gender Equality.

Operating and financial review

1 About Challenger

Challenger Limited (Challenger, CGF, the Group or the Company) is an investment manager founded in 1985. Challenger is the largest annuity provider and one of the fastest growing fund managers in Australia. It is also expanding into international markets.

Challenger is listed on the Australian Securities Exchange (ASX) and has offices in Australia, London, New York and Tokyo. Challenger is regulated by the Australian Prudential Regulation Authority (APRA), the Australian banking, superannuation, general insurance and life insurance regulator.

Challenger's activities are also subject to supervision by other regulatory agencies both in Australia and in other markets in which it operates.

Challenger's assets under management were $81.8 billion, up 0.8% (30 June 2018: $81.1 million). Normalised net profit before tax was $548.3 million, up $1.0 million or 0.2% (30 June 2018: $547.3 million). Earnings were impacted by investment market volatility resulting in lower asset returns in the Life business and lower Funds Management performance fees. See sections 2 and 8 for a description of Challenger's operating segments and its normalised cash operating earnings framework.

Normalised net profit after tax was down $10.0 million or 2.5% to $396.1 million (30 June 2018: $406.1 million). Statutory net profit after tax, which includes investment experience, being the valuation movements on assets and liabilities supporting the Life business, was $307.8 million (30 June 2018: $322.5 million), down $14.7 million mainly due to volatile investment markets in the year.

Challenger has total equity of $3.6 billion as at 30 June 2019 and employs 687 people on a full-time equivalent (FTE) basis.

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. The Life operating segment is serviced by the Distribution, Product and Marketing team, which is responsible for ensuring the appropriate marketing and distribution of Life's products. Both operating segments and the Distribution, Product and Marketing team are supported by centralised operations 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 Challenger Life Company Limited (CLC), Australia's leading provider of annuities and guaranteed retirement income products and Accurium Pty Limited, a provider of self-managed superannuation fund (SMSF) actuarial certificates.

As Australia's largest annuity provider, Life provides reliable guaranteed[1] incomes to approximately 60,000 Australian retirees.

Life's annuity products appeal to retirees because they provide security and certainty of guaranteed income while protecting against risks from market downturns and inflation. Lifetime annuities protect retirees from the risk of outliving their savings by paying guaranteed income for life.

The retirement incomes Life pays are backed by a high-quality investment portfolio, predominantly in fixed income and commercial property investments. These long-term investments generate regular and predictable investment income which is used to fund retirement incomes paid to Life's customers.

Life's products are distributed via both independent financial advisers and financial advisers tied to the administrative platforms serviced by the four major Australian banks and AMP (the 'major hubs'). Life's products are included on all major hub Approved Product Lists (APLs) and are available on other leading investment and administration platforms, such as HUB24 and Netwealth.

Life is the market leader in Australian retirement incomes, with a 76%[2] annuity market share and has won the Association of Financial Advisers 'Annuity Provider of the Year' for eleven consecutive years.

Life also has an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary), a leading provider of both US dollar and Australian dollar denominated annuities in Japan.

Funds Management – the Funds Management segment focuses predominantly on the retirement savings phase of Australia's superannuation system by providing products seeking to deliver superior investment returns. Funds Management is also expanding into international markets.

As one of Australia's fastest growing asset managers, Funds Management invests across a broad range of asset classes including fixed income, commercial property and Australian and global equities. The Funds Management segment comprises two business divisions, Fidante Partners and Challenger Investment Partners (CIP).

Fidante Partners encompasses a number of investments in boutique investment managers that each operate under their own brands. Fidante Partners provides administration and distribution services to the boutique investment managers and shares in the profits of these businesses through equity ownership. Fidante Partners also has a presence in Europe with interests in alternative asset managers.

[1] The word 'guaranteed' means payments are guaranteed by Challenger Life Company Limited from the assets of its relevant statutory fund.

[2] Strategic Insights – March 2019.

2 Operating segments and principal activities (continued)

CIP develops and manages assets for CLC and under Challenger's brand principally on behalf of third-party institutional investors. The investments managed by CIP are predominantly in fixed income and commercial property.

The Funds Management business is growing strongly, with funds under management (FUM) increasing by more than 68% over the last five years to $79 billion.

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

3 Challenger's vision and strategy

Challenger's vision is to provide its customers with financial security for retirement. Challenger has four strategic pillars to ensure that it achieves its vision over the long-term. The four strategic pillars are:

- increase the use of secure retirement income streams;
- lead the retirement incomes market and be recognised as the partner of choice;
- provide customers with excellent funds management solutions; and
- maintain leading operational and people practices.

4 Risk management

An integral part of risk management for Challenger is the maintenance of a strong risk culture amongst its employees. Challenger's expectations of its employees are encapsulated in the 'Challenger Principles' of integrity, commercial ownership, working together, compliance and creative customer solutions. Employees are made aware that these principles should form the basis of all behaviours and actions.

The management of risk is fundamental to Challenger's business and to building shareholder value and has been the key to Challenger's profitable and disciplined growth over many years. At Challenger, risk is everyone's business. 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. This is combined with a robust risk management framework which monitors, mitigates and manages the risks to which Challenger is exposed.

Challenger's Board recognises the broad range of risks that apply to a participant in the financial services industry. These include funding and liquidity risk, investment and pricing risk, counterparty risk, business and reputational risk, operational risk, licence and regulatory risk, cyber and information security risk and environmental and social risks. Increasingly, the risk of climate change is being considered within the investment process. Challenger invests in assets with long term cash flows to match the annuity payments required to be made within its portfolio. This means that Challenger must consider the risk of climate change within its risk management framework and work to ensure that these risks are mitigated where possible. Challenger is not currently materially exposed to climate risk.

5 Challenger's 2019 strategic progress

2019 strategic progress

Progress in 2019 against our strategic priorities is set out below:

Increase the use of secure retirement income streams

Industry lifetime annuity sales represent less than 2% of the annual transfer from the retirement savings (accumulation) phase to the retirement spending (retirement) phase. Challenger is focused on growing the allocation of Australian retirement savings to secure and stable incomes.

2019 progress includes:

- Australian annuity sales were down 4%;
- Term annuities sales were down 6%;
- Lifetime annuity sales were unchanged; and
- Japan annuity sales were down 54%.

Significant financial advice market disruption

In 2019, Challenger's Australian annuity sales reduced by 4% as a result of disruption to the wealth management and financial advice industry following the Royal Commission into Misconduct in the Banking and Financial Services Industry (Royal Commission). The major financial advice hubs[1] have been impacted more than independent financial advisers, and as a result Challenger annuity sales via major hubs reduced by 16% on 2018 and represented 62% of total Australian annuity sales.

Partially offsetting the decline in sales by major advice hubs was strong growth in sales by independent financial advisers (IFAs), which increased by 26% on 2018. Growth in IFA sales reflect the evolution of the advice industry over the past 12 months, with advisers moving from the major hubs to independent groups. Challenger is evolving its service model to support an increased proportion of advisers being independent and not aligned to the major hubs.

Life sales mix and focus on long-term products

Challenger's annuity sales mix continues to evolve to long-term products. Long-term annuities embed more value for shareholders as they lengthen the annuity book tenor, improve the maturity profile and typically enhance return on equity (RoE).

In 2019, long-term annuity sales, which represent Australian lifetime annuities and fixed term annuities distributed through MS Primary in Japan, represented 32% of total annuity sales, down from 36% in 2018. The reduction in long-term annuity sales relates to lower MS Primary Australian dollar annuity sales as a result of higher US interest rates relative to Australia. The higher relative US interest rates increased demand for US dollar products and reduced demand for Australian dollar denominated products.

Long-term annuity sales are expected to benefit from a new reinsurance agreement with MS Primary that commences on 1 July 2019 and includes US dollar annuity reinsurance, and new means test rules that support lifetime income streams.

Solid lifetime annuity sales in disrupted advice market

Despite the significant disruption occurring in the Australian financial advice market, Challenger's lifetime annuity sales were unchanged from 2018. Lifetime sales by major financial advice hubs were down 22% on 2018, reflecting the industry disruption, while lifetime sales by independent financial advisers increased by 35%.

Lifetime annuity sales are benefiting from rising superannuation savings and retirees taking less risk in retirement and placing more value on lifetime income streams. Sales of CarePlus, a lifetime annuity specifically designed for the aged care market, are benefiting from demographic trends with approximately 300 older Australians entering home or residential care each day.

Retirement reforms engagement and advocacy

The Australian Government is considering a range of superannuation reforms aimed at enhancing the retirement phase of superannuation.

The Government announced a Retirement Income Framework policy in May 2018. The first stage of the proposed Retirement Income Framework is to include a Retirement Income Covenant in the *Superannuation Industry (Supervision) Act 1993*, which would require superannuation trustees to have a retirement income strategy in place for members by 1 July 2020.

The second stage of the Retirement Income Framework is to develop simplified, standardised metrics in product disclosures to help members make decisions about the most appropriate retirement income product for them. The Government consulted on disclosure in late 2018 and has indicated consumer testing will be undertaken on the design and content of product disclosures.

[1] Major advice hubs include AMP and the wealth management operations of the major Australian banks.

5 Challenger's 2019 strategic progress (continued)

2019 strategic progress (continued)

Increase the use of secure retirement income streams (continued)

From 1 July 2019, new pension means test rules commenced for lifetime income stream products. The new means test rules are expected to encourage the development of innovative lifetime income products that will help retirees manage the risk of outliving their savings, while ensuring a fair and consistent means test treatment for all retirement income products.

Following the Australian federal election in May 2019, the Government has indicated it is considering accepting the Productivity Commission's recommendation for an independent review of Australia's retirement income system. The terms of reference and timeline for the review have not yet been released.

Maintaining thought leadership position

As a key thought leader in retirement incomes in Australia, Challenger works with industry and consumer organisations and the Government to develop policy outcomes that will provide Australians with financial security for retirement.

In 2019, Challenger partnered with National Seniors Australia to understand retirees' attitudes to and confidence in managing the financial aspects of retirement. Challenger has also supported the Council of the Ageing (COTA) to explore consumer-related retirement income issues.

Throughout 2019, Challenger published a range of thought leadership papers, made presentations and conducted workshops focusing on retirement income policy settings and outcomes.

Lead the retirement incomes market and be the partner of choice

Challenger's strategy includes being the partner of choice for superannuation funds, wealth managers and investment platforms for providing retirement income solutions. Challenger is the market leader in retirement incomes with 76%[1] annuity market share.

2019 progress includes:

Leading adviser ratings

Among Australian financial advisers, Challenger continues to be the most recognised retirement income provider with 95%[2] of financial advisers rating Challenger as a leader in retirement income.

Challenger's leadership position in retirement increased by 2 percentage points over the year, despite the adviser and industry disruption. Challenger's retirement income leadership position, which is important in supporting new distribution relationships, is 36 percentage points above its nearest competitor and has increased by 31 percentage points over the past eight years.

In 2019, Wealth Insights undertook an analysis to compare the service level of Challenger Annuities to the broader Australian funds management market. When compared to the market, Challenger annuities rated number one across six key categories, including Overall Adviser Satisfaction (4th consecutive year); BDM Team (8th consecutive year); Adviser Contact Centre (4th consecutive year); Image and Reputation (4th consecutive year); Technical Services (4th consecutive year) and Website (3rd consecutive year).

Increased product access via investment and administration platforms

Challenger's strategic priorities include making its annuity products available on leading investment and administration platforms, allowing financial advisers and their customers easy and efficient access to Challenger annuities.

By making Challenger annuities available via investment and administration platforms, advisers and superannuation funds can easily create solutions that combine lifetime income streams with other products, such as account-based pensions.

[1] Strategic Insights – March 2019 – based on annuities in force at 31 March 2019.
[2] Marketing Pulse Adviser Study December 2018.

5 Challenger's 2019 strategic progress (continued)

2019 strategic progress (continued)

Lead the retirement incomes market and be the partner of choice (continued)	In 2019, Challenger's full range of annuity products were made available via BT's Panorama, and leading independent platforms HUB24 and Netwealth. By making annuities available via platform, it makes it simple and easy for advisers to include secure and stable income streams in their client portfolios. These new annuity relationships further expand Challenger's distribution reach, with Challenger annuities now available on a wide range of traditional retail hub platforms and the fast-growing independent platform market. Challenger annuities are now available to over 70% of Australian financial advisers via their primary investment and administration platform. New brand campaign In June 2019, Challenger launched a new consumer brand campaign that responds to extensive adviser and consumer research undertaken. The new integrated campaign focuses on building product familiarity, with annuities an important component to creating confidence in retirement. Previous brand campaigns have focused on building Challenger brand awareness rather than promoting product familiarity. Investing in new customer and adviser growth initiatives In 2020, Challenger will invest up to $15 million in a range of new initiatives to drive the next phase of growth and enable annuities to become a mainstream option in retirement. Research conducted in 2019 identified two areas of focus to drive growth which centred around building bottom-up customer demand and increasing the allocation made to annuities via retail financial advice. Customer research showed that improving understanding of annuities leads to a higher consideration of them in retirement. A range of customer initiatives has been identified and will be implemented in 2020 with a focus on greater engagement and education on retirement income and the role annuities can play, which is expected to build more bottom-up customer demand. Challenger will also be investing in improving the adviser experience to drive increased use of annuities in financial advice. Investment will focus on increasing efficiency for advisers and providing more tailored marketing and sales support to better meet the needs of more diverse financial advice groups, including independent financial advisers. In 2019, Challenger also simplified its product offering, including removing over 1,000 lifetime product permutations from its Liquid Lifetime product range. Product positioning was also refined, with improved marketing collateral. Simplifying the product offering is expected to assist both consumers and advisers in their understanding of Challenger's products.
Provide customers with excellent funds management solutions	Challenger is focused on providing relevant investment strategies that exhibit superior investment performance in order to help build retirement savings. 2019 progress includes: Maintaining superior investment performance Funds Management has a long track record of achieving superior investment performance, which is helping attract superior net flows. Over five years, 93% of Funds Management funds have outperformed their benchmark[1]. For Fidante Partners, over the past ten years, 86% of funds have achieved either first or second quartile investment performance[2], with most funds performing well above average. Over three years, 76% of funds achieved first or second quartile investment performance. Adding new boutiques and investment strategies Fidante Partners continues to expand its product offering by adding new boutiques and new investment strategies for existing managers. In April 2019, Eiger Capital, a new Australian small cap boutique was formed through partnering with an experienced and highly rated small caps team.

[1] Fidante Partners as at 31 March 2019. Percentage of Funds Management Australian boutiques and CIP funds meeting or exceeding performance benchmark over five years.

[2] Mercer as at 30 June 2019.

5 Challenger's 2019 strategic progress (continued)

2019 strategic progress (continued)

Provide customers with excellent funds management solutions (continued)

During 2019, Funds Management expanded its product offering:

- Ardea Investment Management commenced development of the High Alpha Real Outcome Fund, which is a higher returning version of the flagship Ardea Real Outcome Fund;
- Kapstream launched the Kapstream Absolute Return Income Plus strategy, which targets an absolute return of 3– 4% above the cash rate;
- Whitehelm Capital launched the Smart City Infrastructure Fund backed by Dutch pension fund APG, which aims to bring the traditional long-term infrastructure investment model to new business models and use cases; and
- Eiger Capital launched its flagship Australian Small Companies Fund, which aims to outperform its benchmark over rolling five-year periods (after fees).

Award-winning investment strategies

The quality of Fidante Partners' investment managers continues to be externally recognised. During 2019, the following funds won investment manager awards.

- Ardea Investment Management – Kanganews Australian Rates Fund Manager of the Year (2018);
- Bentham Asset Management – Money Magazine Best of the Best Award for Best Income Fund (2019);
- Greencape Capital – Money Magazine Best of the Best Award for Best Australian Share Fund (2019);
- Kapstream – Kanganews Australian Credit Fund Manager of the Year (2018);
- Lennox Capital Partners – SuperRatings & Lonsec Rising Star Award (2018); and
- Lennox Capital Partners – Lonsec/Money Management Emerging Manager of the Year (2019).

Highly rated investment products

Fidante Partners' investment managers and funds are highly rated by external asset consultants. For Fidante Partners' funds rated by asset consultants:

- 39% of ratings are the top rating (e.g. 'Highly Recommended' or 'Gold') compared to an average of approximately 10% across the Australian funds management industry; and
- 95% of ratings are a 'buy' rating compared to an average of approximately 70% across the Australian funds management industry.

Expanding capability into exchange traded fund (ETF) market

There is strong demand from investors for simple and easy-to-access liquid investment products. ETFs have experienced very strong growth in a number of markets as they provide the ability to deliver diversified investment strategies in a liquid and simple-to-execute format. ETFs have traditionally focused on passive or factor-based investments; however, Funds Management identified an opportunity to expand ETF usage to active manager products.

In December 2018, Fidante Partners launched one of Australia's first active fixed income ETFs, the ActiveX Ardea Real Outcome Bond Fund (Managed Fund) (ASX: XARO). The fund was listed on the ASX in December 2018 and is managed by Ardea Investment Management.

Fidante Partners is well advanced to launch more ETFs for its boutique managers, which are expected to be rolled out progressively throughout 2020.

Expanding into Japanese funds management market

Funds Management is expanding its presence in Japan. Following the opening of a Tokyo office to support the MS&AD strategic relationship, in the second half of 2018 the business was granted a licence to manage real estate assets in Japan. In late March 2019, the funds management business was granted an investment advisory and agency business licence, which enables it to introduce Fidante and CIP investment capabilities into the Japanese market. Following granting of the relevant investment licences, Funds Management has assumed responsibility for managing Life's $0.8 billion Japanese commercial property portfolio and is well progressed to start managing Japanese property on behalf of its third party client base.

5 Challenger's 2019 strategic progress (continued)

2019 strategic progress (continued)

Provide customers with excellent funds management solutions (continued)

Challenger Investment Partners (CIP) Credit Income Fund

CIP Fixed Income manages funds and investment mandates across multiple underlying investment strategies that includes both public and private credit investments in the Australian market.

In October 2017, CIP launched its first fund, the CIP Credit Income Fund. The fund is a floating rate, multi-sector credit income strategy that invests in investment grade public and private debt investments. With an investment grade average portfolio credit rating[1], the fund provides investors with a higher income, defensive and diversifying investment without taking excessive credit or interest rate risk.

The Credit Income Fund is performing strongly and since inception has outperformed its benchmark, which is a return of 3% above the Bank Bill rate and is currently ranked top quartile in relevant investment surveys. Importantly, the fund has demonstrated its defensive characteristics during periods of heightened market volatility during the year.

Reflecting the success of the fund, during 2019 the fund continued to attract interest from institutions looking to benefit from the enhanced yield without taking excessive credit risk. As a result of investor interest, distribution of the fund will be expanded to target high net-worth investors.

Maintain leading operational and people practices

Challenger believes maintaining a highly engaged, diverse and agile workforce committed to sustainable business practices and a strong risk and compliance culture is essential for providing customers and shareholders with superior outcomes.

2019 progress includes:

Employee engagement and risk culture

Employee engagement measures the nature of the relationship between an organisation and its employees. Challenger believes having a highly engaged team with a positive attitude towards the organisation and its values will lead to superior shareholder and customer outcomes.

Challenger's latest employee engagement survey, which was conducted by Willis Towers Watson in March 2019, showed a sustainable employee engagement score of 84%, which was above both the Australian Company and Global Financial Services Norms.

Challenger's employee engagement survey also measured employee attitudes to important matters such as risk culture and views on diversity and flexibility. Challenger's risk culture score was 85%, which was well above all Willis Towers Watson's benchmarks, including the Global High Performance Norm.

Diversity and gender pay equality

Challenger seeks to create an inclusive workforce and values the capability and experience that diversity brings to the organisation. To encourage greater representation of women at senior levels of the organisation, Challenger continues to develop initiatives targeted at improving gender equality, including setting gender diversity targets.

Challenger set diversity targets in December 2015, which included a target of 38% of management roles being held by women in 2020. In 2019, the 2020 target for women in management roles was increased from 38% to 40%.

At 30 June 2019, Challenger had 37% of management roles held by women.

Challenger is committed to pay equality. Management and the Board review gender pay equality annually as part of the remuneration process. This focus has ensured that for the past five years, the gender pay gap has been closed and gender pay equality for similar roles has been maintained.

During 2019, Challenger was recognised as an Employer of Choice for Gender Equality (WGEA) for the second year running. Challenger's commitment to diversity was recognised in Challenger's March 2019 employee engagement survey, with a diversity and flexibility engagement score of 94%, which was well above Willis Towers Watson's Australian Company and Global Financial Services Norms.

Flexible work

Challenger has a focus on providing its employees with flexibility. Over the past year, almost 90 employees moved to a formal flexible working arrangement, representing approximately 15% of Challenger's people. In addition, a large number of men and women took advantage of informal flexible work arrangements throughout the year.

[1] Based on Moody's Investors Service Inc weighted average rating factors.

5 Challenger's 2019 strategic progress (continued)

2019 strategic progress (continued)

Maintain leading operational and people practices (continued)

Maintain superior cost to income ratio

Challenger's business is highly scalable and efficient. Challenger's normalised cost to income ratio target is a range of 30% to 34%. The cost to income ratio in 2019 was a record low of 32.6% and has fallen by 18 percentage points over the past ten years.

Challenger maintains one of the leading cost to income ratios in the Australian wealth management industry.

Enhancing sustainability capability

At Challenger, being sustainable is about addressing environmental, social and governance (ESG) opportunities and risks that have the potential to affect Challenger's vision to provide financial security for retirement.

Challenger has made significant progress during the year implementing priorities under its sustainability strategy and this is highlighted in Challenger's Sustainability Report.

Challenger continues to be a constituent of the FTSE4Good Index and a signatory to the Principles for Responsible Investment (PRI). Challenger has adopted an integrated investment management approach to deliver responsible investment outcomes and believes there are links between long-term sustainable returns and the quality of an organisation's ESG practices.

In 2019, ESG capability was increased across Challenger with the appointment of specialist resources. In addition, CLC released an ESG statement in May 2019, outlining Challenger's approach to ESG risks and opportunities in investment analysis and decision-making. Challenger continued to support Fidante Partners to develop ESG practices across their boutique firms. As a result, most of the boutiques have become signatories to the PRI and many have developed stand-alone ESG policies. Challenger has also supported a number of boutiques in documenting their own responsible investment policies.

Commitment to reducing emissions

Challenger is committed to reducing the environmental impact of its operations and offsets all known greenhouse gas emissions, making Challenger's business operations carbon neutral. In 2019, Challenger extended the calculation of emissions from Scope 2 to include Scope 3 and had the emission calculation independently verified. In 2019, greenhouse emissions were 4% lower than in 2018 and electricity usage in our three largest offices (Sydney, Melbourne and Tokyo) reduced by 5%.

6 Market overview and outlook

Challenger is an investment management firm focusing on providing customers with financial security for retirement.

Challenger has two businesses, Life and Funds Management, both providing products for Australia's growing superannuation system.

Australia's superannuation system commenced in 1992 and is now the fourth largest pension system globally, with pension assets having increased by 10% per annum over the past 20 years[1].

Growth in Australia's superannuation system is underpinned by mandatory contributions, which are scheduled to increase from currently 9.5% of gross salaries to 12.0% by 2025. The superannuation system is forecast to grow from $2.8 trillion today[2] to over $10 trillion by 2035[3]. Growth in the superannuation system is also supported by changing demographics and the Government enhancing the retirement phase of superannuation.

Both Life and Funds Management are expected to benefit from growth in Australia's superannuation system.

Life outlook

Life focuses on the retirement spending phase of superannuation by providing products that convert retirement savings into safe and secure income. Challenger Life is Australia's leading provider of annuities[4] providing reliable guaranteed[5] incomes to approximately 60,000 Australian retirees.

The retirement spending phase of superannuation is expected to grow strongly over the next 20 years, driven by demographic changes and maturing of the superannuation system.

The number of Australians over the age of 65, which is Life's target market, is expected to increase by ~56% over the next twenty years[6].

[1] Willis Towers Watson Global Pension Study 2018.
[2] The Association of Superannuation Funds of Australia, Superannuation Statistics as at the end of March 2019.
[3] Rice Warner 2017 superannuation projections.
[4] Strategic Insights – March 2019 – based on immediate annuities under administration at 31 March 2019.
[5] The word 'guaranteed' means payments are guaranteed by Challenger Life Company Limited from the assets of its relevant statutory fund.
[6] Australian Bureau of Statistics population projections series B, Cat No 3222.0.

6 Market overview and outlook (continued)

Life outlook (continued)

Reflecting the demographic changes underway, and growth in Australia's superannuation system, the annual transfer from the retirement savings phase of superannuation to the retirement spending phase was estimated to be ~$67bn[1] in 2019. Industry annuity sales (term and lifetime annuities) currently represent less than approximately 5% of the annual transfer to the retirement phase. Lifetime annuity sales represent less than 2% of the annual transfer.

There is growing recognition that retirees need to take a different approach to investing in retirement. As retirees transition from Government-funded age pensions to private pensions, retirees are demanding safe, secure retirement income products that convert savings into income and provide financial security.

The superannuation system is helping Australians build savings for their retirement. Australians now have meaningful superannuation balances when they retire, with an estimated total financial wealth at retirement of $680,000[2], despite the system only being in place for half the working life of today's retirees.

There are a range of Government retirement income regulatory reforms that are being implemented and are currently proposed, designed to enhance the retirement phase and better align it with the overall objective of the superannuation system – to provide income in retirement to substitute or supplement the age pension. These reforms provide a significant opportunity to increase the proportion of retirement savings invested in longevity products, including annuities.

As Australia's leading provider of annuities, Life is expected to continue to benefit from the long-term growth in Australia's superannuation system and regulatory reforms designed to enhance the retirement phase. Life has a range of initiatives underway to build bottom-up customer demand for annuities and to increase the allocation of retirement savings made to annuities through retail financial advice.

Life is also diversifying its range of products and expanding its distribution relationships in both Australia and Japan.

In Australia, Life is broadening access by making annuities available via leading investment and administration platforms. As a result, Challenger's range of annuities are accessible by more than 70% of Australia's financial advisers via their primary investment and administration platform.

Challenger has been recognised as a product innovator and was awarded the Association of Financial Advisers Annuity Provider of the Year, as well as the Long Term Income Stream and Annuity and Income Stream Innovation Award for its Deferred Lifetime Annuity product. Challenger is also recognised by 95%[3] of advisers as a leader in Australian retirement incomes.

The Life business is resilient and well-positioned to capture the long-term growth opportunity through increased superannuation savings and a greater allocation made to annuities. Over the short term, the Australian wealth management and adviser market has been disrupted, which is impacting Life domestic annuity sales.

Life relies on third party financial advisers, both independent and part of the major advice hubs[4], to distribute its products. Following the public hearings and completion of the Royal Commission, there has been significant disruption across the financial advice market which has reduced customer confidence in retail financial advice and reduced the acquisition of new customers by financial advisers. The financial advice market disruption is impacting the Australian wealth management industry sales over the short term.

While Challenger was not called to give evidence at the Royal Commission and Life's customers are not questioning the quality of its products or services, the disrupted advice market is impacting Life's domestic annuity sales, which reduced by 4% on 2018.

Life has a strong reputation with both consumers and advisers and is undertaking a range of initiatives to support sales while the financial advice market is disrupted.

Life is engaging and educating customers in order to increase consumer understanding in order to build bottom-up demand. Initiatives include enhancing and simplifying its product offering, developing engagement and education initiatives and nurturing prospective clients.

Following the Royal Commission, the financial advice landscape is evolving and there are opportunities to improve the adviser experience. Challenger is evolving its service model to cater for an increased number of independent financial advisers and has a range of initiatives under way to support advisers by providing efficiencies and support in order to meet best interests duty requirements.

The profit-for-member sector of superannuation is growing strongly and as their members transition to retirement, their focus on providing retirement solutions to retiree members is increasing. The profit-for-member sector provides a significant growth opportunity for Challenger.

In Japan, Life commenced an annuity relationship with Mitsui Sumitomo Primary Life Insurance Company Limited (MS Primary) to provide Australian dollar annuities in November 2016.

[1] Australian Taxation Office.
[2] Australian Bureau of Statistic Household Income and Wealth 2017-18 Cat No 6523.0. Average household wealth includes superannuation and non-superannuation assets and excludes the family home.
[3] Market Pulse Adviser Study December 2018.
[4] Major advice hubs include AMP and the wealth management operations of the major Australian banks.

6 Market overview and outlook (continued)

Life outlook (continued)

MS Primary is a leading provider of annuity products in Japan and is part of the MS&AD Insurance Group Holdings Inc. (MS&AD).

As part of the reinsurance agreement with MS Primary, Challenger Life currently reinsures an Australian dollar 20-year term product and an Australian dollar lifetime annuity product.

In March 2019, Challenger entered into a new agreement with MS Primary to commence reinsuring a 20-year term US dollar annuity product from 1 July 2019.

Under the new reinsurance arrangement, MS Primary provides Challenger an annual amount of reinsurance, across both Australian and US dollar annuities, of at least ¥50 billion (~$660 million[1]) per year for a minimum of five years[2,3].

MS&AD also announced its intention to increase its shareholding in Challenger to over 15% of issued capital and seek representation on the Challenger Limited Board. At 30 June 2019, MS&AD held 16% of Challenger's issued capital and a representative from MS&AD is expected to join the Board early in the 2020 financial year.

Funds Management outlook

Funds Management focuses on building savings for retirement by providing products seeking to deliver superior investment returns. Funds Management is one of Australia's largest[4] active fund managers.

Growth in funds under management can be attributed to the strength of Challenger's retail and institutional distribution teams, a market leading business model focused on investor alignment and strong long-term investment performance.

The Fidante Partners business model involves taking minority equity interests in separately branded, boutique fund management firms, with Challenger providing the distribution, administration and business support, leaving investment managers to focus on managing investment portfolios.

Challenger's Fidante Partners business model has allowed it to attract and build successful alliances with traditional and alternative investment managers.

Fidante Partners has operations in Australia and the United Kingdom. Fidante Partners is authorised and regulated by the Financial Conduct Authority in the United Kingdom and also holds a registration as a broker-dealer with the Financial Industry Regulatory Authority in the United States.

Fidante Partners is expanding its product offering by adding new boutiques and accessing new distribution channels. During 2019, new products were added, including new boutiques, new investment strategies and Fidante Partners launched its first actively managed exchange traded fund.

Funds Management also includes Challenger Investment Partners (CIP), an institutional manager that originates and manages fixed income and property assets for leading global and Australian institutions, including Challenger Life. CIP clients benefit from the broad product offering and market insights CIP gains through its experienced team and scale of its investment business.

Funds Management is also expanding its presence in Japan, with Challenger opening a Tokyo office in order to support the MS&AD strategic relationship and to develop distribution opportunities in the region. A Japanese real estate funds management licence and an investment advisory licence has been granted, which will facilitate distribution of investment products in Japan.

Funds Management is expected to continue to benefit from the overall growth in Australia's superannuation system and Challenger's expansion into international funds management and pension markets.

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;
- investment market volatility; and
- general uncertainty around the global economy and its impact on markets in which Challenger operates and invests.

Other risks to which Challenger's businesses are exposed are summarised in section 4 Risk Management and in the Corporate Governance summary on page 23.

[1] Based on AUD/JPY close of 75.705 as at 28 June 2019.
[2] Challenger Life has entered into a new agreement with MS Primary to commence reinsuring the US dollar version of the 20-year term product. Challenger will provide a guaranteed interest rate and assume the investment risk in relation to those policies issued by MS Primary and reinsured by Challenger.
[3] Subject to review in the event of a material adverse change for either MS Primary or Challenger Life.
[4] Consolidated FUM for Australian Fund Managers – Rainmaker Roundup March 2019.

7 Key performance indicators (KPIs)

7.1 Profitability and growth

KPIs for the year ended 30 June 2019 (with the year to 30 June 2018 being the prior comparative period (PCP), unless otherwise stated) include:

	2019	2018	Change %
Profitability			
Statutory profit attributable to equity holders ($m)	307.8	322.5	(4.6)
Normalised NPBT	548.3	547.3	1.0
Normalised NPAT ($m)	396.1	406.1	(2.5)
Statutory EPS (cents)	50.9	54.0	(5.7)
Normalised EPS (cents)	65.5	68.1	(3.8)
Total dividend (cents)	35.5	35.5	-
Total dividend franking	100%	100%	-
Normalised cost: income ratio	32.6%	32.7%	(0.1)
Statutory RoE after tax	8.9%	9.7%	(0.8)
Normalised RoE pre-tax	15.8%	16.5%	(0.7)
Normalised RoE after tax	11.4%	12.2%	(0.8)
Growth			
Total Life annuity sales ($m)	3,543.1	4,000.7	(11.4)
Life annuity net book growth ($m)	685.8	1,392.7	(50.8)
Life annuity net book growth (%)	5.8%	13.5%	(7.7)
Total FM net flows ($bn)	(2.4)	5.3	(Large)
Total AUM ($bn)	81.8	81.1	0.9

Challenger's statutory profit attributable to equity holders was 4.6% lower for the year ended 30 June 2019. Statutory EPS has decreased for the year when compared to the prior year, reflecting the lower profit attributable to equity holders as a result of higher pre-tax normalised earnings offset by the impact of fair value changes on Challenger Life Company Limited's (CLC's) assets and liabilities together with the impact of the issue of additional ordinary shares in the period to satisfy the dividend reinvestment plan (DRP) and as a result of a reduction in Treasury shares. Statutory EPS has decreased by 5.7% for the year when compared to 2018.

Normalised net profit after tax decreased by 2.5%, and normalised EPS decreased by 3.8% compared to 2018, reflecting slightly higher earnings in Life and marginally lower earnings in the Funds Management business, offset by a higher effective tax rate in the period and a higher share count as a result of additional capital being issued to satisfy the DRP and as a result of a reduction in Treasury shares.

A final dividend of 18.0 cents was announced, franked at 100%, taking the total dividend for 2019 to 35.5 cents franked at 100%, which is unchanged from the prior year (100% franked).

Challenger's normalised cost to income ratio of 32.6% remains within the targeted range and is lower than the ratio in 2018 (32.7%). This reflects continued cost discipline throughout the business. Challenger's medium-term expected normalised cost to income ratio target is 30–34%.

However, it is expected that this range will be exceeded in the next period as a result of additional costs being incurred in the Distribution, Product and Marketing area to support growth initiatives.

Challenger has historically targeted a normalised pre-tax RoE of 18%. The normalised pre-tax RoE was 15.8% in 2019 compared to 16.5% in the prior year due to higher average capital levels. The RoE target has been lowered for 2020 and beyond from 18% to the Reserve Bank of Australia (RBA) cash rate plus a margin of 14%. This reflects the structural change in interest rates, being at historic lows and expected to remain low for the foreseeable future.

Statutory RoE after tax of 8.9% has decreased compared to the prior year (2018: 9.7%) as a result of lower after-tax statutory profit and higher capital levels. Normalised RoE after tax decreased from 12.2% in the prior period to 11.4%, primarily reflecting the increased share count and the reduced normalised net profit after tax.

7.2 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	2019	2018	Change
Net assets attributable to equity holders ($m)	3,600.3	3,485.4	114.9
CLC excess capital over PCA ($m)	1,377.0	1,341.9	35.1
Group cash ($m)	91.5	84.9	6.6
CLC excess capital over PCA + Group cash ($m)	1,468.5	1,426.8	41.7
CLC PCA ratio (times)	1.53	1.53	-
CLC Tier 1 ratio (times)	1.37	1.37	-

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 has ongoing and open engagement with APRA.

CLC maintains a level of capital representing the 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.

7 Key performance indicators (KPIs) (continued)

CLC regulatory capital base (continued)

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 may change over time and is dependent on a number of factors.

In addition to CLC's excess regulatory capital, Challenger maintains cash at a Group level which can be used to meet regulatory capital requirements. Challenger further maintains a Group corporate debt facility of $400 million in order to provide additional financial flexibility. The facility remained undrawn throughout the period.

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. There has been no further update from APRA in relation to this position.

Dividends and dividend reinvestment plan

Dividends	2019	2018	Change	Change %
Interim dividend (cents)[1]	17.5	17.5	-	-
Final dividend (cents)[2]	18.0	18.0	-	-
Total dividend (cents)	35.5	35.5	-	-
Interim dividend franking	100%	100%	-	-
Final dividend franking	100%	100%	-	-

[1] Interim dividend declared on 12 February 2019 and paid on 26 March 2019 in respect of the half year ended 31 December 2018.
[2] Final dividend declared on 12 August 2019 and payable on 25 September 2019 in respect of the half year ended 30 June 2019.

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 2019 was 54.2% (30 June 2018: 52.1%).

The payout ratio is currently above the target reflecting the resilience of Challenger's business and strong capital position.

The Company also seeks to frank its dividend to the maximum extent possible and expects future dividends over the medium term 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 DRP during the period. The DRP participation rate for the 2018 final dividend was 3.1% of all issued shares, and 329,710 ordinary shares were issued to satisfy the DRP requirements on 26 September 2018. The participation rate for the 2019 interim dividend was 3.1%, and 411,192 ordinary shares were issued to satisfy DRP requirements on 26 March 2019.

The DRP will continue in operation for the 2019 final dividend, and the Board has determined that new shares will be issued to fulfil DRP requirements in respect of the final dividend. The new shares will not be issued at a discount to the prevailing Challenger share price.

No shares were bought back during the year.

7.3 Credit ratings

Challenger Limited and CLC are rated by Standard & Poor's (S&P). In December 2018, S&P reaffirmed both CLC and Challenger Limited's credit ratings.

Ratings were confirmed as:

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

The S&P ratings reflect the financial strength of Challenger Limited and CLC. In particular, S&P note that CLC has an extremely strong capital and earnings position with significant financial flexibility.

8 Normalised profit and investment experience

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 together with the new business strain[1] that results from writing new annuities. Investment experience also includes any impact from changes in economic and other actuarial assumptions.

[1] New business strain is a non-cash accounting adjustment recognised when annuity rates on new business are higher than the risk-free rate used to fair value annuities. The new business strain unwinds over the annuity contract.

8 Normalised profit and investment experience (continued)

Normalised framework (Non IFRS) (continued)

A reconciliation between statutory revenue and the management view of revenue and net income is included in the financial report as part of Note 3 Segment information. This note also includes a reconciliation of statutory profit after tax and normalised net profit after tax (the management view of post-tax profit). The application of the normalised profit framework has been reviewed by Challenger's independent auditor to ensure that the reported results are consistently applied in accordance with the methodology described in Note 3 Segment information in the financial report.

Management analysis – normalised results

	2019 $m	2018 $m	Change $m	Change %
Net income[1]	821.0	821.8	(0.8)	(0.1)
Comprising:				
– Life normalised COE	670.1	669.6	0.5	0.1
– FM net income	149.9	151.2	(1.3)	(0.9)
– Corporate and other income	1.0	1.0	-	-
Operating expenses[1]	(267.4)	(268.4)	1.0	0.4
Normalised EBIT	**553.6**	**553.4**	**0.2**	**-**
Comprising:				
– Life normalised EBIT	563.6	562.7	0.9	0.2
– FM normalised EBIT	50.9	57.9	(7.0)	(12.1)
– Corporate and other normalised EBIT	(60.9)	(67.2)	6.3	9.4
Interest and borrowing costs	(5.3)	(6.1)	0.8	13.1
Tax on normalised profit	(152.2)	(141.2)	(11.0)	(7.8)
Normalised NPAT	**396.1**	**406.1**	**(10.0)**	**(2.5)**
Investment experience after tax	(88.3)	(76.0)	(12.3)	(16.2)
Significant items after tax	-	(7.6)	7.6	100.0
Statutory net profit after tax attributable to equity holders	**307.8**	**322.5**	**(14.7)**	**(4.6)**

[1] 'Net income' and 'Operating expenses' are internal classifications and are defined in Note 3 Segment information in the financial report. These differ from the statutory revenue and expenses classifications, as certain costs (including distribution expenses, property expenses, management fees, 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 differ 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 marginally as a result of higher Life investment assets, offset by a lower margin being earned on those assets. Life's average investment assets increased by 8.6% as a result of increased net book growth in annuities and valuation movements on those assets.

Funds Management net income decreased (down $1.3 million) due to both reduced Fidante Partners fee income and reduced Challenger Investment Partners income. Funds Management average FUM increased by 5.5%.

Management analysis – normalised results

Operating expenses decreased (down $1.0 million), with cost discipline maintained across the Group.

In 2019, Challenger's full-time equivalent employee numbers increased by 11 (or 1.6%) to 687.

Normalised tax for the year was $152.2 million, up $11.0 million (or 7.8%) from 2018 due to flat earnings before interest and tax, offset by a higher normalised effective tax rate. The normalised effective tax rate for the period increased to 27.8% (25.8% at 30 June 2018).

Management analysis – investment experience

	2019 $m	2018 $m
Actual capital growth[1]		
– Cash and fixed income	9.4	40.8
– Infrastructure	116.9	(34.2)
– Property (net of debt)	43.5	134.6
– Equity and other investments	(90.7)	(80.2)
Total actual capital growth	**79.1**	**61.0**
Normalised capital growth[2]		
– Cash and fixed income	(42.0)	(38.9)
– Infrastructure	30.2	24.4
– Property (net of debt)	72.1	70.3
– Equity and other investments	94.8	74.7
Total normalised capital growth	**155.1**	**130.5**
Investment experience		
– Cash and fixed income	51.4	79.7
– Infrastructure	86.7	(58.6)
– Property (net of debt)	(28.6)	64.3
– Equity and other investments	(185.5)	(154.9)
– Policy liability experience[3]	5.8	24.5
Asset and policy liability experience	(70.2)	(45.0)
New business strain[4]	(33.3)	(58.9)
Investment experience before tax	(103.5)	(103.9)
Tax benefit/(expense)	15.2	27.9
Investment experience after tax	**(88.3)**	**(76.0)**

[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 (revised to +3.5% from 1 July 2019), +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] Policy liability experience represents the impact of changes in macroeconomic variables, including bond yields and inflation factors, expense assumptions and other factors applied in the valuation of life contract liabilities.

[4] New business strain is a non-cash accounting adjustment recognised when annuity rates on new business are higher than the risk-free rate used to fair value annuities. The new business strain unwinds over the annuity contract.

8 Normalised profit and investment experience (continued)

Management analysis – investment experience

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 and new business strain from Life business earnings so as to more accurately reflect the underlying performance of the Life business.

Pre-tax investment experience in 2019 comprised an asset and policyholder liability experience loss of $70.2 million and a loss of $33.3 million from Life's new business strain. Life's asset portfolio experienced losses across equity and alternatives and property which were partially offset by gains on Life's fixed income and infrastructure portfolios. 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 a lower discount rate used to determine their fair value.

9 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 eleven consecutive years.

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

Life normalised results	2019 $m	2018 $m	Change $m	Change %
Normalised COE	670.1	669.6	0.5	0.1
– Cash earnings	515.0	539.1	(24.1)	(4.5)
– Normalised capital growth	155.1	130.5	24.6	18.9
Operating expenses	(106.5)	(106.9)	0.4	0.4
Normalised EBIT	563.6	562.7	0.9	0.2

Life normalised EBIT increased by $0.9 million (up 0.2%) due to marginally higher normalised COE (up $0.5 million or 0.1%), which was combined with lower operating expenses decreasing by $0.4 million (or 0.4%). The higher normalised COE was as a result of higher investment assets, with Life average investment assets increasing 8.6%, offset by reduced cash earnings generated on those assets.

Life generated a normalised RoE (pre-tax) of 17.7%, down by 0.8 percentage points from the prior year as a result of a lower margin combined with increased average net assets resulting from increased CLC capital following the MS&AD share placement in 2018.

Life annuity sales declined from the prior period (down 11.4%), with reduced fixed term sales (down 14.5%), reduced other Life sales (down 35.2%) and reduced lifetime sales (down 0.2%). Lifetime annuity sales in 2019 were impacted by significant financial advice market disruption reducing financial adviser productivity.

In September 2018, Life's annuity products were made available on BT's Panorama platform. In addition, Life's annuity products also launched on HUB24's platform in May 2019 and on Netwealth's platform in June 2019. The disruption in the financial advice market has had the most impact on financial advisers connected to the major hubs, while independent financial advisers on platforms like HUB24 and Netwealth have been growing their proportion of Life's annuity sales when compared to the prior period.

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 product, the customer can choose an annuity payment period of five, 10 or 20 years, with a benefit payable upon death. 8% of Life's total annuity sales in 2019 are represented by sales with MS Primary which has reduced compared to 2018 due to the relative attractiveness of Australian dollar denominated annuities when compared with US dollar annuities in the Japanese market.

As a result of this, Challenger announced in March 2019 that from 1 July 2019 it will commence a quota share reinsurance of US dollar denominated annuities issued in the Japanese market by MS Primary. The arrangement will provide CLC with an annual amount of reinsurance across both Australian and US dollar annuities of at least ¥50 billion (approximately A$660 million as at 30 June 2019) each year for a minimum of five years.

As part of the expansion of the reinsurance arrangement, MS&AD also intends to increase its shareholding in Challenger to over 15% and will seek representation on Challenger's Board subject to relevant regulatory approvals (expected in early financial year 2020).

Life sales	2019 $m	2018 $m	Change $m	Change %
Fixed-term annuities	2,689.8	3,145.8	(456.0)	(14.5)
Lifetime annuities	853.3	854.9	(1.6)	(0.2)
Total Life annuity sales	3,543.1	4,000.7	(457.6)	(11.4)
Other Life sales	1,006.9	1,554.9	(548.0)	(35.2)
Total Life sales	**4,550.0**	**5,555.6**	**(1,005.6)**	**(18.1)**
Annuity net flows	685.8	1,392.7	(706.9)	(50.8)
Other Life net flows	(211.0)	403.6	(614.6)	(Large)

Annuity net flows (new annuity sales less capital repayments) decreased by 50.8% to $685.8 million. Based on the opening Life annuity book for the 2019 financial year ($11,728.3 million), annuity net book growth for the period was 5.8%, down from 13.5% 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). Other Life sales decreased by $548.0 million (down 35.2%) as a result of lower new client sales during the period together with reduced reinvestments of maturities.

Other Life net flows for the period were negative $211.0 million, decreasing by $614.6 million compared to $403.6 million in the prior period. Total Life net flows were $474.8 million, representing, total Life net book growth of 3.4% (30 June 2018: $1,796.3 million or 15.0% book growth).

10 Funds Management segment results

Challenger's Funds Management segment is one of Australia's fastest growing investment managers.

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 Funds Management model is delivering superior investment performance, with 93% of strategies exceeding benchmark over the last five years.

FM normalised results	2019 $m	2018 $m	Change $m	Change %
Net income	149.9	151.2	(1.3)	(0.9)
– Fidante Partners	86.7	92.9	(6.2)	(6.7)
– CIP	63.2	58.3	4.9	8.4
Operating expenses	(99.0)	(93.3)	(5.7)	6.1
Normalised EBIT	50.9	57.9	(7.0)	(12.1)

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

Funds Management normalised EBIT decreased by 12.1% in 2019, with reduced net income combined with increased expenses 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.

Fidante Partners' net income declined for the period primarily as a result of performance fees (down $15.8 million), which was partially offset by increased Fidante Partners' income relative to the prior period (up $9.6 million), mainly due to higher transaction fees.

CIP's net income increased due to higher net management fees and transaction fees (up $4.9 million).

Funds Management's normalised RoE (pre-tax) for the year was 23.5%, down by 5.9 percentage points from the prior year. This decrease comes largely as a result of reduced performance fees earned during the year. RoE in Funds Management continues to see the benefits of scale and increased earnings flexibility.

FM FUM and flows	2019 $bn	2018 $bn	Change $bn	Change %
Total FUM	79.0	78.0	1.0	1.3
– Fidante Partners	58.9	59.6	(0.7)	(1.2)
– CIP	20.1	18.4	1.7	9.3
Net flows	(2.4)	5.3	(7.7)	(Large)
– Fidante Partners	(3.6)	3.9	(7.5)	(Large)
– CIP	1.2	1.4	(0.2)	(16.2)

Fidante Partners' FUM decrease ($0.7 billion) was driven by net outflows ($3.6 billion) and positive impact from investment markets (up $2.4 billion).

CIP FUM growth (up $1.7 billion) is primarily a result of additional fixed income flows (up $1.8 billion) offset by reduced property flows (down $623.1 million), from both CLC and third party investors and positive impact from investment markets ($565.8 million).

11 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	2019 $m	2018 $m	Change $m	Change %
Net income	1.0	1.0	-	-
Operating expenses	(61.9)	(68.2)	6.3	9.2
Normalised EBIT	(60.9)	(67.2)	6.3	9.4
Interest and borrowing costs	(5.3)	(6.1)	0.8	13.1
Normalised loss before tax	(66.2)	(73.3)	7.1	9.7

Normalised EBIT for the Corporate and other segment was higher (up $7.1 million) as a result of lower operating expenses.

12 Guidance for the 2020 financial year

Challenger is well positioned with strong product offerings, positive retirement market demographics and highly efficient operations. It is, however, facing some short term challenges from financial advice market disruption and increased market volatility.

For 2020, Challenger is targeting normalised net profit before tax of between $500 million and $550 million. This profit range reflects the lower normalised growth assumption for Equity and other investments ($23.0 million), increased expenditure in Distribution, Product and Marketing to support growth initiatives (up to $15.0 million) and lower expected interest rates reducing the return on shareholder capital.

The normalised cost to income ratio is also forecast to be above the medium term range of 30 – 34% in 2020 as a result of the increased spend to support growth initiatives in Distribution, Product and Marketing.

Challenger Group RoE and dividend

Challenger has revised its RoE target, and is now targeting a normalised RoE of RBA cash rate plus 14% (pre-tax). Reflecting the resilience and capital strength of the business, the Board expects to maintain the same annual dividend of 35.5 cents per share in 2020[1]. This will result in the normalised dividend payout ratio being above the target payout ratio of 45 – 50% of normalised profit.

[1] Subject to market conditions and capital allocation priorities.

Five-year history

	2019	2018	2017	2016	2015
Earnings ($m)					
Normalised cash operating earnings	670.1	669.6	631.4	592.4	543.8
Net fee income	149.9	151.2	134.0	127.7	117.5
Other income	1.0	1.0	0.8	1.0	1.3
Total net income	821.0	821.8	766.2	721.1	662.6
Personnel expenses	(185.3)	(187.8)	(179.3)	(172.8)	(154.8)
Other expenses	(82.1)	(80.6)	(76.6)	(76.8)	(69.4)
Total expenses	(267.4)	(268.4)	(255.9)	(249.6)	(224.2)
Normalised EBIT	553.6	553.4	510.3	471.5	438.4
Interest and borrowing costs	(5.3)	(6.1)	(5.3)	(4.1)	(3.8)
Normalised profit before tax	548.3	547.3	505.0	467.4	434.6
Normalised tax	(152.2)	(141.2)	(120.1)	(105.7)	(100.6)
Normalised profit after tax	396.1	406.1	384.9	361.7	334.0
Investment experience after tax	(88.3)	(76.0)	12.7	(56.1)	(35.0)
Significant items after tax	-	(7.6)	-	22.1	-
Profit attributable to equity holders	307.8	322.5	397.6	327.7	299.0
Normalised cost to income ratio (%)	32.6%	32.7%	33.4%	34.6%	33.8%
Normalised effective tax rate (%)	27.8%	25.8%	23.8%	22.6%	23.1%
Earnings per share (EPS) (cents)					
Basic EPS – normalised profit	65.5	68.1	68.5	64.6	61.2
Basic EPS – statutory profit	50.9	54.0	70.7	58.5	54.8
Diluted EPS – normalised profit	56.0	64.2	65.8	60.9	57.2
Diluted EPS – statutory profit	44.8	52.2	67.8	55.4	51.4
Capital management (%)					
Normalised return on equity – pre-tax	15.8%	16.5%	18.3%	17.8%	18.0%
Normalised return on equity – post tax	11.4%	12.2%	14.0%	13.7%	13.9%
Statutory return on equity – post tax	8.9%	9.7%	14.4%	12.5%	12.4%
Statement of financial position ($m)					
Total assets	27,457.5	25,300.5	23,026.7	21,256.6	18,531.6
Total liabilities	23,834.7	21,814.7	20,125.4	18,572.6	15,893.0
Net assets[1]	3,622.8	3,485.8	2,901.3	2,684.0	2,638.6
Net assets[2]	3,600.3	3,485.4	2,888.1	2,680.9	2,543.2
Net assets[2] – average[3]	3,462.1	3,323.3	2,753.8	2,630.7	2,410.4
Net tangible assets	3,019.1	2,892.5	2,299.7	2,097.0	1,993.8
Net assets per basic share ($)	5.94	5.79	5.14	4.80	4.60
Net tangible assets per basic share ($)	4.98	4.81	4.09	3.75	3.60

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

Five-year history (continued)

	2019	2018	2017	2016	2015
Underlying operating cash flow ($m)	236.9	197.4	299.9	297.1	287.9
Dividends per share (cents)					
Dividend – interim	17.5	17.5	17.0	16.0	14.5
Dividend – final	18.0	18.0	17.5	16.5	15.5
Total dividend	35.5	35.5	34.5	32.5	30.0
Dividend payout ratio – normalised profit (%)	54.2%	52.1%	50.4%	50.3%	49.0%
Dividend payout ratio – statutory profit (%)	69.7%	65.7%	48.8%	55.6%	54.7%
Sales and annuity book net flows ($m)					
Annuity sales	3,543.1	4,000.7	4,011.2	3,351.2	2,753.1
Other Life sales	1,006.9	1,554.9	941.2	998.5	944.0
Total Life sales	4,550.0	5,555.6	4,952.4	4,349.7	3,697.1
Life annuity net flows	685.8	1,392.7	900.4	740.4	738.2
Life annuity book	12,870.2	11,728.3	10,322.2	9,558.5	8,692.6
Life annuity net book growth (%)	5.8%	13.5%	9.4%	8.5%	9.4%
Funds Management – net flows[1]	(2,438.4)	5,301.2	6,220.6	(2,517.2)	7,738.9
Assets under management ($m)					
Life	19,010	18,085	15,677	14,112	12,795
Funds Management	79,029	77,984	66,906	56,662	57,902
Elimination of cross-holdings[2]	(16,269)	(14,926)	(12,595)	(10,723)	(10,908)
Total assets under management	81,770	81,143	69,988	60,051	59,789
Other					
Headcount – closing full time employees	687	676	655	635	560
Weighted average number of ASX-listed basic shares on issue (m)	605.0	596.7	562.2	560.2	545.7
Number of shares on issue – closing (m)	611.6	610.9	572.0	571.2	569.7
Share price – closing ($)	6.64	11.83	13.34	8.63	6.72
Market capitalisation at 30 June 2019 ($m)[3]	4,061.0	7,226.9	7,630.5	4,929.5	3,828.4

[1] 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.
[2] Life assets managed by Funds Management.
[3] 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 2019.

The information appearing on pages 1 to 18 forms part of the Directors' report for the financial year ended 30 June 2019 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 2019 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).

Richard J Howes
(appointed 2 January 2019)

Managing Director and Chief Executive Officer.

Experience and qualifications:
Bachelor of Commerce (Hons) and Bachelor of Economics (University of Queensland).

Mr Howes has previously held a number of senior executive roles at Challenger since joining in 2003, including Chief Executive of Distribution, Product and Marketing, Chief Executive of Challenger's Life business and Chief Investment Officer.

Mr Howes has over 25 years' financial services experience. Prior to joining Challenger, he held senior roles at Zurich Capital Markets, Macquarie Bank and Bankers Trust where his primary responsibility was providing risk management solutions to major companies and institutions globally.

Brian R Benari
(appointed 17 February 2012, retired 1 January 2019)

Former Managing Director and Chief Executive Officer.

Experience and qualifications:
Bachelor of Business (Curtin University, Perth).

A qualified Chartered Accountant, Mr Benari joined the Company in March 2003 and was Chief Executive Officer for seven years. Mr Benari has many years of finance industry experience, both locally and abroad, and held senior executive roles with institutions including JP Morgan, Bankers Trust, Macquarie Bank and Zurich Capital Markets.

Graham A Cubbin
(appointed 6 January 2004, retired 26 October 2018)

Independent Non-Executive Director.

Former Chair of Remuneration Committee.

Former 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).

John M Green
(appointed 6 December 2017)

Independent Non-Executive Director.

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

Experience and qualifications:
Bachelor of Law and Bachelor of Jurisprudence (University of New South Wales), Fellow of the Australian Institute of Company Directors and Life Member and Senior Fellow of FINSIA.

Mr Green was previously an executive director at Macquarie Group and has also been a partner at two major law firms. He is Deputy Chair of QBE Insurance Group Limited, director of Cyber Security Cooperative Research Centre and also a novelist and co-founder of book publisher Pantera Press.

Directorships of other listed companies:
Non-executive director of QBE Insurance Group Limited (appointed 1 March 2010 and appointed Deputy Chair on 1 January 2015) and WorleyParsons Limited (from listing in November 2002 to 25 October 2016).

1 Directors (continued)

Steven Gregg
(appointed 8 October 2012)

Independent Non-Executive Director.

Chair of Group Audit Committee.

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

Experience and qualifications:
Bachelor of Commerce (University of New South Wales).

Mr Gregg has held a number of executive roles in management consulting and investment banking. His more recent senior executive roles included Partner and Senior Adviser at McKinsey & Company and Global Head of Investment Banking at ABN AMRO. His experience has spanned both domestic and international arenas, because of his work in both the USA and the UK.

Directorships of other listed companies:
Non-executive director of Tabcorp Holdings Limited (appointed 18 July 2012) and Caltex Australia Limited (appointed 9 October 2015 and appointed Chair on 18 August 2017).

JoAnne M Stephenson
(appointed 8 October 2012)

Independent Non-Executive Director.

Chair of Group Remuneration Committee.

Member of Group Audit Committee and 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 in 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).

Duncan G West
(appointed 10 September 2018)

Independent Non-Executive Director.

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

Experience and qualifications:
Bachelor of Science in Economics (University of Hull, UK), Fellow of the Chartered Insurance Institute, member of the Australian Institute of Company Directors and a Senior Associate of the Australia and New Zealand Institute of Insurance and Finance.

Mr West has over 30 years' experience in financial services in the UK and Australia, with the past 5 years as a non-executive director. He has held a series of senior executive positions including as CEO of Vero Insurance and CGU Insurance, and as EGM of Insurance at MLC.

Directorships of other listed companies:
Non-executive director of Genworth Mortgage Insurance Australia Limited (appointed on 1 September 2018).

Melanie V R Willis
(appointed 6 December 2017)

Independent Non-Executive Director.

Chair of Group Risk Committee.

Member of Group Audit Committee and Nomination Committee.

Experience and qualifications:
Bachelor of Economics (University of Western Australia), Master of Law, Tax (University of Melbourne) and a Fellow of the Australian Institute of Company Directors.

Ms Willis has significant senior executive experience in corporate finance, strategy and innovation and funds management. Ms Willis previously held the position of Chief Executive Officer of NRMA Investments and senior executive roles at Deutsche Bank and Bankers Trust. She is also a non-executive director of Chief Executive Women.

Directorships of other listed companies:
Non-executive director of Southern Cross Media Group Limited (appointed 26 May 2016), Mantra Group Limited (appointed 29 September 2014 until its delisting in May 2018), Pepper Group Limited (appointed 19 September 2014 until its delisting in December 2017), Ardent Leisure Limited and Ardent Leisure Management Limited (from 17 July 2015 to 8 September 2017).

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 at the law firm Arnold Bloch Leibler.

2 Company Secretary

Michael Vardanega (Bachelor of Commerce and Bachelor of Laws) is the General Counsel and Chief Executive, Group Strategy. He is a qualified solicitor and was appointed as Company Secretary on 1 March 2011. Mr Vardanega's responsibilities at Challenger encompass the Group's strategy, legal, regulatory, corporate governance and company secretarial functions. 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), a Fellow of the Governance Institute of Australia and a member of the Australian Institute of Company Directors. Mr Brown has over 21 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 Challenger by overseeing the creation of sustainable shareholder value within an appropriate framework of risk and having regard for all stakeholder interests.

The Board is responsible for setting Challenger's vision, which is to provide its customers with financial security for retirement. This is a long-term vision and the Board sets strategic priorities each year to work towards fulfilling this vision.

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

The Board has identified its key functions, and full details are set out in the Board Charter, which is available at:

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

The Board has established committees to assist in carrying out its responsibilities and to consider certain issues and functions in detail. The Board committees are discussed on page 22.

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 Challenger 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 has determined 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.

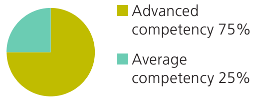
The Board's competencies are assessed annually. The results of the most recent assessment are shown in the table following.

Board members generally have a high level of competency across the areas of expertise relevant to the business.

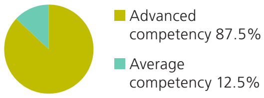
3 Corporate governance summary (continued)

Leadership & Strategy
Effective communication and influencing skills. Strategic thinking capability and transactional expertise.

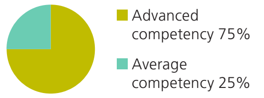
Investment & Credit Expertise
Credit risk management and investment expertise including asset class literacy and exposure (for example, property, fixed income, equities, etc).



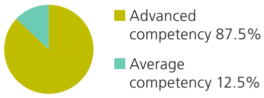
Corporate Governance
Company corporate governance literacy.



Marketing & Distribution
Experience in distribution, marketing and fostering key customer relationships.



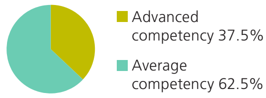
Financial Acumen
Financial reporting literacy including exposure to Accounting Standards.



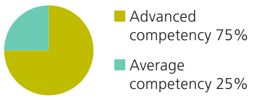
Public Policy
Experience in relevant public policy areas and key Government and regulator relationships.

Risk & Compliance
Financial services and fiduciary regulatory awareness. Relevant compliance and risk experience including legal and tax risk management.

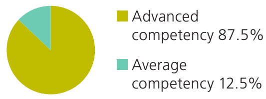
Information Technology
Understanding of IT strategy, the application of technology in large organisations and innovation.



Sectoral Exposure
Exposure to funds management and life insurance sectors, and market experience in jurisdictions in which Challenger operates.



People & Remuneration
Experience in building capable and highly engaged teams and understanding of current remuneration regulation, structuring and sectoral conditions.



3.3 Board committees

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

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

Each committee has its own charter, copies of which are available at:

› 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 2018 to 30 June 2019 are set out below.

Directors' meetings

	Board		Group Risk Committee		Group Audit Committee		Remuneration Committee		Nomination Committee	
Director	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended	Eligible to attend	Attended
P Polson	16	16	4	3	4	4	8	8	4	4
R Howes[1,9]	11	11	2	2	2	2	3	3	2	2
B Benari[2,9]	5	5	2	2	2	2	3	3	1	0
G Cubbin[3]	2	2	1	1	1	1	4	4	1	1
J M Green[4]	16	15	4	4	4	4	4	4	4	4
S Gregg[5]	16	16	4	4	4	4	8	7	4	4
J Stephenson[6]	16	15	4	4	4	4	4	4	4	4
D West[7]	15	14	3	3	3	3	-	-	3	3
M Willis[8]	16	15	4	4	4	4	-	-	4	4
L Zwier	16	11	-	-	-	-	-	-	4	1

1 R Howes commenced as Managing Director & Chief Executive Officer on 2 January 2019.
2 B Benari transferred to a non-KMP role on 2 January 2019 and transitioned to retirement on 30 June 2019.
3 G Cubbin retired from his role as Non-Executive Director of Challenger on 26 October 2018.
4 J M Green joined the Remuneration Committee on 26 October 2018.
5 S Gregg was appointed Chair of the Group Audit Committee on 26 October 2018.
6 J Stephenson was appointed Chair of the Remuneration Committee and retired as Chair of the Group Risk and Group Audit Committees on 26 October 2018.
7 D West was appointed a Director on 10 September 2018. D West joined the Nomination Committee on 10 September 2018 and the Group Risk and Group Audit Committees on 26 October 2018.
8 M Willis was appointed Chair of the Group Risk Committee on 26 October 2018.
9 The Managing Director and CEO attends the Group Risk Committee, Group Audit Committee, Remuneration Committee and Nomination Committee meetings at the invitation of these committees. There are no management representatives appointed as members of any Board Committee.

3 Corporate governance summary (continued)

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 which includes consideration of financial, operational conduct and social risks.

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 will provide a return. The management of these risks is fundamental to Challenger's business and to 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 a separate 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 are judged. In addition to this, Challenger regularly assesses its risk culture with a combination of external audits and internal staff surveys to ensure that the management of risk and day-to-day compliance remains entrenched within the way in which Challenger operates. Challenger's risk appetite statement provides that, subject to earning acceptable economic returns, it can retain exposure to credit risk, property risk, equity risk and life insurance risk.

- Credit risk – is the risk of loss in the value of an asset due to a counterparty failing to perform its contractual obligations when they fall due;
- Property risk – is the potential impact of movements in the market value of property investments on Challenger's income and includes leasing risk which may impact the cash flows from these investments;
- Equity risk – is the potential impact of movements in the market value of listed equity investments, unlisted equity investments and investments in absolute return strategies. Returns for unlisted equity and absolute return strategies are generally uncorrelated to listed equity market returns. Challenger holds equities as part of its investment portfolio in order to provide diversification across the investment portfolio; 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 mortality 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 both the 2019 Sustainability Report and Section 5 of the financial report.

4 Remuneration report

Letter from the Chair

Dear Shareholders,

Financial year 2019 has been difficult and while we have made good progress in many areas of our business, our performance has been impacted by the challenging operating environment. As shareholders would expect, our performance is reflected in the remuneration outcomes for key management personnel (KMP), which are substantially lower this year than in 2018.

This year we have also undertaken an extensive review of our Remuneration Framework, taking into consideration Challenger's business strategy, stakeholder feedback, community expectations and market standards. As a result, we have made important changes that will continue to drive long-term performance and strong risk management, ensure clear alignment with shareholder interests and enhance disclosure and transparency.

2019 performance and remuneration

In 2019, we continued to make good progress implementing our strategy for long-term growth, expanding our distribution channels, launching new products and building on our brand leadership. We have maintained a strong capital position, leading employee engagement and a highly effective risk culture.

Unfortunately, investment market volatility and disruption in our sector have presented challenges for our business resulting in performance outcomes below expectations.

Accordingly, the Board has reduced the variable reward pool for the year to the lowest level in five years. The KMP have borne the bulk of the reduction with their short term incentives reduced by 36% compared to last year.

In our remuneration report this year we have simplified and enhanced our balanced scorecard to provide greater clarity about how short term incentive outcomes have been determined. I encourage you to read this, and the full details on KMP remuneration outcomes on pages 31.

CEO remuneration

As part of the CEO transition that occurred during the year, we have rebased the CEO's remuneration package, including the fixed remuneration and variable reward. The CEO's fixed remuneration is not expected to increase in 2020 and his short term incentive (STI) opportunity is capped at 200% of fixed pay. His STI for 2019 was 49% of the new maximum. We will also seek approval for the CEO's long term incentive (LTI) grant at the upcoming 2019 AGM.

Remuneration Framework Review

This year the Board has undertaken a comprehensive review of executive remuneration in response to feedback from stakeholders and to ensure the structure remains fit-for-purpose in the delivery of our strategic objectives. As a result, we are making a number of important changes in financial year 2019 including:

- significantly extending vesting periods for short and long term incentives;
- capping the maximum possible short term incentive for KMP; and
- allocating a fixed amount of long term incentives on a face value, or maximum value, basis.

The new framework provides transparency on the maximum possible total reward, which is positioned appropriately to market benchmarks and is strongly weighted to variable performance-based pay. This means a large proportion of executive reward is at risk and issued in equity with long deferral, ensuring strong alignment with shareholder interests.

The changes to our framework are designed to drive long-term performance and support retention of our talented team, while providing alignment and transparency for shareholders. I encourage you to read the full details about the significant changes we're making on page 27.

As always, throughout the year the Board has engaged in extensive consultation with shareholders, proxy advisers and other stakeholders to understand and respond to their priorities. Since we undertook this work, stakeholder views have continued to evolve and APRA has released a proposed new prudential standard for remuneration. We look forward to continuing our engagement with all stakeholders as we work to ensure that our framework and outcomes consistently deliver on our commitment to responsible and effective remuneration practices.

Yours sincerely

Peter Polson
Independent Chair

4 Remuneration report (continued)

4.1 Contents

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4.2 Key Management Personnel (KMP)

Challenger's KMP for 2019 are detailed in the table below:

Name	Role	Term as KMP in 2019
Richard Howes	Managing Director & Chief Executive Officer,	From 2 January 2019
	Former Chief Executive, Distribution, Product & Marketing	Until 1 January 2019
Brian Benari	Former Managing Director & Chief Executive Officer	Until 1 January 2019
Angela Murphy	Chief Executive, Distribution, Product & Marketing	From 12 December 2018
Chris Plater	Chief Executive & Chief Investment Officer, Life	Full year
Ian Saines	Chief Executive, Funds Management	Full year
Andrew Tobin	Chief Financial Officer	Full year

Challenger's Non-Executive Directors for 2019 are detailed in the table below:

Name	Term as Non-Executive Director in 2019
Peter Polson (Chair)	Full year
Graham Cubbin	Retired 26 October 2018
John M Green	Full year
Steven Gregg	Full year
JoAnne Stephenson	Full year
Duncan West	Appointed 10 September 2018
Melanie Willis	Full year
Leon Zwier	Full year

4 Remuneration report (continued)

4.3 2019 at a glance

Our vision and strategy

To provide our customers with financial security for retirement

Increase the use of secure retirement income streams

Lead the retirement incomes market and be the partner of choice

Provide our customers with excellent funds management solutions

Maintain leading operational and people practices

Key 2019 outcomes

While industry disruption and market volatility have impacted our performance in 2019, we have made good progress implementing our strategy to position the business for future growth.

Financial

- Group normalised NPBT of $548.3 million (30 June 2018: $547.3 million). This was below target reflecting challenging investment markets and advice market disruption.
- Pre-tax normalised ROE 15.8%, below target due to higher capital held and below target earnings.
- Strong capital position with 1.53 times APRA's Prescribed Capital Amount (PCA), towards the top of our target range of 1.3 to 1.6 times.
- AUM $81.8 billion (30 June 2018: $81.1 billion) was below target reflecting advice market disruption impacting flows, with one profit-for-member superannuation fund internalising its investment functions. Life annuities sales of $3.5 billion and net book growth of 5.8%. Funds Management net outflows of $2.4 billion, reflected solid underlying growth offset by redemptions by one large superannuation fund.
- Normalised cost to income ratio of 32.6%, within target range of 30% to 34% and well below industry averages.

Strategic and operational

- Significantly expanded strategic partnership with MS&AD to include US dollar annuities (commenced 1 July 2019).
- Expanded distribution reach with the launch of BT Panorama platform in first half of 2019, and HUB24 and Netwealth in second half of 2019.
- Fidante Partners launched the first ETF in the Active X series in the first half of 2019 and is on track to launch additional products in the first half of 2020.
- Added new boutique, Eiger Capital, in second half of 2019.
- New means test rules that support the use of lifetime annuities finalised and effective on 1 July 2019.
- Recognised as the leader in retirement income by advisers (95%, 36% above nearest competitor).
- Rated number one by financial advisers for overall adviser satisfaction and in five other categories.
- Launched new brand campaign and supporting initiatives.
- Employee sustainable engagement score of 84% (above Australian Companies Norm and Global Financial Services Norm); risk culture score of 85% (above all norms).

Key reward outcomes

Variable reward pool	Reduced to lowest level in past five years – 9.4% of normalised net profit before variable reward and tax (target range 10%-15%).
Fixed remuneration	Incoming CEO fixed remuneration set 6% below outgoing CEO fixed remuneration. The only change to KMP fixed remuneration was a $50,000 increase for the Chief Executive & Chief Investment Officer, Life, made in September 2018. This was made after considering relevant benchmarks, internal relativities, role scope and complexity.
Short term incentives (STI)	Total KMP STIs down 36% on 2018. The outgoing CEO, Mr Benari's variable reward, was 50% less than 2018 on an annualised basis. Current CEO, Mr Howes' STI was 49% below the former CEO's 2018 outcome on an annualised basis and 49% of the new maximum.
Long term incentives (LTI)	LTIs issued in September 2014, March 2015 and September 2015 vested in September 2018 with Challenger having recorded compound total shareholder returns of 17%, 25% and 26% per annum respectively since issue, well above the hurdle of 8%-12% per annum for these LTI grants. LTIs awarded in September 2015, September 2016 and June 2017 will not meet the performance hurdle and so will not vest in September 2019. LTIs issued in 2017 to 2018 also face a significantly reduced likelihood of vesting in future periods.

4 Remuneration report (continued)

4.3 2019 at a glance (continued)

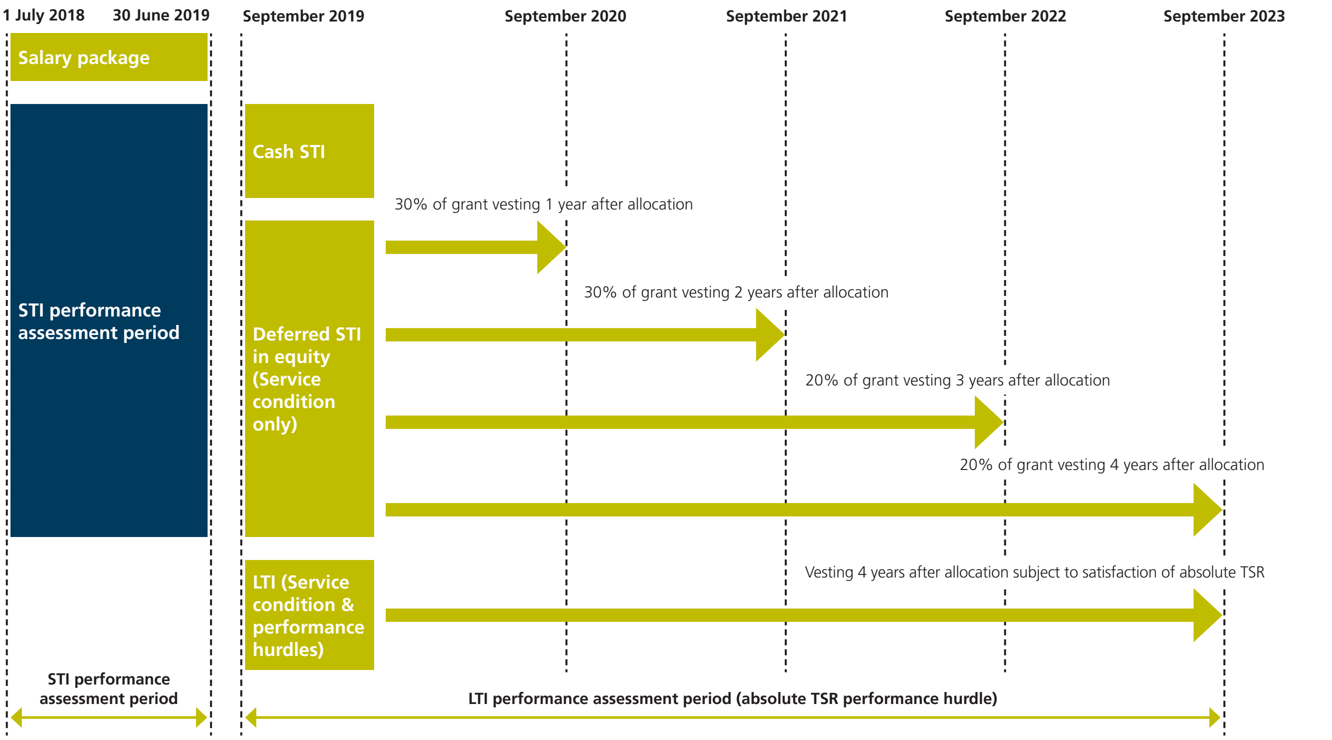
Changes to our KMP remuneration arrangements

In 2019, we conducted a comprehensive review of our KMP remuneration framework in response to stakeholder feedback and to ensure it remains well aligned with Challenger's strategic priorities. As a result, we have made a number of key changes, while maintaining our high weighting to long-term equity-based reward that is at risk. The Board believes this approach drives strong performance and prudent risk management, in the best interests of shareholders. These changes have been applied to the 2019 remuneration outcomes for our KMP.

What has changed?	Why have we made the change?
STI maximum deferral period extended from two to four years.	• The extended vesting period is consistent with Challenger's business strategy and the long-term promises we make to customers. • Reflects changing stakeholder expectations and regulatory trends.
Maximum STI award cap set at 200% of fixed remuneration.	• Setting individual maximum STI awards provides transparency for external stakeholders and executives about the reward opportunity.
Removed three year Deferred Performance Share Rights (DPSRs).	• Simplifies alignment of remuneration components.
LTI deferral period extended, with the earliest possible vesting date moving from three to four years.	• Reflects strong commitment to long-term performance and risk management. • Responds to stakeholder preference for longer vesting periods and emerging regulatory change.
LTI awards to be allocated at Face Value in Hurdled Performance Share Rights (HPSRs).	• Reflects stakeholder preference for the use of face value. • Aligns with the change in allocation methodology for LTI to a fixed percentage of fixed remuneration with a future performance hurdle.
LTI awards set at 225% of Fixed remuneration for all KMP.	• Reflects strong linkage of reward outcomes to longer term performance. • Ensures a high proportion of reward will only be realised if shareholder outcomes are achieved. The amount granted in the award year may ultimately be worth zero and will only be worth the value stated if shareholder return hurdles are met. • LTI award level is broadly consistent with previous year's awards. • Provides transparency on reward quantum.
Dividends not paid on HPSRs.	• Aligns with stakeholder feedback that dividends should not be paid on HPSRs as they are subject to future performance hurdles and as a result may not vest.

Timing of executive reward

Under the new framework, executive reward is realised over an extended period supporting a focus on strong risk management and long-term performance.



4 Remuneration report (continued)

4.3 2019 at a glance (continued)

KMP changes	
Retirement of Mr Benari	• Mr Benari retired from the role of Managing Director & Chief Executive Officer on 1 January 2019 and this represents the conclusion of his designation as KMP for the reporting period. • Mr Benari was eligible to receive a variable remuneration award for 2019 that considers his employment in the role of Managing Director & Chief Executive Officer up until 1 January 2019 and the work performed and support provided during the balance of the financial year. The variable remuneration was delivered as a mix of cash and deferred equity to ensure continued alignment of the reward outcomes with the shareholder experience. • Mr Benari's termination of employment occurred after the conclusion of the financial year and accordingly no termination payments were made during this period. Upon termination Mr Benari had 318,427 DPSRs vest to him in accordance with the terms of the grant. In addition, unvested HPSRs granted to Mr Benari between 2015 and 2018 remain on foot subject to the specified performance hurdles and time based vesting conditions set at grant. No HPSRs will meet the performance hurdle in September 2019. The remaining HPSRs also face a significantly reduced likelihood of vesting in future periods.
Appointment of Mr Howes	• Mr Howes was appointed to the the role of Managing Director & Chief Executive Officer on 2 January 2019. • Mr Howes was designated as KMP for the full 2019 reporting period as his most recent prior role of Chief Executive, Distribution, Product & Marketing was also designated as KMP. The remuneration arrangements for Mr Howes are set considerably lower than his predecessor and are summarised below: • Fixed remuneration is $1,275,000 per annum (inclusive of statutory superannuation contributions and any salary sacrifice items), which is reviewable annually. • Eligible for discretionary annual short term incentives determined by the Board. The annual short term incentive is capped at twice Mr Howes' fixed remuneration. • Eligible to receive annual grants of longer term incentives in the form of equity. Equity is delivered in HPSRs that are awarded at face value with the quantum set at 225% of fixed remuneration.
Appointment of Ms Murphy	• Ms Murphy was appointed to the role of Chief Executive, Distribution, Product & Marketing on 12 December 2018 and was designated as KMP from the date of appointment.
Retirement of Mr Saines	• Mr Saines has expressed his intention to retire from Challenger at a future date in 2020 to be confirmed. Given Mr Saines' intention to retire, his 2019 LTI allocation has been moderated accordingly. • Mr Saines was designated as KMP for the full 2019 reporting period.

4.4 Performance and remuneration outcomes for 2019

Following many years of strong growth, financial year 2019 was challenging, with external headwinds impacting the business. While Challenger made good progress implementing its strategy for long-term growth, investment market volatility and sector disruption resulted in performance outcomes below expectations. This section provides performance information including five year trends and key financial and operational outcomes for the year.

For the year ended	30 June 2015	30 June 2016	30 June 2017	30 June 2018	30 June 2019
Normalised NPAT[1] ($m)	334.0	361.7	384.9	406.1	396.1
Normalised EPS (cents)	61.2	64.6	68.5	68.1	65.5
Closing share price ($)	6.72	8.63	13.34	11.83	6.64
Dividends per share (cents)	30.0	32.5	34.5	35.5	35.5

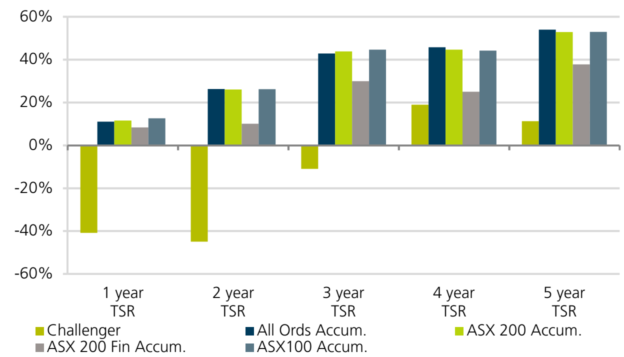
[1] Normalised NPAT excludes asset or liability valuation movements that are above or below expected long-term trends and significant items that may positively or negatively impact financial results. Refer to the Operating and financial review section for further information.

4 Remuneration report (continued)

4.4 Performance and remuneration outcomes for 2019 (continued)

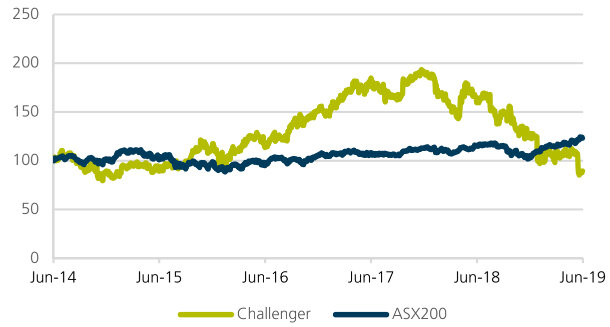
Total shareholders return (TSR)

Source: IRESS and Bloomberg



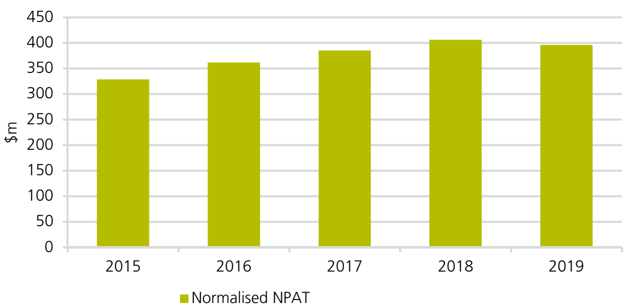
Challenger share price performance versus ASX 200

Source: Company data



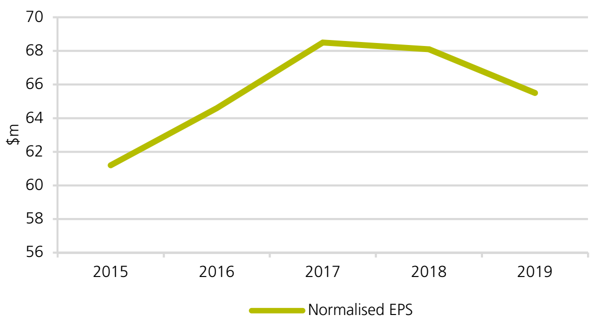
Normalised NPAT

Increased by 19% since 2015 with 2019 impacted by lower equity distributions and lower performance fees.



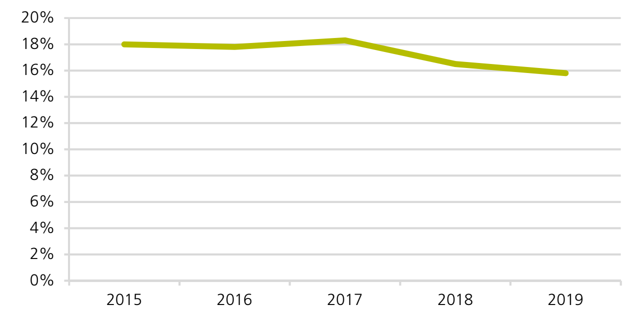
Normalised Earnings Per Share (EPS)

Increased by 7% since 2015 with 2019 impacted by lower normalised NPAT and higher share count.



Normalised pre-tax Return on Equity (RoE)

Reflects earnings and shareholder capital held.



Group assets under management

Increased by 37% since 2015.

4 Remuneration report (continued)

4.4 Performance and remuneration outcomes for 2019 (continued)

2019 balanced scorecard outcomes

Key Performance Indicators (KPIs) for Challenger are aligned to our vision and strategy to provide our customers with financial security for retirement. The KPIs are underpinned by strong risk management practices that inform how we deliver on our commitments to customers and shareholders with risk behaviour assessed as a gate-opener for individual participation in Challenger's variable remuneration plans.

Measure	Weight	Performance	Outcome
Financial Normalised NPBT Pre-tax normalised ROE (target - 18%) PCA (target 1.3x– 1.6x) AUM growth	60%	• Group normalised NPBT of $548.3 million (30 June 2018: $547.3 million). This was below target reflecting challenging investment markets and advice market disruption. • Pre-tax normalised ROE 15.8%, below target due to higher capital held and below target earnings. • Strong capital position 1.53 times APRA's Prescribed Capital Amount (PCA) at the top of our target range of 1.3 to 1.6 times. • AUM $81.8 billion (30 June 2018: $81.1 billion) was below target reflecting advice market disruption impacting flows, one profit for member superannuation fund internalisation and challenging investment markets. – Life annuities sales of $3.5 billion and net book growth of 5.8% were below target reflecting advice market disruption. – Funds Management net outflows of $2.4 billion reflected solid underlying growth offset by redemptions by one large superannuation fund. • New record low normalised cost to income ratio of 32.6%, within target range of 30% to 34% and well below industry averages.	Partial achievement
People and culture Risk culture Employee engagement	20%	• Risk culture score of 85% (above all norms). • Satisfactory completion of external review of risk culture. • Employee sustainable engagement score of 84% (above the Australian Companies Norm and Global Financial Services Norm). • Diversity and flexibility score of 94% (above all norms). • Received 2018 WGEA Employer of Choice for Gender Equality citation.	Full achievement
Customer and strategic initiatives Diversify distribution by channel and geography Expand product offering Build understanding and acceptance of the importance of lifetime income streams	20%	• Significantly expanded strategic partnership with MS&AD to include US dollar annuities (commenced 1 July 2019). Challenger will receive a minimum annuity reinsurance value of at least ¥50 billion (currently $660m) per year for a minimum of five years. This represents approximately 2.5 times the value received in 2019. • Expanded distribution reach with the launch of BT Panorama platform in first half of 2019, and HUB24 and Netwealth in second half of 2019. Fidante Partners launched the first ETF in ActiveX series in first half of 2019 and is on track to launch additional products in the first half of 2020. • Added new boutique, Eiger Capital, in second half of 2019. • New means test rules that support the use of lifetime annuities finalised and effective on 1 July 2019. • Maintained thought leadership positioning and a high level of public engagement on retirement income issues. • Rated number one by financial advisers for overall adviser satisfaction and in five other categories. • Recognised as the leader in retirement income by advisers (95%, 36% above nearest competitor). • Launched new brand campaign and supporting initiatives.	Full achievement
Total	100%		Partial achievement

4 Remuneration report (continued)

4.4 Performance and remuneration outcomes for 2019 (continued)

2019 Awarded KMP remuneration outcomes

Challenger's remuneration strategy is focused on the alignment between performance, prudent risk management and reward outcomes. Consequently achievement against KPIs for Challenger is a key determinant of remuneration outcomes. Accordingly, awarded remuneration has decreased significantly for the financial year in the table below.

- The outgoing CEO's variable reward for 2019 was 50% lower than in 2018 on an annualised basis.
- The new CEO's STI for 2019 was 49% lower than the previous CEO's 2018 STI and 49% of the new maximum.
- Total KMP STIs for 2019 were 36% lower than in 2018.

Awarded remuneration represents the value of remuneration that has been awarded for the financial year as determined by the Board and includes fixed remuneration, cash STI and deferred and hurdled share awards. The actual value realised will depend on future performance outcomes, ensuring strong alignment with shareholder interests. HPSRs awarded in this year will only deliver value to executives in the future if shareholder return hurdles are achieved.

In 2019, Challenger has changed the allocation methodology for HPSR awards from a fair to face value allocation methodology. This responds to feedback from stakeholders who have expressed a preference for the use of face value. The future value of HPSRs that may be realised by executives is uncertain and depends on outcomes against hurdles in the future. The face value of the award will only be realised if the highest performance threshold is achieved. Both the face value and the fair value of the HPSR awards have been shown in the table below for completeness.

								Future hurdled awards	
KMP	Year	Salary[1] $	Super-annuation $	Cash STI $	Deferred STI (1-4 yrs)[2] $	Other[3] $	Total $	Face Value HPSRs[4] $	Fair Value HPSRs[5] $
R Howes[6]	2019	975,009	20,531	625,000	625,000	71,450	2,316,990	2,868,750	1,176,188
	2018	731,753	20,049	712,500	1,065,000	118,750	2,648,052	1,968,170	822,500
B Benari[7]	2019	673,510	10,340	510,000	510,000	56,930	1,760,780	-	-
	2018	1,320,102	20,049	887,500	1,562,500	201,692	3,991,843	3,768,846	1,575,000
A Murphy[8]	2019	323,721	11,406	145,833	145,833	7,797	634,590	750,000	307,500
	2018	-	-	-	-	-	-	-	-
C Plater	2019	722,922	20,531	494,000	494,000	58,369	1,789,822	1,687,500	691,875
	2018	673,074	20,049	612,500	912,500	78,709	2,296,832	1,675,038	700,000
I Saines	2019	810,605	20,531	372,500	372,500	43,677	1,619,813	1,361,000	558,010
	2018	844,020	20,049	450,000	697,500	82,473	2,094,042	1,381,906	577,500
A Tobin	2019	688,674	20,531	425,000	425,000	46,707	1,605,912	1,575,000	645,750
	2018	679,204	20,049	462,500	710,000	77,890	1,949,643	1,381,906	577,500
Total	2019	4,194,441	103,870	2,572,333	2,572,333	284,930	9,727,907	8,242,250	3,379,323
	2018	4,248,153	100,245	3,125,000	4,947,500	559,514	12,980,412	10,175,866	4,252,500

1 Includes the cost of death, total permanent disability and salary continuance insurances.
2 2019 DPSRs will be formally granted in September 2019 and vest 30% one year after grant, 30% two years after grant, 20% three years after grant and 20% four years after grant. 2018 DPSR awards included one and two year deferred STI and three year DPSRs.
3 Values represent distributions from the CPP Trust.
4 The 2019 face value HPSR award has been determined as 225% of fixed remuneration as at 30 June 2019 for all KMP except Mr Saines who is retiring at a future date in 2020. The number of HPSRs will be formally granted in September 2019 with the face value of each HPSR determined by the five-day volume weighted average price (VWAP) prior to the grant date. The 2018 face value for each HPSR granted was determined using the five-day VWAP prior to grant date.
5 The HPSRs awarded in 2019 will be formally granted in September 2019. It is not possible to determine the fair value of these awards until the grant date and so an estimate of fair value has been determined as 41% of the face value. This estimate is based on the the average fair value relative to the face value of 4 year HPSRs awarded over the past three years. The 2018 HPSR values were awarded on a fair value basis.
6 Mr Howes was appointed Managing Director & Chief Executive Officer on 2 January 2019.
7 Mr Benari transferred to a non-KMP role on 2 January 2019 as transition to retirement. The 2019 disclosure is pro rata for the period in which he was a KMP.
8 Ms Murphy transferred to a KMP role on 12 December 2018. The 2019 disclosure is pro rata for the period in which she was a KMP.

4 Remuneration report (continued)

4.5 Remuneration strategy and structure

Challenger's remuneration strategy is focused on the alignment between performance, prudent risk management and reward outcomes. It is designed to support the attraction, retention and reward of the high performing talent required to deliver strong customer outcomes and sustained returns to shareholders. The remuneration strategy is underpinned by the guiding principles outlined below:

Market-competitive	Performance-based and equitable	Aligned with shareholders and underpinned by sound risk management
• Positioned to attract and retain KMP and employees with the necessary capabilities and experience to deliver Challenger's business strategy. • Remuneration structure and quantum benchmarked to the external market using remuneration surveys and publicly disclosed data. • KMP remuneration benchmark data independently reviewed by Challenger's remuneration adviser (KPMG).	• High weighting to performance-based reward to drive strong customer outcomes and long-term growth for Challenger and its shareholders. • Remuneration outcomes differentiated according to individual contribution to Challenger's performance. • Demonstration of Challenger Principles directly linked to remuneration outcomes. • Rigorous annual calibration of performance and reward recommendations to ensure internal equity, fairness and transparency.	• Significant proportion of STI subject to deferral into shares, aligning medium to longer term reward outcomes with the shareholder experience. • Long-term share-based awards, with vesting subject to satisfaction of both a shareholder return performance measure and time-based vesting conditions. • All deferred share-based awards are subject to forfeiture provisions. • Remuneration processes and governance in place to ensure that remuneration arrangements encourage prudent risk-management. • Risk behaviour is a gate-opener for individual participation in Challenger's variable remuneration plans.

4 Remuneration report (continued)

4.5 Remuneration strategy and structure (continued)

Remuneration components

In 2019, the Board undertook a comprehensive review of executive remuneration in response to feedback from stakeholders and to ensure the structure remains fit-for-purpose in the delivery of our strategic objectives. The changes to our framework are designed to drive long-term performance, prudent risk management and talent retention, while providing strong alignment and transparency for shareholders. These changes have been applied to the 2019 remuneration outcomes for our KMP.

	Component	Overview	Link to remuneration strategy
Fixed	Fixed remuneration	Base salary, salary-sacrificed benefits and applicable fringe benefits tax. Employer superannuation contributions.	Positioned around the market median using appropriate benchmarks, reflecting size and complexity of role, responsibilities, experience and skills.
Variable	Cash STI	Annual 'at risk' remuneration, rewarding Challenger, division and individual performance.	Remuneration outcomes determined based on performance and contribution against annual KPIs which include financial measures, people and culture measures, customer and strategic objectives and application of and adherence to the risk management framework.
Variable	Deferred STI - share awards deferred for up to four years	50% of STI awards for KMP are deferred into DPSRs, with vesting over four years as per the schedule below: At the end of year / % of grant vesting 1 / 30% 2 / 30% 3 / 20% 4 / 20% Subject to forfeiture provisions under the Challenger Performance Plan (CPP).	Balances risk management and governance considerations along with supporting shareholder alignment through the deferral of a significant portion of STI into shares over the medium to longer term.
Variable	Hurdled share awards deferred for up to five years	Longer-term 'at risk' remuneration. Awarded as HPSRs vesting up to five years. Awards consist of a single HPSR tranche, that is subject to a cumulative absolute TSR hurdle tested four years or five years from the date of grant. Any unvested awards lapse at the end of the fifth anniversary following grant. Subject to forfeiture provisions under the CPP Trust.	Balances risk management and governance considerations along with supporting shareholder alignment over the long term. Aligns executives' interests with Challenger's long-term success, sustained shareholder returns and the customer experience.

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.

Variable remuneration

Variable remuneration takes two forms: short term incentives, in the form of DPSRs; and long term incentives, in the form of HPSRs. Both short term and long term variable remuneration outcomes are determined based on performance. The face value (at the time of the award) of short term incentives can be a maximum of 200% of fixed remuneration. The face value (at the time of the award) of long term incentives can be a maximum of 225% of fixed remuneration. The performance period for short term incentives is the financial year prior to the award date with performance assessed against a balanced scorecard. The performance period for long term incentives is the four to five year period following the award date with performance assessed in terms of total shareholder return against hurdles.

Short term incentive

KMP STI awards are determined by the Board and can vary from zero to 200% of fixed remuneration. STI outcomes are assessed considering the performance of Challenger, the performance of the individual and market pay benchmarks. In evaluating individual performance, the Board uses a balanced scorecard with specific objectives for each KMP. Annual contribution is assessed against these objectives, and behaviour in line with the Challenger Principles of Integrity; Compliance; Commercial Ownership; Working Together; and Creative Customer Solutions.

To ensure STI award quantum is appropriate and not excessive, the Board sets an overall budget for variable reward based on company performance (set out on page 37).

4 Remuneration report (continued)

4.5 Remuneration strategy and structure (continued)

Deferred Performance Share Rights (DPSRs)

The Board believes deferring a portion of STI into equity provides strong alignment with shareholder interests and supports retention.

At Challenger, deferred STI awards are delivered as DPSRs under the Challenger Performance Plan (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 number of DPSRs granted is determined based on the five-day volume weighted average price (VWAP) of shares prior to grant date.

In 2019 the Board extended the maximum deferral period for STI from two to four years. This extended deferral will apply to awards granted from 1 July 2019 onwards.

Long term incentive

LTIs are awarded annually to KMP to support a continued focus on long-term performance outcomes. Executives will only realise value from LTIs if total shareholder returns exceed the hurdles set, ensuring a direct link between executive reward and shareholder outcomes.

Following its executive remuneration framework review, the Board decided from 2019 onwards to set the LTI awards for all KMP at 225% of fixed remuneration at face value. The selection of this LTI award value reflects Challenger's strong commitment to long-term performance whereby executives will only realise value if the shareholder return performance hurdle is achieved. The application of a common proportionate LTI allocation methodology for all KMP:

- reflects their shared stewardship of Challenger;
- provides proportionate linkage of reward outcomes to Challenger's longer term success;
- recognises that the performance period for long term incentives is the four to five year period following the award; and
- provides greater transparency to both external stakeholders and the KMP on potential reward quantum.

Hurdled Performance Share Rights (HPSRs)

LTIs are awarded in the form of HPSRs. 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.

In 2019, Challenger has changed the allocation methodology for HPSR awards from a fair to face value allocation methodology. This responds to feedback from stakeholders who have expressed a preference for the use of face value.

The future value of HPSRs that may be realised by executives is uncertain and depends on outcomes against hurdles in the future. The face value of the award will only be realised if the highest performance threshold is achieved.

LTI Performance measurement

The Board considers TSR an effective measure of shareholder outcomes. 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 because:

- there are no other listed companies in the Australian market with a retirement income business which are directly comparable to Challenger;
- 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.

The Board continues to consider the appropriateness of a second LTI performance measure.

Consistent with 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 is appropriately challenging for KMP, provides a retention incentive and represents a compelling outcome for shareholders.

As a result of this review, for the 2019 HPSR awards, the Board has determined to retain the same thresholds that were introduced in 2016. This means 50% vest at threshold performance of 7% absolute TSR compounded annually and fully vest when absolute TSR of 10% compounded annually is achieved. The Board believes these thresholds are challenging in the current low growth and low interest rate environment and represent a relatively strong TSR for shareholders.

Absolute TSR compounded annually

Awards pre September 2016	Awards from September 2016	% 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%

It should be noted that HPSR awards made prior to September 2016 will continue to be assessed against the higher performance thresholds of 8% to 12% compounded annually.

Over four years, 7% annual compound growth represents total shareholder return of 31%, and 10% compound growth represents a total shareholder return of 46%.

4 Remuneration report (continued)

4.5 Remuneration strategy and structure (continued)

Absolute TSR compounded annually (continued)

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.

LTI Vesting periods

As noted above, from 1 July 2019 onwards the initial date for performance testing and vesting for LTI awards, issued as HPSRs has been extended from three to four years from the date of grant. Accordingly, subject to continued employment and meeting the absolute TSR performance target, the entire award will be eligible to commence vesting on the fourth anniversary. Previously, two thirds of an award was 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 an award at four years, a higher test is applied in year five (requiring total shareholder returns above the annual thresholds compounded over five years). Any unvested awards lapse at the end of the fifth anniversary following grant.

Challenger's approach differs from the common market practice of three or four-year cliff vesting, reflecting our commitment to driving a focus on long-term performance with strong risk management.

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.

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 2019, the distribution was allocated to DPSRs and an approved charity. The distribution to DPSRs was equal to Challenger's dividend per share. The remaining income from the CPP Trust was allocated to the charity.

In 2019, in response to external stakeholder feedback, the Board determined that unvested HPSRs are not eligible to receive an income distribution from the CPP Trust.

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.

Tax Exempt Share Plan

The Board believes that greater employee ownership increases alignment with shareholders and accordingly encourages employee share ownership.

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)

4.6 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, and 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 2019, eight 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. • In 2019, the Board continued its engagement of 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 2019, 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 $148,415 (inclusive of GST). KPMG provided internal audit, tax, accounting, actuarial and transaction services and general remuneration factual information in 2019. Fees paid or payable to KPMG in respect of these activities were $1,500,138 (inclusive of GST). • Mercer was retained in 2019 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 Corporate Governance Principles and 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 2019 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.
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 skills to Challenger's KMP.

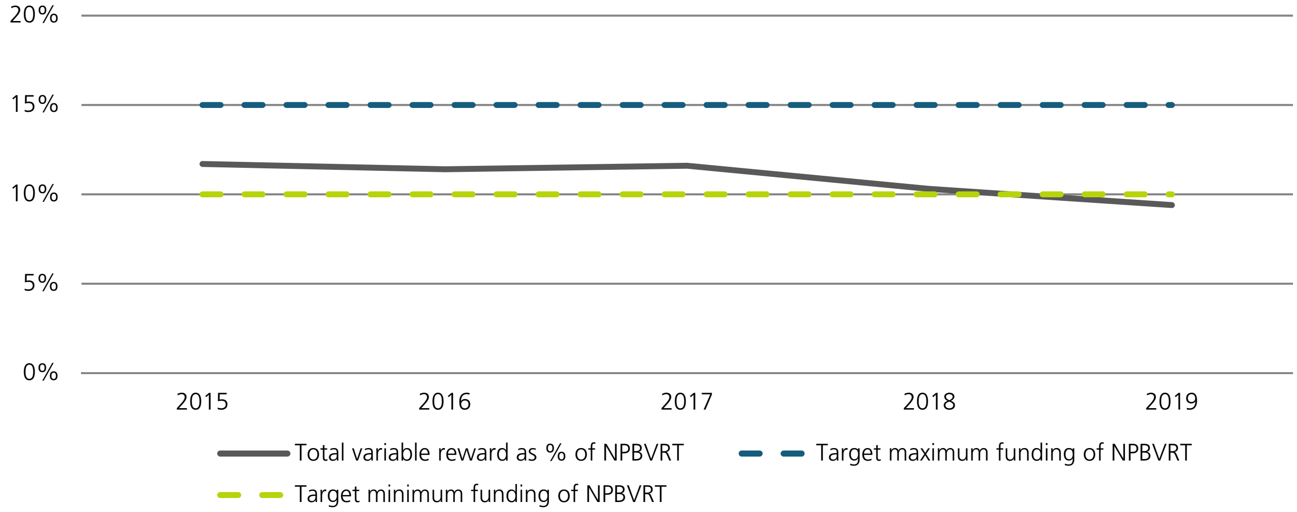
In July 2019, the Board considered remuneration benchmark data as a key input when determining 2019 remuneration outcomes for KMP and is confident that awarded remuneration reflects performance and is positioned and structured at a market-competitive level reflective of the markets in which Challenger competes for talent, and the specialist nature of the skills and experience of Challenger KMP.

4 Remuneration report (continued)

4.6 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 2014 through 2019 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, progress on short and long-term strategic objectives, the cost and amount of capital employed, factors beyond management's control, and management of risk.

For 2019, the Board approved a variable remuneration pool of 9.4% of NPBVRT (total actual variable remuneration was 10.3% in 2018). The Board considers that the 2019 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.

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 2019 review determined that no changes were required to the guidelines at this time. Challenger's minimum shareholding guidelines do not count unvested deferred equity towards minimum holdings; however, for completeness the shareholding disclosures in Section 4.8 Key Management Personnel remuneration arrangements also show unvested DPSR 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	$2,550,000
Other KMP	One times fixed remuneration	$600,000 to $850,000

[1] Based on fees and remuneration at 30 June 2019.

A five-year transitional period in which to acquire the required shareholding applies 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 2019 are set out in Section 4.8 Key Management Personnel remuneration arrangements and 4.9 Non-Executive Director disclosures.

Employee share trading policy

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

4 Remuneration report (continued)

4.6 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 is 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 2019 (no requests in 2018).

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 2019, 76% of permanent employees hold unvested Challenger equity (73% in 2018). This constitutes 2% employee ownership of Challenger (2% in 2018).

4.7 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, is 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 of risk behaviour is treated as a gate-opener for cash STI and share-based awards.

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 2019, this included:

- an assessment was carried out of responses to a company-wide engagement survey, which included specific risk culture questions plus other relevant questions.
- as part of its internal audit program, KPMG provided an assessment of risk culture arising from interviews and control findings.
- Ernst & Young undertook a separate review of Challenger's risk culture through a series of interviews and focus groups.
- a range of key risk indicator metrics are monitored and assessed throughout the year.

Variable reward forfeiture 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 Remuneration report (continued)

4.8 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*.

Statutory remuneration

Statutory remuneration represents the accounting expense of remuneration in the financial year. It includes fixed remuneration, cash STI awards, the fair value amortisation expense of deferred share awards granted, 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 $
R Howes[4]	2019	975,009	20,531	625,000	88,910	1,929,641	3,639,091
	2018	731,753	20,049	712,500	130,814	1,905,451	3,500,567
B Benari[5]	2019	673,510	10,340	510,000	64,367	1,600,128	2,858,345
	2018	1,320,102	20,049	887,500	243,011	3,116,202	5,586,864
A Murphy[6]	2019	323,721	11,406	145,833	15,840	206,528	703,328
	2018	-	-	-	-	-	-
C Plater	2019	722,922	20,531	494,000	70,873	1,497,129	2,805,455
	2018	673,074	20,049	612,500	97,879	1,332,347	2,735,849
I Saines	2019	810,605	20,531	372,500	54,899	1,220,782	2,479,317
	2018	844,020	20,049	450,000	90,386	1,228,781	2,633,236
A Tobin	2019	688,674	20,531	425,000	59,924	1,268,220	2,462,349
	2018	679,204	20,049	462,500	82,583	1,233,211	2,477,547
Total	2019	4,194,441	103,870	2,572,333	354,813	7,722,428	14,947,885
	2018	4,248,153	100,245	3,125,000	644,673	8,815,992	16,934,063

[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 Howes was appointed Managing Director & Chief Executive Officer on 2 January 2019.
[5] Mr Benari transferred to a non-KMP role on 2 January 2019 as transition to retirement. The 2019 disclosure is pro rata for the period in which he was KMP.
[6] Ms Murphy transferred to a KMP role on 12 December 2018. The 2019 disclosure is pro rata for the period in which she was KMP.

4 Remuneration report (continued)

4.8 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
R Howes[1]	2019	28%	17%	53%	2%	100%
	2018	22%	20%	54%	4%	100%
B Benari[2]	2019	24%	18%	56%	2%	100%
	2018	24%	16%	56%	4%	100%
A Murphy[3]	2019	47%	21%	29%	3%	100%
	2018	-	-	-	-	-
C Plater	2019	26%	18%	53%	3%	100%
	2018	25%	22%	49%	4%	100%
I Saines	2019	33%	15%	49%	3%	100%
	2018	33%	17%	47%	3%	100%
A Tobin	2019	28%	17%	52%	3%	100%
	2018	28%	19%	50%	3%	100%

[1] Mr Howes was appointed Managing Director & Chief Executive Officer on 2 January 2019.
[2] Mr Benari transferred to a non-KMP role on 2 January 2019 as transition to retirement. The 2019 disclosure is pro rata for the period in which he was KMP.
[3] Ms Murphy transferred to a KMP role on 12 December 2018. The 2019 disclosure is pro rata for the period in which she was KMP.

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 2019 are detailed below:

					Vesting		
KMP[1]	Awarded DPSR value from 2018 $	Face value allocation price $	Total number of DPSRs granted	Date of grant	Tranche 1 1 September 2019 Number[2]	Tranche 2 1 September 2020 Number[2]	Tranche 3 1 September 2021 Number[2]
R Howes	1,065,000	10.3679	102,719	11/9/18	34,360	34,360	33,999
B Benari	1,562,500	10.3679	150,704	11/9/18	42,800	42,800	65,104
C Plater	912,500	10.3679	88,011	11/9/18	29,538	29,538	28,935
I Saines	697,500	10.3679	67,273	11/9/18	21,701	21,701	23,871
A Tobin	710,000	10.3679	68,479	11/9/18	22,304	22,304	23,871

[1] Ms Murphy transferred to a KMP role on 12 December 2018; grant and vesting disclosures prior to that are not required to be disclosed.
[2] The number of DPSRs granted is determined by dividing the dollar value of the award by the face value allocation price which is determined based on the VWAP in the five days prior to grant. The fair value of each tranche was $10.22 for Tranche 1, $9.94 for Tranche 2 and $9.66 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.

Hurdled Performance Share Rights

From September 2019, HPSRs are awarded as a percentage of fixed remuneration using face value. It's important to note that while 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 subject to attaining the applicable absolute TSR hurdle. HPSRs deliver no value at vesting if absolute TSR is below the performance threshold of 7% compounded annually, and full vesting will only occur if absolute TSR is at or above 10% compounded annually.

4 Remuneration report (continued)

4.8 Key Management Personnel remuneration arrangements (continued)

Share Rights granted (continued)

Hurdled Performance Share Rights (continued)

The table below includes a representation of the awarded face value of the granted HPSRs based on the five-day VWAP of shares prior to grant date as well as the fair value which takes into account the likelihood of vesting and is in line with accounting standards.

HPSRs granted to KMP during the year ended 30 June 2019 are detailed below:

				Vesting					
				Tranche 1 1 September 2021		Tranche 2 1 September 2022			
KMP[1]	Awarded HPSR fair value from 2018 $	TSR start price[2] $	Grant date	Fair value allocation price $	Number[3]	Fair value allocation price $	Number[3]	Total number of HPSRs granted	Awarded HPSR face value[4] from 2018 $
R Howes	822,500	11.7192	11/9/18	4.56	120,248	3.94	69,585	189,833	1,968,170
B Benari	1,575,000	11.7192	11/9/18	4.56	230,263	3.94	133,248	363,511	3,768,846
C Plater	700,000	11.7192	11/9/18	4.56	102,339	3.94	59,221	161,560	1,675,038
I Saines	577,500	11.7192	11/9/18	4.56	84,429	3.94	48,858	133,287	1,381,906
A Tobin	577,500	11.7192	11/9/18	4.56	84,429	3.94	48,858	133,287	1,381,906

1 Ms Murphy transferred to a KMP role on 12 December 2018; grant and vesting of awards prior to that are not required to be disclosed.
2 The TSR start price is the VWAP of shares traded in the 90 calendar days immediately preceding the grant date.
3 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 was 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.
4 The face value unit price has been determined using the five-day volume weighted average price ($10.3679) prior to the grant date. The 2019 awarded HPSRs will be issued in September 2019.

Share Rights vested

The following tables show the short and long-term incentives that vested during the year ended 30 June 2019.

Deferred Performance Share Rights

DPSRs which vested to KMP during the year ended 30 June 2019 are detailed below:

KMP[1]	Date of grant	Number	Face value at grant $	Vesting date
R Howes	13/9/15	41,133	287,495	1/9/18
	12/9/16	38,001	349,993	1/9/18
	11/9/17	31,596	387,500	1/9/18
B Benari	13/9/15	78,690	549,996	1/9/18
	12/9/16	43,430	399,995	1/9/18
	11/9/17	36,635	449,299	1/9/18
C Plater	13/9/15	16,095	112,494	1/9/18
	12/9/16	33,930	312,499	1/9/18
	11/9/17	27,519	337,499	1/9/18
I Saines	13/9/15	41,133	287,495	1/9/18
	12/9/16	17,643	162,494	1/9/18
	11/9/17	17,326	212,490	1/9/18
A Tobin	13/9/15	28,614	199,995	1/9/18
	12/9/16	24,429	224,994	1/9/18
	11/9/17	19,365	237,496	1/9/18

1 Ms Murphy transferred to a KMP role on 12 December 2018; grant and vesting of awards prior to that are not required to be disclosed.

4 Remuneration report (continued)

4.8 Key Management Personnel remuneration arrangements (continued)

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 2019 are detailed below, together with TSR performance outcomes.

Total shareholder return outcomes for all HPSRs vested during the year range between 17% and 26% per annum and are significantly above the internal performance hurdles and external market benchmarks over these timeframes. As a result of this TSR performance, all eligible HPSRs vested during the year.

It should be noted that due to a deterioration in TSR performance across 2019, no HPSRs will vest in September 2019.

	Grant details			Vesting details				
KMP[1]	Grant Date	Number	Fair value at grant[2] $	Vesting Date	Number vested	TSR outcome per annum	Number vested or lapsed in prior years	Number yet to vest or lapse
R Howes	16/9/14	225,066	727,713	1/9/18	75,022	17%	150,044	-
	13/9/15	277,073	862,499	1/9/18	175,840	26%	-	101,233
B Benari	16/9/14	419,089	1,355,054	1/9/18	139,697	17%	279,392	-
	13/9/15	530,053	1,649,999	1/9/18	336,391	26%	-	193,662
C Plater	16/9/14	93,441	302,126	1/9/18	31,147	17%	62,294	-
	13/9/15	108,420	337,500	1/9/18	68,807	26%	-	39,613
I Saines	4/3/15	204,383	749,996	1/9/18	74,850	25%	129,533	-
	13/9/15	277,073	862,499	1/9/18	175,840	26%	-	101,233
A Tobin	16/9/14	147,457	476,777	1/9/18	49,153	17%	98,304	-
	13/9/15	192,746	599,998	1/9/18	122,324	26%	-	70,422

[1] Ms Murphy transferred to a KMP role on 12 December 2018; grant and vesting of awards prior to that are not required to be disclosed.
[2] 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.

Share Rights held

Performance Share Rights held

Details of KMP DPSRs and HPSRs held as at 30 June 2019 are set out below:

KMP	Instrument	Number held at 1 July 2018	Number granted as remuneration	Number vested	Number held at 30 June 2019
R Howes	DPSRs	209,278	102,719	(110,730)	201,267
	HPSRs	739,899	189,833	(250,862)	678,870
B Benari	DPSRs	326,478	150,704	(158,755)	318,427
	HPSRs	1,427,235	363,511	(476,088)	1,314,658
A Murphy[1]	DPSRs	-	-	-	39,536
	HPSRs	-	-	-	131,998
C Plater	DPSRs	153,953	88,011	(77,544)	164,420
	HPSRs	422,130	161,560	(99,954)	483,736
I Saines	DPSRs	131,863	67,273	(76,102)	123,034
	HPSRs	571,256	133,287	(250,690)	453,853
A Tobin	DPSRs	135,503	68,479	(72,408)	131,574
	HPSRs	494,393	133,287	(171,477)	456,203

[1] Ms Murphy transferred to a KMP role on 12 December 2018; grant and vesting of awards prior to that are not required to be disclosed.

4 Remuneration report (continued)

4.8 Key Management Personnel remuneration arrangements (continued)

Key Management Personnel and their affiliates' shareholdings in Challenger Limited

Details of KMP and their affiliates' shareholdings in Challenger Limited as at 30 June 2019 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. Mr Howes and Mr Tobin, hold substantially more than the minimum requirement as at 30 June 2019 and all other current KMP remain within their transition period.

							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
R Howes[2]	2019	100,000	361,592	-	461,592	201,267	3.1	4.4
	2018	100,000	474,282	(474,282)	100,000	209,278	1.6	4.9
B Benari[3]	2019	-	-	-	-	-	-	-
	2018	1,000,000	746,991	(746,991)	1,000,000	326,478	8.9	11.8
A Murphy[4]	2019	-	-	-	-	39,536	-	0.5
	2018	-	-	-	-	-	-	-
C Plater	2019	27,347	177,498	(150,000)	54,845	164,420	0.5	2.0
	2018	3,385	236,067	(212,105)	27,347	153,953	0.5	3.1
I Saines	2019	171,498	326,792	(498,290)	-	123,034	-	1.0
	2018	12,161	159,337	-	171,498	131,863	2.4	4.2
A Tobin	2019	320,880	243,885	(200,000)	364,765	131,574	3.5	4.7
	2018	298,341	287,539	(265,000)	320,880	135,503	5.5	7.8
Total	2019	619,725	1,109,767	(848,290)	881,202	658,831		
	2018	1,413,887	1,904,216	(1,698,378)	1,619,725	957,075		

[1] Shareholding multiple based on 30 June 2019 closing share price of $6.64 (30 June 2018: $11.83).
[2] Mr Howes was appointed Managing Director & Chief Executive Officer on 2 January 2019
[3] Mr Benari transferred to a non-KMP role on 2 January 2019 as transition to retirement.
[4] Ms Murphy transferred to a KMP role on 12 December 2018 and has a five year transition period in which to acquire the required shareholding.

Richard Howes – Managing Director & CEO

Mr Howes was appointed Managing Director & CEO effective 2 January 2019. 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 Howes upon termination.

	Notice period	Payment in lieu of notice	Eligibility for STI	Treatment of unvested performance rights
Bad leaver termination[1]	Employee initiated: 6 months Employer initiated (Poor performance): 12 months	The Board may elect to make a payment of salary package in lieu of notice	No	Lapse
	Employer initiated (Misconduct): None	None		
Good leaver termination[2]	Employee initiated: 6 months Employee initiated (Material Change[3]): 1 month Employer initiated: 12 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	Continued vesting[4]

[1] Bad leaver termination will occur where employment is terminated by Challenger for poor performance, misconduct or resignation without the prior approval of the Board.
[2] Good leaver termination will occur if employment ends in any circumstances that do not constitute a bad leaver termination.
[3] Material Change means where there is a substantial diminution of Mr Howes' duties, status, responsibilities and/or authority arising without his agreement.
[4] Unvested Performance rights will remain on foot subject to the specified time based vesting conditions and/or performance hurdles and to the rules of the CPP.

4 Remuneration report (continued)

4.8 Key Management Personnel remuneration arrangements (continued)

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

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

Upon termination, if the KMP is considered a good leaver (such as cessation of employment due to redundancy), they will be entitled to a pro rata STI award. Board discretion applies in relation to unvested awards under the CPP issued for awards prior to 30 June 2019. Awards issued under the CPP from 1 July 2019 onwards are subject to specific good leaver conditions specified at the time of grant.

Loans and other transactions

There were no loans made to Directors or key executives as at 30 June 2019 (30 June 2018: nil). From time to time, Directors of the Company or their Director related entities may purchase products from the Company. These purchases are on the same arm's length terms and conditions as those offered to other employees or customers.

4.9 Non-Executive Director disclosures

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 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 for the Chair of the Group Risk Committee and the Group Audit Committee increased. All other Board fees remain unchanged for the year ended 30 June 2019.

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 2019. All amounts are inclusive of superannuation, where applicable.

	2019 fee structure		2018 fee structure	
Board/Committee	Chair fee[2] $	Member fee $	Chair fee[2] $	Member fee $
Board[1]	525,500	179,000	525,500	179,000
Group Risk	47,000	14,000	30,000	14,000
Group Audit	47,000	14,000	30,000	14,000
Remuneration	47,000	23,500	47,000	23,500

[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.

4 Remuneration report (continued)

4.9 Non-Executive Director disclosures (continued)

Non-Executive Director fees for the year ended 30 June 2019

The following table summarises Non-Executive Director fees for the year ended 30 June 2019.

Non-Executive Director	Year	Director fees $	Superannuation $	Total $
P Polson	2019	504,969	20,531	525,500
	2018	505,451	20,049	525,500
G Cubbin[1,2]	2019	86,638	-	86,638
	2018	267,750	-	267,750
J M Green[3]	2019	203,660	19,348	223,008
	2018	95,543	9,077	104,620
S Gregg	2019	236,631	20,398	257,029
	2018	186,834	17,749	204,583
J Grunzweig[1,4]	2019	-	-	-
	2018	77,534	-	77,534
B Shanahan[5]	2019	-	-	-
	2018	69,254	6,579	75,833
J Stephenson	2019	245,280	20,531	265,811
	2018	238,951	20,049	259,000
D West[1,6]	2019	146,569	-	146,569
	2018	-	-	-
M Willis[3]	2019	210,198	19,772	229,970
	2018	95,543	9,077	104,620
L Zwier[1]	2019	179,000	-	179,000
	2018	179,000	-	179,000
Total	2019	1,812,945	100,580	1,913,525
	2018	1,715,860	82,580	1,798,440

[1] Mr Cubbin, Mr Grunzweig, Mr West and Mr Zwier provide services through companies. Fees exclude GST.
[2] Mr Cubbin retired from the Board on 26 October 2018. The 2019 remuneration reflects fees earned on a pro-rata basis.
[3] Mr Green and Ms Willis were appointed as Directors on 6 December 2017. The 2018 remuneration reflects fees earned on a pro-rata basis.
[4] Mr Grunzweig retired from the Board on 6 December 2017. The 2018 remuneration reflects fees earned on a pro-rata basis.
[5] Ms Shanahan retired from the Board on 26 October 2017. The 2018 remuneration reflects fees earned on a pro-rata basis.
[6] Mr West was appointed as a director on 10 September 2018. The 2019 remuneration reflects fees earned on a pro-rata basis.

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)

4.9 Non-Executive Director disclosures (continued)

Non-Executive Director shareholdings in Challenger Limited at 30 June 2019

Details of the Non-Executive Directors' 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	2019	122,000	-	122,000
	2018	122,000	-	122,000
G Cubbin[1,2]	2019	97,878	(97,878)	-
	2018	97,797	81	97,878
J M Green	2019	-	10,000	10,000
	2018	-	-	-
S Gregg[3]	2019	14,000	-	14,000
	2018	10,000	4,000	14,000
J Grunzweig[4]	2019	-	-	-
	2018	250	(250)	-
B Shanahan[4]	2019	-	-	-
	2018	252,112	(252,112)	-
J Stephenson[3]	2019	15,000	-	15,000
	2018	13,000	2,000	15,000
D West	2019	-	18,957	18,957
	2018	-	-	-
M Willis	2019	149,892	-	149,892
	2018	-	149,892	149,892
L Zwier	2019	7,360	-	7,360
	2018	7,360	-	7,360
Total	2019	406,130	(68,921)	337,209
	2018	502,519	(96,389)	406,130

[1] An affiliate of Mr Cubbin received as an employee 6,653 performance share rights during the year.
[2] Mr Cubbin retired from the Board on 26 October 2018, so his holding disclosure is removed under 'movements'.
[3] Due to significant share price movement during 2019, Mr Gregg and Ms Stephenson's shareholding do not currently satisfy the minimum shareholding requirements.
[4] Ms Shanahan retired from the Board on 26 October 2017 and Mr Grunzweig retired from the Board on 6 December 2017 and so the holding disclosures for each director have been removed under 'movements'.

Total remuneration of KMP and Non-Executive Directors

KMP and Non-Executive Directors	Short-term benefits $	Post-employment benefits $	Share-based payments $	Other benefits $	Termination benefits $	Total $
Non-Executive Directors						
2019	1,812,945	100,580	-	-	-	1,913,525
2018	1,715,860	82,580	-	-	-	1,798,440
KMP						
2019	6,766,774	103,870	7,722,428	354,813	-	14,947,885
2018	7,373,153	100,245	8,815,992	644,673	-	16,934,063
All KMP and Non-Executive Directors						
2019	8,579,719	204,450	7,722,428	354,813	-	16,861,410
2018	9,089,013	182,825	8,815,992	644,673	-	18,732,503

4 Remuneration report (continued)

4.10 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 established in 2006 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. The Board has discretion to amend or withdraw DPSRs at any point.
Face value	The number of DPSRs granted to KMP is determined based on the face value of the shares using a five-day Volume Weighted Average Price (VWAP) prior to the grant date. The number of Hurdled Performance Share Rights granted to KMP from 1 July 2019 is determined based on the face value of the shares using a five-day Volume Weighted Average Price (VWAP) prior to the grant date.
Fair value	The number of HPSRs awarded to KMP prior to 1 July 2019 was 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 as their responsibilities provide them with the opportunity to materially influence long-term performance, strategy and shareholder value. The Board has discretion to amend or withdraw HPSRs 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*.
LTI	*Long term incentive*. LTIs are awarded annually to KMP to support a continued focus on long-term performance outcomes. Executives will only realise value from LTIs if total shareholder returns exceed the hurdles set, ensuring a direct link between executive reward and shareholder outcomes.
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 fair value amortisation expense of share-based awards granted up to balance sheet date, 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 five-day VWAP is used to calculate the number of DPSRs per dollar of deferred STI. A five-day VWAP is used to calculate the number of HPSRs per dollar of LTI. 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 that is fraudulent, dishonest, criminal, malicious or a reckless act, error or omission.

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

Some members of the Group act 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

At the date of this financial report, no matter or circumstance has arisen that has affected, or may significantly affect, the Group's operations, the results of those operations or the Group's state of affairs in future financial years which has not already been reflected in this report.

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 2019 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 2001* and did not compromise the auditor independence requirements of the *Corporations Act 2001* 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 Authorisation

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

P Polson
Independent Chair

Sydney
12 August 2019

R Howes
Managing Director & Chief Executive Officer

Sydney
12 August 2019

12 Auditor's independence declaration

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

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 2019, 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

T Johnson
Partner

Sydney
12 August 2019

Sustainability

At Challenger, being sustainable is about addressing environmental, social and governance (ESG) opportunities and risks that have the potential to affect its vision to provide financial security for customers.

Challenger's sustainability strategy supports the delivery of its business strategy and highlights its commitment to:

- responsible business practices that focus on our customers, employees, shareholders and the environment;
- taking action on issues affecting the ability of retirees to achieve financial security; and
- helping our customers and communities to be strong and financially resilient.

Challenger's 2019 Sustainability Report reflects its approach to sustainability and is available from the company website:

› challenger.com.au

This report focuses on the first full year of implementation of Challenger's new sustainability strategy and highlights progress made against each of its priority areas.

This year, Challenger engaged with internal and external stakeholders to identify material areas of importance to both the business and its stakeholders. Responding to the material matters identified, supports the achievement of the UN Sustainable Development Goals (SDGs).

Complementing this, is a continuing focus on employee engagement, diversity and inclusion, risk management and managing Challenger's impact on the environment.

Material matters

Trust and confidence

Maintaining stakeholder trust and confidence is critical to Challenger's ability to deliver for its customers, shareholders, employees and the broader community. Earning public trust requires Challenger to set and maintain high standards of conduct, provide open, transparent and continuous disclosure, to ensure the security of its customers' information, and to contribute to industry-wide sustainability commitments.

Long-term risk management

How Challenger manages risk in the long term is central to providing secure and stable income to its customers. To match the long-dated annuities sold, Challenger invests in a diversified portfolio of assets. Taking a long-term view also involves investing responsibly and anticipating current and long-term impacts such as climate change.

People and culture

A strong risk culture and highly engaged workforce is critical to success. Challenger seeks to provide an engaged and enabled workforce that embraces diverse thinking and has positive labour practices. Focusing on diversity, wellbeing, leadership and talent are important elements of this.

Changing operating environment

Challenger works within a complex operating landscapes. This includes working closely with distribution and product partners, fund managers and financial advisers, all of which have been impacted by a changing regulatory and market environment.

Retirement policy setting

As a retirement income provider, Challenger plays a key role in contributing to fiscally responsible solutions that help fund an ageing population.

There is broad agreement across industry and government that the retirement phase of the superannuation system is underdeveloped and that reform is needed. Challenger is engaging broadly to contribute to this fundamental public policy process.

Great customer experiences

Challenger is committed to providing great customer experiences and to providing its customers with financial security for retirement. To deliver this, Challenger invests in customer research; provides education for advisers and customers on how annuities help provide a sustainable retirement income; designs products to meet customers' needs; and provides trusted products and services.

Supporting the community

Financial services play a key role in communities – affecting environmental and social change. Through its giving and volunteering programs and plans for future community activities, Challenger aims to connect with and support the communities in which it operates.

Providing a great workplace

Challenger aspires to create an environment where employees are highly engaged and its teams can thrive.

Challenger's 2019 sustainable engagement score was 84%; a level of engagement well above both the Australian National and Global Financial Services norms. Challenger recognises that strong employee engagement achieves higher employee retention, attracts talent and can lead to better customer and shareholder outcomes.

Challenger also understands that having healthy employees benefits both business and the broader community. The Wellbeing@Challenger program seeks to support its employees inside and outside of work. The goals of the program are:

- Health – promoting physical and mental wellbeing by providing access to health experts and creating awareness;
- Life – providing flexibility for employees to manage the demands of both work and their personal lives;
- Financial – supporting employees with financial tools to enable them to achieve sustained financial security;
- Community – providing opportunities for employees to support and engage with the community; and
- Work – maintaining a safe and connected environment where employees can work effectively to achieve their goals.

Sustainability (continued)

Diversity and inclusion

Creating a diverse and inclusive workplace is key to Challenger's strategic approach to its employees. Challenger seeks to create an inclusive workforce and values the capability and experience that diversity brings to the organisation. It also believes that to provide the best services and outcomes for its customers, it must attract and retain talented people.

Challenger's Diversity Policy outlines its commitment to treat employees fairly, equally and with respect when employment and career decisions are made. Challenger sets measurable objectives for continuous monitoring to ensure that the policy remains effective.

Challenger believes that gender equality is essential in creating a truly diverse and inclusive workplace and is committed to achieving gender equality. 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 a diversity scorecard.

For the second year, Challenger has been awarded an Employer of Choice for Gender Equality (EOCGE) citation by the Workplace Gender Equality Agency (WGEA). This citation provides valuable public recognition of Challenger's commitment to gender equality and reflects the growing commitment to workplace gender equality in Australia.

Complementing this, in 2019 Challenger became a partner of Future IM/Pact, an industry initiative aimed at attracting more talented women into the investment management industry.

Challenger is also in the second year of its Women Leading @Challenger program. Using a strengths-based approach, this program aims to accelerate the development of female talent across the organisation.

Risk is everyone's business

Effective risk management is fundamental to Challenger's business and to building shareholder value. At Challenger, risk is everybody's business.

The Board's Risk Appetite Statement outlines the level of risk that is acceptable to the business to achieve its strategic objectives. Guiding its broader suite of policies, the statement provides clear boundaries on acceptable risk-taking activities across the organisation.

As a participant in the financial services industry, Challenger is impacted by a wide range of risks, including investment and pricing risk; licence and regulatory risk; funding and liquidity risk; strategic, business and reputation risk; climate change risk; and operational risk.

The Board is committed to ensuring effective risk management. The Leadership Team is accountable for managing identified key risks and is required to manage risk as part of business objectives with risk management integrated across business processes.

Challenger considers sustainability to be an important part of its broader risk management framework and has in place a range of policies and practices to ensure that sustainability risks are carefully considered when making key business decisions.

More detailed information about Challenger's risk management approach is provided in the 2019 Sustainability Report.

Managing Challenger's impact on the environment

Challenger is committed to reducing the impacts it operations have on the environment. Through its sustainability strategy, Challenger focuses on programs that deliver improved environmental impacts.

This year, Challenger added resourcing to the investments business to enhance its focus on environmental, social and governance risks across its investment decision making practices.

In terms of understanding the impact of emissions from its direct operations, Challenger has continued its commitment to improved transparency. It engaged with an external party to compile a scope 1, 2 and 3 greenhouse gas emissions profile, which was audited by a third party. All emissions associated with its direct operations were offset, contributing to climate protection projects worldwide.

Employees at Challenger are passionate about supporting the community and environment. The Sustainability Action Group was launched in 2017 and continues to innovate ways for Challenger to improve its environmental impacts and engage in community initiatives.

Challenger's full commitment to sustainability is outlined in the 2019 Sustainability Report, which can be viewed at:

› challenger.com.au/sustainabilityreport2019

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Statement of comprehensive income

For the year ended 30 June	Note	2019 $m	2018 $m
Revenue	1	2,372.6	2,190.5
Expenses	2	(1,571.4)	(1,536.6)
Finance costs	15	(385.6)	(265.5)
Share of profits of associates	23	22.2	30.0
Profit before income tax		**437.8**	**418.4**
Income tax expense	4	(127.1)	(94.6)
Profit for the year after income tax		**310.7**	**323.8**
Profit attributable to shareholders of Challenger Limited		307.8	322.5
Profit attributable to non-controlling interests		2.9	1.3
Profit for the year after income tax		**310.7**	**323.8**
Other comprehensive income			
Items that may be reclassified to profit and loss, net of tax			
Translation of foreign entities	14	35.4	18.5
Hedge of net investment in foreign entities	14	(34.7)	(16.6)
Cash flow hedges – SPV[1]	14	(0.2)	0.5
Other comprehensive income for the year		0.5	2.4
Total comprehensive income for the year after tax		**311.2**	**326.2**
Comprehensive income attributable to shareholders of Challenger Limited		308.3	324.9
Comprehensive income attributable to non-controlling interests		2.9	1.3
Total comprehensive income for the year after tax		**311.2**	**326.2**
Earnings per share attributable to ordinary shareholders of Challenger Limited		Cents	Cents
Basic	17	50.9	54.0
Diluted	17	44.8	52.2

[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	2019 $m	2018 $m
Assets			
Cash and cash equivalents	11	725.4	741.7
Cash and cash equivalents – SPV	7	66.5	97.3
Receivables		580.0	436.5
Current tax assets	4	2.7	-
Derivative assets	10	762.5	421.1
Financial assets – fair value through profit and loss	5	19,929.6	17,591.6
Investment property held for sale	6	166.5	452.2
Investment and development property	6	3,562.7	3,583.7
Mortgage assets – SPV	7	860.6	1,044.5
Finance leases		49.5	50.8
Property, plant and equipment		28.6	161.4
Investment in associates	23	58.1	62.4
Other assets		76.6	50.6
Goodwill	25	557.3	571.6
Deferred tax assets	4	7.0	13.8
Other intangible assets	25	23.9	21.3
Total assets of shareholders of Challenger Limited and non-controlling interests		27,457.5	25,300.5
Liabilities			
Payables		1,168.2	642.1
Current tax liability	4	-	0.9
Derivative liabilities	10	569.2	453.0
Interest bearing financial liabilities	13	6,313.1	5,773.1
Interest bearing financial liabilities – SPV	7	763.4	959.8
External unit holders' liabilities	9	1,966.2	2,135.0
Provisions		19.2	20.6
Deferred tax liabilities	4	165.2	101.9
Life contract liabilities	8	12,870.2	11,728.3
Total liabilities of shareholders of Challenger Limited and non-controlling interests		23,834.7	21,814.7
Net assets of shareholders of Challenger Limited and non-controlling interests		3,622.8	3,485.8
Equity			
Contributed equity	12	2,093.7	2,051.7
Reserves	14	(52.4)	(33.3)
Retained earnings	14	1,559.0	1,467.0
Total equity of shareholders of Challenger Limited		3,600.3	3,485.4
Non-controlling interests		22.5	0.4
Total equity of shareholders of Challenger Limited and non-controlling interests		3,622.8	3,485.8

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

Statement of changes in equity

For the year ended 30 June 2018	Note	Contributed equity $m	Share-based payment reserve $m	Cash flow hedge reserve –SPV $m	Foreign currency translation reserve $m	Adjusted controlling interest reserve $m	Retained earnings $m	Total shareholder equity $m	Non-controlling interests $m	Total equity $m
		Attributable to shareholders of Challenger Limited								
Balance at 1 July 2017		1,554.5	(23.2)	(0.2)	(5.2)	12.1	1,350.1	2,888.1	13.2	2,901.3
Profit for the year	14	-	-	-	-	-	322.5	322.5	1.3	323.8
Other comprehensive income for the year		-	-	0.5	1.9	-	-	2.4	-	2.4
Total comprehensive income for the year		**-**	**-**	**0.5**	**1.9**	**-**	**322.5**	**324.9**	**1.3**	**326.2**
Other equity movements										
Ordinary shares issued	12	506.6	-	-	-	-	-	506.6	-	506.6
Treasury shares purchased	12	(49.4)	-	-	-	-	-	(49.4)	-	(49.4)
Treasury shares vested	12	48.5	-	-	-	-	-	48.5	-	48.5
Deferred Treasury share purchases	12	(47.4)	-	-	-	-	-	(47.4)	-	(47.4)
Settled forward purchases of Treasury shares	12	38.9	-	-	-	-	-	38.9	-	38.9
Share-based payment expense net of tax less releases	14	-	(19.8)	-	-	-	-	(19.8)	-	(19.8)
Dividends paid	16	-	-	-	-	-	(205.6)	(205.6)	-	(205.6)
Other movements		-	-	-	-	0.6	-	0.6	(14.1)	(13.5)
Balance at 30 June 2018 and 1 July 2018		**2,051.7**	**(43.0)**	**0.3**	**(3.3)**	**12.7**	**1,467.0**	**3,485.4**	**0.4**	**3,485.8**
For the year ended 30 June 2019										
Profit for the year	14	-	-	-	-	-	307.8	307.8	2.9	310.7
Other comprehensive income for the year		-	-	(0.2)	0.7	-	-	0.5	-	0.5
Total comprehensive income for the year		**-**	**-**	**(0.2)**	**0.7**	**-**	**307.8**	**308.3**	**2.9**	**311.2**
Other equity movements										
Ordinary shares issued	12	6.8	-	-	-	-	-	6.8	-	6.8
Treasury shares purchased	12	(32.8)	-	-	-	-	-	(32.8)	-	(32.8)
Treasury shares vested	12	42.7	-	-	-	-	-	42.7	-	42.7
Deferred Treasury share purchases	12	(7.5)	-	-	-	-	-	(7.5)	-	(7.5)
Settled forward purchases of Treasury shares	12	32.8	-	-	-	-	-	32.8	-	32.8
Share-based payment expense net of tax less releases	14	-	(14.7)	-	-	-	-	(14.7)	-	(14.7)
Dividends paid	16	-	-	-	-	-	(215.8)	(215.8)	-	(215.8)
Other movements		-	-	-	-	(4.9)	-	(4.9)	19.2	14.3
Balance at 30 June 2019		**2,093.7**	**(57.7)**	**0.1**	**(2.6)**	**7.8**	**1,559.0**	**3,600.3**	**22.5**	**3,622.8**

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	2019 $m	2018 $m
Operating activities			
Receipts from customers		673.8	652.4
Annuity and premium receipts	8	3,565.4	4,017.3
Annuity and claim payments	8	(3,246.0)	(2,969.4)
Payments to reinsurer	8	(58.7)	(6.1)
Receipts from external unit holders		1,006.9	1,554.9
Payments to external unit holders		(1,388.8)	(1,215.1)
Payments to vendors and employees		(600.3)	(594.7)
Dividends received		105.6	94.8
Interest received		804.2	770.7
Interest paid		(154.4)	(129.9)
Income tax paid		(55.4)	(197.5)
Net cash inflows from operating activities	11	652.3	1,977.4
Investing activities			
Payments on net purchases of investments		(1,096.2)	(2,460.1)
Net proceeds from sale of controlled entities		255.9	-
Net mortgage loan repayments		145.0	213.1
Payments for net purchases of property, plant and equipment		(59.9)	(69.9)
Payments for purchase of associate interest		(5.1)	(3.3)
Net cash outflows from investing activities		(760.3)	(2,320.2)
Financing activities			
Proceeds from issue of ordinary shares		6.8	506.6
Net proceeds from borrowings – interest bearing financial liabilities	13	317.4	280.4
Payments for Treasury shares		(47.5)	(36.7)
Net dividends paid		(215.8)	(205.6)
Net cash inflows from financing activities		60.9	544.7
Net (decrease)/increase in cash and cash equivalents		(47.1)	201.9
Cash and cash equivalents at the beginning of the year		839.0	637.1
Cash and cash equivalents at the end of the year		791.9	839.0

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

Section 1: Basis of preparation and overarching significant accounting policies

Challenger Limited (the Company or the parent entity) is a company limited by shares, incorporated and domiciled 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 2019 was authorised for issue in accordance with a resolution of the Directors of the Company on 12 August 2019.

(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, 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 policies

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 amendments to existing accounting standards that were effective from 1 July 2018 but do not have a material impact on the financial statements.

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 standard makes changes to the classification of financial assets for the purpose of determining their measurement basis, as well as the recognition of changes in fair values. 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. In addition, there are also 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 assessment and concluded that no material adjustments were required 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 Contracts* and as permitted under both AASB 139 and AASB 9. The impact to the Group from the adoption of the expected credit loss model on the *Mortgage assets – SPV* is minimal because the historical provisioning methodology of the Group is materially consistent with the provision estimated under the expected credit loss model.

AASB 15 *Revenue from Contracts with Customers*

The new revenue standard establishes a single, comprehensive framework for revenue recognition and is 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 assessment on existing revenue streams and concluded that no material adjustments were required as a result of complying with the new requirements. The majority of Funds Management fee revenue is accrued when earned and the adoption of AASB 15 does not have a significant impact on the accounting policies or the amounts recognised. Life revenue is mainly derived from income on financial instruments and life insurance contract premiums which are not within the scope of the standard.

Accounting standards and interpretations issued but not yet effective

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 onto the statement of financial position. The standard will be effective for the Group from 1 July 2019 and the Group has not early adopted.

The majority of leases from the lessee's 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 has elected to apply the partial retrospective approach. At 1 July 2019, the Group is expected to recognise approximately $40.0 million as a 'right-of-use' asset in addition to an existing $22.0 million of fixed assets (net of accumulated depreciation) on the statement of financial position, together with a related lease liability of $75.0 million. This is subject to the relevant contracts remaining in force at transition.

(ii) New and revised accounting standards and policies (continued)

AASB 17 *Insurance Contracts*

AASB 17 *Insurance Contracts* replaces AASB 4 *Insurance Contracts*, AASB 1038 *Life Insurance Contracts* and AASB 1023 *General Insurance Contracts* and is effective for Challenger from 1 July 2022. AASB 17 *Insurance Contracts* establishes globally consistent principles for the recognition, measurement, presentation and disclosure of life insurance contracts issued. Life investment contracts are currently measured under the financial instruments standard and will continue to be measured in the same way on adoption of its replacement standard, AASB 9 *Financial Instruments*.

AASB 17 introduces changes to the profit emergence profiles of life insurance contracts but does not affect the underlying economics or cash flows of the contracts. The impacts on capital requirements and income tax are unknown, pending regulatory responses from APRA and the Australian Taxation Office (ATO) respectively.

The main changes anticipated for the Group under AASB 17 are set out below:

- insurance contract portfolios will be disaggregated to more granular levels and will be required not only by risk type but also by issue year and profitability;
- although conceptually similar, the Contractual Service Margin uses a different basis to recognise profit to the current Margin on Services approach and therefore the profit signature is likely to change for portfolios with positive profit margins;
- a new risk adjustment for non-financial risk will be introduced which reflects the compensation that the Group requires for bearing the uncertainty in relation to the amount and timing of cash flows. The confidence level used to determine the risk adjustment will need to be disclosed;
- an accounting policy choice will be available to recognise all insurance finance income and expenses (e.g. discount rate changes) in the statement of comprehensive income; and
- additional disclosures will be more extensive, requiring increased granularity and more analysis of movements.

The Group has conducted a business impact assessment and key recommendations will be implemented ahead of the standard being introduced.

The standard is expected to impact the Group's profit and loss, however, it is not yet practicable to determine the quantum.

AASB Interpretation 23 Uncertainty over Income Tax Treatment

The Interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of AASB 112 *Income Taxes* and does not apply to taxes or levies outside the scope of AASB 112, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The Interpretation specifically addresses the following:

- whether an entity considers uncertain tax treatments separately;
- the assumptions an entity makes about the examination of tax treatments by taxation authorities;
- how an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates; and
- how an entity considers changes in facts and circumstances.

An entity has to determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The interpretation is effective for annual reporting periods beginning on or after 1 July 2019. The Group will apply the interpretation from its effective date. No material impact is expected.

Existing standards and interpretations not yet effective

Other amendments to existing standards or interpretations that are not yet effective are not expected to result in a material impact to the Group's financial statements.

(iii) Comparatives

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

(iv) 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 ASIC Corporations Instrument 2016/191.

(v) 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 functional 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.

Foreign controlled entities (continued)

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.

(vi) Finance leases

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

(vii) Property, plant and equipment

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

Infrastructure property, plant and equipment

Infrastructure property, plant and equipment are stated at cost and amortised on a straight line basis over their expected useful life. This is done on an asset by asset basis with amortisation commencing when the asset is available for use. The expected useful life of current infrastructure property, plant and equipment is 20 years.

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

Any impairment losses recognised in prior periods are reversed through the Statement of Comprehensive income if there has been a change in the estimated useful life used to determine the asset's recoverable amount since the last impairment loss was recognised. The increased carrying amount of an asset attributable to a reversal of an impairment loss would not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

(viii) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. A provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Future operating costs are not provided for.
When the Group expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognised as a separate asset only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of comprehensive income net of any reimbursement.

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

(ix) 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 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.

(x) Receivables

Receivables are recognised at amortised cost using the effective interest method, less any allowance for expected credit losses. The entity has applied a simplified approach to measuring expected credit losses, which uses a lifetime expected loss allowance. To measure the expected credit losses, receivables have been grouped based on days overdue.

(xi) 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.

(xii) 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.

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 2019 $m	30 June 2018 $m
Investment revenue		
Fixed income securities and cash		
Interest revenue[1]	890.9	839.1
Net realised and unrealised gains on fixed income securities	714.0	64.1
Investment property and property securities		
Property rental revenue	318.6	330.5
Dividend revenue	8.0	21.6
Net realised and unrealised gains on investment property and property securities	60.7	159.8
Revenue from sale of development properties	-	26.2
Equity and infrastructure investments		
Dividend revenue	51.4	58.5
Net realised and unrealised gains/(losses) on equity investments	0.7	(32.9)
Net realised and unrealised gains/(losses) on infrastructure investments	128.1	(5.9)
Other		
Net realised and unrealised gains on foreign exchange translation and hedges	26.5	29.4
Net realised and unrealised losses on interest rate derivatives	(186.8)	(56.3)
Net realised and unrealised losses on equity swap derivatives	(25.3)	(3.3)
Net realised and unrealised gains/(losses) on credit default swap derivatives	13.1	(8.2)
Fee revenue		
Management and performance fee revenue	176.2	167.7
Transaction fee revenue	47.6	39.2
Other revenue		
Life insurance contract premiums and related revenue	1,143.5	1,452.7
Change in life insurance contract liabilities	(916.5)	(939.9)
Change in life investment contract liabilities	(98.3)	48.1
Change in reinsurance contract liabilities	20.2	0.1
Total revenue	2,372.6	2,190.5

[1] Interest revenue earned for items measured at amortised cost using the effective interest method $57.1 million (30 June 2018: $70.7 million) and interest revenue earned for items measured at fair value through profit and loss $833.8 million (30 June 2018: $768.4 million).

Accounting policy

Revenue is recognised at an amount that reflects the consideration to which the Group expects to be entitled in exchange for transferring services to a customer. 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. The effective interest rate is the rate that discounts estimated future cash flows through the expected life of a financial instrument or where appropriate a shorter period.
- 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.

Note 1 Revenue (continued)

Accounting policy (continued)

- Lease incentives granted are recognised as an integral part of the total rental income. Operating lease rental income is recognised on a straight line basis over the life of the contract.
- Dividend revenue from listed equity shares and listed property securities is recognised as income on the date the share is quoted ex-dividend. Dividend revenue from unlisted equity shares and unlisted property securities is recognised when the dividend is declared.
- Management fees are invoiced quarterly based on a percentage of the funds under management (FUM). The fees relate specifically to the services provided in that quarter, and are distinct from services provided in other quarters.
- Performance fees are based on returns in excess of a specified benchmark market return, over the contract period. Performance fees are typically received at the end of the performance period specified in the contract.

  The Company recognises revenue from performance fees over the contract period, but only to the extent that it is highly probable that a significant reversal of revenue will not occur in subsequent periods.
- Transaction fee revenue is accrued when the transaction is executed.
- 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 details on the accounting policy of life contract liabilities.

Note 2 Expenses

	30 June 2019 $m	30 June 2018 $m
Life insurance contract claims and expenses	634.0	499.2
Cost of life insurance contract liabilities	179.9	191.3
Cost of life investment contract liabilities	214.2	232.5
Reinsurance contracts	2.0	2.3
Investment property related expenses[1]	109.5	113.8
Development properties cost of sales	0.1	26.5
Management fee expense	107.5	109.6
Distribution expenses	47.8	49.9
Employee expenses	156.8	163.5
Employee share-based payments and superannuation	30.1	31.8
Occupancy expense – operating lease	12.2	11.8
Depreciation and amortisation expense	15.3	16.0
Technology and communications	25.2	24.0
Professional fees	18.4	21.0
Impairment loss on equity accounted associates	-	1.9
Other expenses	18.4	41.5
Total expenses	1,571.4	1,536.6

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

Accounting policy

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 details on the accounting policy of life contract liabilities.

Note 3 Segment information

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

	Life		Funds Management		Total reporting segments		Corporate and other[2]		Total	
For the year ended 30 June	2019 $m	2018 $m	2019 $m	2018 $m	2019 $m	2018 $m	2019 $m	2018 $m	2019 $m	2018 $m
Net income	670.1	669.6	149.9	151.2	820.0	820.8	1.0	1.0	821.0	821.8
Operating expenses	(106.5)	(106.9)	(99.0)	(93.3)	(205.5)	(200.2)	(61.9)	(68.2)	(267.4)	(268.4)
Normalised EBIT	**563.6**	**562.7**	**50.9**	**57.9**	**614.5**	**620.6**	**(60.9)**	**(67.2)**	**553.6**	**553.4**
Interest and borrowing costs	-	-	-	-	-	-	(5.3)	(6.1)	(5.3)	(6.1)
Normalised net profit/(loss) before tax	**563.6**	**562.7**	**50.9**	**57.9**	**614.5**	**620.6**	**(66.2)**	**(73.3)**	**548.3**	**547.3**
Tax on normalised profit									(152.2)	(141.2)
Normalised net profit after tax									**396.1**	**406.1**
Investment experience after tax									(88.3)	(76.0)
Significant items after tax									-	(7.6)
Profit attributable to the shareholders of Challenger Ltd									**307.8**	**322.5**
Other statutory segment information										
Revenue from external customers[3]	1,305.5	1,183.4	176.2	167.7	1,481.7	1,351.1	-	0.3	1,481.7	1,351.4
Interest revenue	889.9	838.0	-	-	889.9	838.0	1.0	1.1	890.9	839.1
Interest expense	(343.7)	(223.3)	-	(0.6)	(343.7)	(223.9)	(41.9)	(41.6)	(385.6)	(265.5)
Intersegment revenue	(46.4)	(40.8)	46.4	40.8	-	-	-	-	-	-
Depreciation and amortisation	(5.7)	(5.7)	(0.6)	(0.3)	(6.3)	(6.0)	(9.0)	(10.0)	(15.3)	(16.0)
As at 30 June										
Segment assets	19,712.8	18,594.6	253.3	245.2	19,966.1	18,839.8	7,468.9	6,460.3	27,435.0	25,300.1
Segment liabilities	(16,393.9)	(15,389.7)	(27.3)	(34.5)	(16,421.2)	(15,424.2)	(7,413.5)	(6,390.5)	(23,834.7)	(21,814.7)
Net assets attributable to shareholders	**3,318.9**	**3,204.9**	**226.0**	**210.7**	**3,544.9**	**3,415.6**	**55.4**	**69.8**	**3,600.3**	**3,485.4**

[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.
[3] Funds management revenue from external customers is predominantly management fees.

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 Pty Limited (provision of self-managed superannuation fund actuarial certificates). CLC offers fixed rate retirement and superannuation products that are designed for Australian investors who are seeking a low-risk, fixed term or lifetime investment and reliable income. CLC also offers fixed term and lifetime investments to investors in Japan through its reinsurance arrangement with MSP. 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. 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.

Note 3 Segment information (continued)

Definitions (continued)

Corporate and other

The corporate segment, which is not considered an operating segment of the Group, is used to reconcile the total segment results back to the consolidated results and 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.

Transactions between segments

All transactions and transfers between segments are generally determined on an arm's length basis and are included within the relevant categories of income and expense. These transactions eliminate on consolidation.

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, significant items 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 and 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 life contract valuation changes and new business strain. 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 and other investments, +4.0% for infrastructure, +2.0% for property and -0.35% for cash and fixed income and are consistent with the rates applied in the prior year. The rates have been set with reference to medium to long-term market growth rates and are reviewed to ensure consistency with prevailing market conditions. The normalised growth rate for equity and other investments has been revised to +3.5% for the year beginning 1 July 2019.

Life contract valuation assumption changes represent the impact of changes in macroeconomic variables, including bond yields and inflation factors, expense assumptions 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 for hedging.

New business strain is a non-cash valuation adjustment recognised when annuity rates on new business are higher than the risk-free rate used to fair value life contracts. Maintenance expense allowances over the expected future term of the new business are also included in the life contract valuation. New business strain reported in the period represents the valuation loss on new sales generated in the current period net of the reversal of new business strain of prior period sales.

Note 3 Segment information (continued)

Definitions (continued)

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. There have been no non-recurring or abnormal items classified as significant items for the period ended 30 June 2019 in accordance with the definition.

Major customers

No individual customer amounted to greater than 10% of the Group's revenue.

Geographical areas

The Group operates predominantly in Australia; hence, no geographical split is provided to the chief operating decision maker.

	30 June 2019 $m	30 June 2018 $m
Reconciliation of management to statutory view of after-tax profit		
Operating segments normalised net profit before tax	614.5	620.6
Corporate and other normalised net loss before tax	(66.2)	(73.3)
Normalised net profit before tax (management view of pre-tax profit)	**548.3**	**547.3**
Tax on normalised profit	(152.2)	(141.2)
Normalised net profit after tax	**396.1**	**406.1**
Investment experience after tax	(88.3)	(76.0)
Significant items after tax	-	(7.6)
Profit attributable to the shareholders of Challenger Limited	**307.8**	**322.5**
Profit attributable to non-controlling interests excluded from management view	2.9	1.3
Statutory view of profit after tax	**310.7**	**323.8**
Reconciliation of management view of revenue to statutory revenue		
Operating segments	820.0	820.8
Corporate and other	1.0	1.0
Net income (management view of revenue)	**821.0**	**821.8**
Expenses and finance costs offset against revenue		
SPV expenses and finance costs offset against SPV income	23.1	28.1
Distribution expenses offset against related income	47.8	49.9
Change in life contract liabilities and reinsurance contracts recognised in expenses	1,030.1	925.3
Property related expenses offset against property income	109.5	113.8
Interest and loan amortisation costs	320.5	195.4
Management fee expenses	107.5	109.6
Adjustment for non-controlling interests and other items	16.6	50.5
Difference between management view of investment experience and statutory recognition		
Actual capital growth	79.1	61.0
Normalised capital growth	(155.1)	(130.5)
Life contract valuation experience	5.8	24.5
New business strain	(33.3)	(58.9)
Statutory revenue (refer Note 1 Revenue)	**2,372.6**	**2,190.5**

Note 4 Income tax

Reconciliation of income tax expense	30 June 2019 $m	30 June 2018 $m
Profit before income tax	437.8	418.4
Prima facie income tax based on the Australian company tax rate of 30%	(131.3)	(125.5)
Tax effect of amounts not assessable/deductible in calculating taxable income:		
– Challenger Capital Notes distributions	(9.9)	(9.7)
– non-assessable and non-deductible items	12.4	30.1
– tax rate differentials	4.5	7.8
– tax adjustment in respect of non-controlling interests	0.9	0.4
– other items	(3.7)	2.3
Income tax expense	(127.1)	(94.6)
Underlying effective tax rate[1]	29.2%	22.7%

[1] The calculation of the underlying effective tax rate excludes the non-controlling interests' profit of $2.9 million (30 June 2018: $1.3 million).

Analysis of income tax expense	30 June 2019 $m	30 June 2018 $m
Current income tax expense for the year	(65.6)	(99.6)
Current income tax benefit prior year adjustment	4.9	5.0
Deferred income tax expense	(57.8)	(2.3)
Deferred income tax (expense)/benefit prior year adjustment	(8.6)	2.3
Income tax expense	(127.1)	(94.6)
Income tax expense on translation of foreign entities	(14.3)	(9.0)
Income tax benefit on hedge of net investment in foreign operations	14.9	7.1
Income tax benefit/(expense) from other comprehensive income	0.6	(1.9)

	Statement of financial position		Statement of comprehensive income	
Analysis of deferred tax	30 June 2019 $m	30 June 2018 $m	30 June 2019 $m	30 June 2018 $m
Deferred tax assets				
Accruals and provisions	39.1	28.2	10.9	(0.4)
Employee entitlements	4.0	3.8	0.1	0.1
Losses	11.3	25.3	(14.0)	3.9
Other	9.7	11.2	(2.8)	(13.5)
Total deferred tax assets	64.1	68.5	(5.8)	(9.9)
Set off of deferred tax assets	(57.1)	(54.7)		
Net deferred tax assets recognised in statement of financial position	7.0	13.8		
Deferred tax liabilities				
Unrealised foreign exchange movements	(19.0)	0.3	(20.0)	12.8
Unrealised net gains on investments	(183.1)	(142.4)	(35.0)	(2.6)
Other	(20.2)	(14.5)	(5.6)	(0.3)
Total deferred tax liabilities	(222.3)	(156.6)	(60.6)	9.9
Set off of deferred tax liabilities	57.1	54.7		
Net deferred tax liabilities recognised in statement of financial position	(165.2)	(101.9)		
Deferred income tax expense recognised in statement of comprehensive income			(66.4)	-

Note 4 Income tax (continued)

Tax Transparency Code Disclosures

Australia and overseas tax expense	30 June 2019 $m	30 June 2018 $m	Change $m
Total Australia	(117.6)	(91.5)	(26.1)
Total overseas	(9.5)	(3.1)	(6.4)
Income tax expense	(127.1)	(94.6)	(32.5)

Analysis of current tax (asset)/liability	30 June 2019 $m	30 June 2018 $m
Opening balance	0.9	107.6
Current income tax expense for the year	65.6	99.6
Current income tax prior year adjustment	(4.9)	(5.0)
Tax in equity	(5.5)	(2.9)
Income tax paid	(55.4)	(197.5)
Other	(3.4)	(0.9)
Closing balance	(2.7)	0.9

Unrecognised deferred tax balances	30 June 2019 $m	30 June 2018 $m
Non-tax consolidated group revenue losses – tax effected	2.9	19.3
Tax consolidated group capital losses – tax effected	54.8	55.8

Accounting policy

Income tax expense

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

Current tax assets and liabilities for the current and prior periods are the amounts 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 assets and liabilities

Deferred income tax is provided on 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 assets and liabilities are recognised for deductible or taxable temporary differences and are measured at the tax rates that are expected to apply to the year the asset is realised or the liability is settled, based on the tax rates (and tax laws) that have been enacted or substantially enacted as at the statement of financial position date. Deferred income tax assets and liabilities have been offset where they relate to income tax levied by the same taxation authority on either the same taxable entity or different taxable entities within the same taxable group who have a legal right and an intention to settle on a net basis.

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.

Key estimates and assumptions

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Section 3: Operating assets and liabilities

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

Note 5 Financial assets – fair value through profit and loss

	30 June 2019 $m	30 June 2018 $m
Domestic sovereign bonds and semi-government bonds	5,486.8	6,003.9
Floating rate notes and corporate bonds	7,798.5	5,602.4
Residential mortgage and asset-backed securities	4,044.4	3,466.8
Non-SPV mortgage assets	272.8	208.6
Fixed income securities	17,602.5	15,281.7
Shares in listed and unlisted corporations	96.1	69.7
Unit trusts, managed funds and other	1,236.1	1,073.6
Equity securities	1,332.2	1,143.3
Units in listed and unlisted infrastructure trusts	542.5	479.6
Other infrastructure investments	324.6	304.3
Infrastructure investments	867.1	783.9
Indirect property investments in listed and unlisted trusts	127.8	382.7
Property securities	127.8	382.7
Total financial assets – fair value through profit and loss	19,929.6	17,591.6
Current	9,985.2	7,628.1
Non-current	9,944.4	9,963.5
	19,929.6	17,591.6

Accounting policy

The Group categorises its financial assets as financial assets – fair value through profit and loss (being initially designated as such). 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.

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;
- option pricing models refined to reflect the issuer's specific circumstances;
- discounted cash flow analysis; or
- other methods consistent with market best practice.

Refer to Note 18 Financial risk management for further disclosure.

Note 6 Investment and development property

	30 June 2019 $m	30 June 2018 $m
Investment property held for sale[1]	166.5	452.2
Investment property in use	3,384.3	3,328.6
Investment property under development	178.4	254.4
Total investment property	**3,729.2**	**4,035.2**
Development property held for resale[2]	-	0.7
Total investment and development property[3]	**3,729.2**	**4,035.9**

[1] Held for sale properties: Next Hotel, Aulnay sous Bois and TRE Data Centre (30 June 2018: 35 Clarence Street and 53 Albert Street).
[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.

	Investment property held for sale		Investment property in use		Investment property under development		Development property held for resale	
Reconciliation of carrying amounts	30 June 2019 $m	30 June 2018 $m	30 June 2019 $m	30 June 2018 $m	30 June 2019 $m	30 June 2018 $m	30 June 2019 $m	30 June 2018 $m
Balance at the beginning of the year	452.2	96.0	3,328.6	3,359.4	254.4	144.1	0.7	29.4
Movements for the year								
– acquisitions[1]	-	-	-	184.0	1.8	2.1	-	-
– disposals	(236.2)	(89.3)	(443.6)	-	-	-	(0.7)	(25.6)
– net transfers to/(from) investment property held for sale	(60.0)	445.3	60.0	(445.3)	-	-	-	-
– transfers to/(from) investment property under development	10.5	-	239.3	(57.3)	(249.8)	62.0	-	(4.7)
– capital expenditure	-	0.2	102.3	85.2	164.6	49.2	-	1.3
– net revaluation gain/(loss)	-	-	39.5	169.1	7.4	(3.0)	-	0.3
– foreign exchange gain	-	-	58.2	33.5	-	-	-	-
Balance at the end of the year	166.5	452.2	3,384.3	3,328.6	178.4	254.4	-	0.7

[1] Investment property acquisitions: Acquisition of 839 Collins EXO Car Park $1.8 million during the period (30 June 2018: 14 Childers Street, ACT $97.1 million, North Rocks, NSW (additional land parcel) $2.1 million and TR Mall Ryugasaki, Japan $86.9 million).

Accounting policy

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.

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 to occur in the next 12 months. 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 gain or loss on the retirement or disposal of an investment property is 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)

Accounting policy (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.

Key estimates and assumptions

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 and on the basis that they are engaged for no longer than two consecutive years on an individual property.

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). An internal valuation is undertaken for all investment properties every six months unless they have been independently valued during the current reporting period. In certain circumstances an independent valuation might be obtained.

Fair value for the purposes of the valuation is market value as defined by the International Assets Valuation Standards Committee. In determining market value, valuers examine available market evidence and apply this analysis to both the traditional market capitalisation approach and the discounted cash flow approach (using market-determined risk-adjusted discount rates). Valuers are required to provide valuation methodology and calculations for fair value including reference to annual net market income, comparable capitalisation rates, and property-specific adjustments. The values of investment property do not reflect anticipated enhancement from future capital expenditure.

Note 6 Investment and development property (continued)

Analysis of investment property as at 30 June	Acquisition date[1]	Total cost[2] $m	Carrying value 2019 $m	Cap rate 2019[3] %	Last external valuation date	Carrying value 2018 $m	Cap rate 2018[3] %
Investment property in use and held for sale							
Australia							
14 Childers Street, ACT	01-Dec-17	97.3	92.5	6.50	30-Jun-19	92.2	6.75
21 O'Sullivan Circuit, NT	27-Jan-16	47.7	36.7	8.00	31-Dec-18	39.3	8.00
31 O'Sullivan Circuit, NT	27-Jan-16	29.2	26.5	8.25	31-Dec-18	25.9	8.25
31 Queen Street, VIC	31-Mar-11	-	-	-	-	164.5	5.25
35 Clarence Street, NSW	15-Jan-15	147.1	220.0	5.13	30-Jun-19	216.0	5.13
53 Albert Street, QLD	12-Dec-14	-	-	-	-	236.2	5.88
82 Northbourne Avenue, ACT	01-Jun-17	60.9	55.4	6.00	31-Dec-18	57.5	6.00
215 Adelaide Street, QLD	31-Jul-15	249.7	245.5	6.00	30-Jun-19	231.5	6.25
565 Bourke Street, VIC	28-Jan-15	102.1	142.0	5.00	30-Jun-19	107.0	5.50
839 Collins Street, VIC	22-Dec-16	212.0	232.5	4.88	30-Jun-19	-	-
ABS Building, ACT	01-Jan-00	149.0	219.2	5.75	31-Dec-18	177.0	5.75
The Barracks, QLD	31-Oct-14	-	-	-	-	151.5	6.25
Bunbury Forum, WA	03-Oct-13	155.1	90.0	6.75	30-Jun-19	125.0	6.50
Channel Court, TAS	21-Aug-15	83.4	80.0	7.00	30-Jun-19	82.5	7.00
Cosgrave Industrial Park, Enfield, NSW	31-Dec-08	92.3	122.0	5.50	30-Jun-19	110.1	6.07
County Court, VIC	30-Jun-00	217.6	323.9	n/a	31-Dec-18	306.7	6.13
DIBP (formerly DIAC) Building, ACT	01-Dec-01	108.4	156.7	5.50	31-Dec-18	149.0	5.50
Discovery House, ACT	28-Apr-98	97.4	148.5	5.63	31-Dec-18	131.0	5.63
Executive Building, TAS	30-Mar-01	34.5	45.3	7.00	31-Dec-18	43.0	7.50
Gateway, NT	1-Jul-15	121.1	118.5	5.85	31-Dec-18	107.6	5.75
Golden Grove, SA	31-Jul-14	156.1	171.4	5.75	31-Dec-18	159.8	6.00
Karratha, WA	28-Jun-13	55.0	49.0	7.25	30-Jun-19	53.0	7.00
Kings Langley, NSW	29-Jul-01	16.2	23.9	6.25	30-Jun-19	23.9	6.25
Lennox, NSW	27-Jul-13	28.6	31.5	6.50	30-Jun-19	36.3	6.00
Makerston House, QLD	14-Dec-00	-	-	-	-	70.7	7.38
Next Hotel, QLD	25-Mar-15	143.7	145.3	6.11	30-Jun-19	132.0	6.17
TRE Data Centre, ACT	14-Apr-10	13.9	10.5	-	30-Jun-19	-	-
Total Australia		2,418.3	2,786.8			3,029.2	

[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 2019 $m	Cap rate 2019[3] %	Last external valuation date	Carrying value 2018 $m	Cap rate 2018[3] %
Europe							
Rue Charles Nicolle, Villeneuve les Beziers	31-Dec-08	-	-	-	-	14.1	7.00
Avenue de Savigny, Aulnay sous Bois	31-Dec-08	20.3	10.7	6.53	30-Jun-19	12.5	6.50
105 Route d'Orleans, Sully sur Loire	31-Dec-08	-	-	-	-	9.5	8.00
140 Rue Marcel Paul, Gennevilliers	31-Dec-08	-	-	-	-	10.8	7.25
ZAC Papillon, Parcay-Meslay	31-Dec-08	-	-	-	-	8.1	7.25
Japan							
Aeon Kushiro	31-Jan-10	30.5	37.8	5.40	30-Jun-19	34.8	5.40
Carino Chitosedai	31-Jan-10	118.4	138.9	4.50	31-Dec-18	129.6	4.60
Carino Tokiwadai	31-Jan-10	77.0	85.3	4.60	30-Jun-19	81.0	4.60
DeoDeo Kure	31-Jan-10	32.2	34.4	5.50	30-Jun-19	30.7	5.50
Fitta Natalie Hatsukaichi	28-Aug-15	11.4	14.7	5.90	31-Dec-18	13.9	5.80
Izumiya Hakubaicho	31-Jan-10	68.8	79.8	4.80	31-Dec-18	71.8	4.90
Kansai Super Saigo	31-Jan-10	13.1	14.4	5.50	31-Dec-18	13.4	5.50
Kojima Nishiarai	31-Jan-10	12.2	16.1	4.40	30-Jun-19	14.9	4.30
Life Asakusa	31-Jan-10	27.8	38.0	4.30	30-Jun-19	34.6	4.40
Life Higashi Nakano	31-Jan-10	32.9	40.9	4.40	30-Jun-19	36.7	4.50
Life Nagata	31-Jan-10	25.2	30.0	4.20	30-Jun-19	28.2	4.90
MaxValu Tarumi	28-Aug-15	16.9	20.0	5.70	31-Dec-18	18.9	5.70
Seiyu Miyagino	31-Jan-10	9.8	11.8	5.20	30-Jun-19	10.7	5.30
TR Mall Ryugasaki	30-Mar-18	86.7	98.4	5.70	31-Dec-18	89.9	5.60
Valor Takinomizu	31-Jan-10	26.9	25.5	5.80	31-Dec-18	24.7	5.70
Valor Toda	31-Jan-10	42.5	45.9	5.20	30-Jun-19	44.6	5.40
Yaoko Sakato Chiyoda	31-Jan-10	19.6	21.4	4.80	31-Dec-18	18.2	4.90
Total international		672.2	764.0			751.6	
Total investment property in use and held for sale[4]		3,076.6	3,540.3			3,780.8	
Investment property under development							
Australia							
839 Collins Street, VIC[5]	22-Dec-16	-	-	-	-	74.9	-
Gateway, NT[5]	01-Jul-15	-	-	-	-	15.0	-
North Rocks, NSW	18-Sep-15	180.2	173.7	6.50	30-Jun-19	146.1	-
TRE Data Centre, ACT[5]	14-Apr-10	-	-	-	-	13.5	-
Maitland, NSW	6-Dec-06	5.4	4.7	-	-	4.9	-
Total investment property under development		185.6	178.4			254.4	
Development property held for resale							
Australia							
Maitland, NSW	06-Dec-06	-	-	-	-	0.7	-
Total development property		-	-		-	0.7	-

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 2019, the investment property portfolio occupancy rate for Australia was 92.6% (30 June 2018: 92.5%) with a weighted average lease expiry of 6.1 years (30 June 2018: 5.4 years), Europe 100.0% (30 June 2018: 100.0%) with a weighted average lease expiry of 0.1 years (30 June 2018: 1.2 years) and Japan 100% (30 June 2018: 100%) with a weighted average lease expiry of 10.3 years (30 June 2018: 11.1 years).
5 Transferred to investment property in use and held for sale.

Note 7 Special Purpose Vehicles

Consolidated	30 June 2019 $m	30 June 2018 $m
Cash and cash equivalents	66.5	97.3
Mortgage assets[1]	860.6	1,044.5
Derivative assets	0.5	0.5
Total assets	**927.6**	**1,142.3**
Payables	163.7	182.0
Derivative liabilities	0.3	0.2
Interest bearing financial liabilities[1]	763.4	959.8
Total liabilities	**927.4**	**1,142.0**
Net assets	**0.2**	**0.3**
Cash flow hedge reserve	0.2	0.3
Total equity attributable to residual income unit holders	**0.2**	**0.3**

[1] $209.7 million (30 June 2018: $257.4 million) of the Mortgage assets balance is considered current, and $186.0 million (30 June 2018: $236.6 million) of the Interest bearing financial liabilities balance is considered current.

Accounting policy

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 initially recognised at fair value and subsequently 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 net of any credit loss provision.

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 impact to the Group from the adoption of the expected credit loss model on the mortgage assets is minimal because the historical provisioning methodology of the Group is materially consistent with the provision estimated under the expected credit loss model.

Analysis of SPV mortgage assets impairment provision	30 June 2019 $m	30 June 2018 $m
Balance at the beginning of the year	13.6	30.1
(Decrease)/increase in provisions	(3.9)	0.7
Utilisation of provision against incurred losses and adjustments to estimates	0.5	(17.2)
Balance at the end of the year	**10.2**	**13.6**

Note 8 Life contract liabilities

Fair value of life contract liabilities	30 June 2019 $m	30 June 2018 $m
Life investment contract liabilities – at fair value	6,757.7	6,635.3
Life insurance contract liabilities – at margin on services value	6,113.1	5,016.7
Reinsurance contract liabilities – at margin on services value	(0.6)	76.3
Total life contract liabilities	12,870.2	11,728.3

	Life investment contract liabilities		Life insurance contract liabilities		Outward reinsurance contract liabilities		Total life contract liabilities	
Movement in life contract liabilities	30 June 2019 $m	30 June 2018 $m	30 June 2019 $m	30 June 2018 $m	30 June 2019 $m	30 June 2018 $m	30 June 2019 $m	30 June 2018 $m
Balance at the beginning of the year	6,635.3	6,356.5	5,016.7	3,885.5	76.3	80.2	11,728.3	10,322.2
Deposits and premium receipts	2,421.9	2,564.6	1,143.5	1,452.7	-	-	3,565.4	4,017.3
Payments and withdrawals	(2,612.0)	(2,470.2)	(634.0)	(499.2)	(58.7)	(6.1)	(3,304.7)	(2,975.5)
Revenue per Note 1	98.3	(48.1)	(227.0)	(512.8)	(20.2)	(0.1)	(148.9)	(561.0)
Expense per Note 2	214.2	232.5	813.9	690.5	2.0	2.3	1,030.1	925.3
Balance at the end of the year	6,757.7	6,635.3	6,113.1	5,016.7	(0.6)	76.3	12,870.2	11,728.3

Analysis of life insurance and reinsurance contract liability and expenses	30 June 2019 $m	30 June 2018 $m
Best estimate liability		
Value of future life insurance contract benefits	5,849.8	4,854.7
Value of future expenses	159.8	148.9
Value of future acquisition expenses	134.9	110.7
Value of future premiums	(526.6)	(494.0)
Total best estimate liability	5,617.9	4,620.3
Value of future profit margins	494.6	472.7
Net life insurance and reinsurance contract liability	6,112.5	5,093.0
Life insurance and reinsurance contract operating expenses		
Maintenance expenses	43.7	39.3
Total life insurance and reinsurance contract operating expenses	43.7	39.3
Analysis of life contract profit		
Profit margin release on life insurance contracts	19.9	11.7
Loss recognition in respect of life insurance contracts[1]	(76.8)	(95.4)
Loss recognition in respect of life investment contracts	(68.9)	(81.0)
Difference in actual and assumed experience in respect of life insurance contracts	176.0	157.2
Difference in actual and assumed experience in respect of life investment contracts	174.1	199.6
Profit arising from difference between actual and assumed experience	224.3	192.1
Investment earnings on assets in excess of life contract liabilities	172.2	173.5
Life contract profit after tax	396.5	365.6

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

Note 8 Life contract liabilities (continued)

Accounting policy

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 immediately. 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 (premiums, 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, mortality, surrenders, 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.

Inwards reinsurance

The Group has maintained inwards 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.

Outwards reinsurance

The Group maintained outwards reinsurance arrangements to manage longevity risk in respect of part of the closed book of individual lifetime annuities. During the year, one of these arrangements was recaptured resulting in the partial derecognition of the outward reinsurance liability balance.

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, longevity reinsurance and wholesale lifetime annuities. Annuity payments are used as the profit carrier for 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

Tax rates

The bases of taxation (including deductibility of expenses) are assumed to continue in accordance with legislation current at the reporting date.

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 9 *Financial Instruments*. The discount rates are determined based on the current observable, objective rates that relate to the nature, structure and term of the future liability cash flows.

For both insurance and investment contracts the approach is the same as adopted at 30 June 2018. Discount rates applied for Australian liabilities were between 1.5%-2.5% (30 June 2018: 2.4%-3.7%) per annum.

Note 8 Life contract liabilities (continued)

Valuation (continued)

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

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.

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 1.2% per annum for short-term inflation and 1.6% per annum for long-term inflation (30 June 2018: 1.7% short-term, 2.3% long-term).

Surrenders

For life investment contracts, no surrenders or voluntary discontinuances are assumed. For Australian life insurance contracts where a surrender value is payable on withdrawal, a rate of surrenders is assumed in line with Challenger's own experience on these products, currently between 1.3%-1.7% per annum (30 June 2018: 1.3%-1.7%). 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 (30 June 2018: 3.5%).

Where policyholders have the option to commute a life insurance contract, the value of this option is included within the life contract liabilities. We also assume surrender rates based on past experience for this business which vary by product types and duration in-force for the contract.

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. For the age ranges and cash flow projection periods that contribute the majority of CLC's exposure, rates of future mortality improvement applied are between 0.3%-2.6% per annum (30 June 2018: 0.0%-2.2%).

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). Rates are adjusted for expected future mortality improvements based on observed and expected improvements.

For the age ranges and cash flow projection periods that contribute the majority of CLC's exposure, rates of future mortality improvement applied are between 0.6%-2.1% per annum (30 June 2018: 0.6%-2.1%). Base mortality rates for the inwards reinsurance 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

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.

Statutory fund information

The life contract operations of CLC are conducted within four separate statutory funds. 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 outwards reinsurance, plus the wholesale mortality, wholesale morbidity and longevity inwards reinsurance. Fund 4 contains inwards reinsurance of annuity business written in Japan.

Life contract liabilities for Funds 1, 2, 3 and 4 are $2.0 million, $11,649.0 million, $2.9 million and $1,216.3 million respectively (30 June 2018: $2.4 million, $10,688.0 million, $2.9 million, and $1,035.0 million).

Current/non-current split for total life contracts

There is a fixed settlement date for the majority of life contract liabilities. Approximately $2,428.7 million on a discounted basis (30 June 2018: $2,080.6 million) of life contract liabilities have a contractual maturity within 12 months of the reporting date. Based on assumptions applied for the 30 June 2019 valuation of life contract liabilities, $3,046.8 million of principal payments on fixed term and lifetime business are expected in the year to 30 June 2020 (expected in the year to 30 June 2019: $2,687.3 million).

Note 8 Life contract liabilities (continued)

Life insurance risk

The Group is exposed to longevity risk on its individual lifetime annuities (both direct and reinsured) 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 reinsurance 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 maintained reinsurance arrangements to manage longevity risk in respect of part of the closed book of individual lifetime annuities.

One of these arrangements was discontinued in 2019 resulting in the Group being exposed to the longevity risk in respect to those closed books of individual lifetime annuities. The Group manages the mortality and morbidity risk by regular reviews of the portfolio to ensure that mortality and morbidity assumptions remain appropriate. The Company's insurance risk policy is approved by the Board and sets out the relevant risk limits for insurance exposures, to ensure the insurance risk portfolio is appropriately diversified and contains no significant concentrations of insurance risk.

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				Loss after tax and equity impact			
	Gross		Net		Gross		Net	
Insurance risk sensitivity analysis	30 June 2019 $m	30 June 2018 $m	30 June 2019 $m	30 June 2018 $m	30 June 2019 $m	30 June 2018 $m	30 June 2019 $m	30 June 2018 $m
50% increase in the rate of mortality improvement	29.1	32.3	29.0	16.9	(20.3)	(22.6)	(20.3)	(11.8)
10% increase in maintenance expenses	15.2	13.8	15.2	13.8	(10.6)	(9.7)	(10.6)	(9.7)

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
2019	672.7	1,129.0	871.6	4,449.5	7,122.8
2018	598.7	1,029.6	769.1	3,953.1	6,350.5

Actuarial information

Mr A Kapel 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, APRA Prudential Standards, AASB 1038 *Life Insurance Contracts*, and AASB 9 *Financial Instruments*.

Note 9 External unit holders' liabilities

	30 June 2019 $m	30 June 2018 $m
Current	1,356.4	1,451.0
Non-current	609.8	684.0
Total liabilities to external unit holders	**1,966.2**	**2,135.0**

Accounting policy

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 represent the funds owing to third parties on these mandates. The liability is recognised at fair value.

Note 10 Derivative financial instruments

	30 June 2019			30 June 2018		
Analysis of derivative financial instruments	Notional value $m	Net fair value assets $m	Net fair value liabilities $m	Notional value $m	Net fair value assets $m	Net fair value liabilities $m
Non-SPV						
Interest rate swaps						
Less than one year	5,597.8	8.2	(3.2)	4,544.8	3.4	(3.1)
One to three years	9,363.0	23.6	(13.6)	8,288.1	31.1	(14.6)
Three to five years	5,415.3	61.0	(29.5)	2,492.9	22.7	(22.9)
Greater than five years	25,152.0	352.4	(272.2)	10,538.1	200.7	(124.7)
Total interest rate swaps	**45,528.1**	**445.2**	**(318.5)**	**25,863.9**	**257.9**	**(165.3)**
Inflation-linked swaps						
Less than one year	384.0	12.0	-	1,018.4	10.0	(1.1)
One to three years	221.5	6.4	-	262.0	4.2	-
Three to five years	245.6	5.8	-	243.1	-	(1.3)
Greater than five years	1,394.1	111.6	(36.9)	1,014.1	25.5	(12.4)
Total inflation-linked swaps	**2,245.2**	**135.8**	**(36.9)**	**2,537.6**	**39.7**	**(14.8)**
Futures contracts						
Less than one year	10,838.2	-	(0.9)	10,706.5	-	(0.6)
Total futures contracts	**10,838.2**	**-**	**(0.9)**	**10,706.5**	**-**	**(0.6)**
Forward currency contracts						
Less than one year	2,005.7	16.6	(9.9)	3,975.5	33.5	(34.5)
Total forward currency contracts	**2,005.7**	**16.6**	**(9.9)**	**3,975.5**	**33.5**	**(34.5)**
Cross-currency swaps						
Less than one year	1,546.1	26.7	(113.4)	625.6	4.1	(10.7)
One to three years	1,762.6	10.4	(55.7)	1,324.4	20.3	(121.6)
Three to five years	2,140.6	17.7	(19.3)	2,509.5	7.7	(66.0)
Greater than five years	1,041.5	10.5	(6.5)	530.1	4.1	(10.5)
Total cross-currency swaps	**6,490.8**	**65.3**	**(194.9)**	**4,989.6**	**36.2**	**(208.8)**
Equity swaps						
Less than one year	1,118.0	0.8	(7.7)	1,792.9	6.0	(28.8)
One to three years	836.3	7.8	-	-	-	-
Total equity swaps	**1,954.3**	**8.6**	**(7.7)**	**1,792.9**	**6.0**	**(28.8)**
Infrastructure swaps						
Less than one year	200.0	-	-	-	-	-
Total infrastructure swaps	**200.0**	**-**	**-**	**-**	**-**	**-**

Note 10 Derivative financial instruments (continued)

Analysis of derivative financial instruments (continued)	30 June 2019 Notional value $m	30 June 2019 Net fair value assets $m	30 June 2019 Net fair value liabilities $m	30 June 2018 Notional value $m	30 June 2018 Net fair value assets $m	30 June 2018 Net fair value liabilities $m
Credit default swaps						
Less than one year	10.0	-	(0.1)	40.6	0.2	-
One to three years	66.9	1.0	-	10.0	-	-
Three to five years	1,638.8	88.9	-	858.6	46.5	-
Total credit default swaps	1,715.7	89.9	(0.1)	909.2	46.7	-
Options						
Less than one year	1.1	-	-	3.6	0.6	-
One to three years	2.5	0.6	-	-	-	-
Total options	3.6	0.6	-	3.6	0.6	-
Total non-SPV	70,981.6	762.0	(568.9)	50,778.8	420.6	(452.8)
SPV						
Interest rate swaps – SPV						
Less than one year	6.5	-	(0.1)	7.9	-	(0.1)
One to three years	5.7	-	(0.1)	9.9	-	-
Three to five years	0.2	-	-	0.5	-	-
Total interest rate swaps – SPV	12.4	-	(0.2)	18.3	-	(0.1)
Cross-currency swaps – SPV						
Greater than five years	320.3	0.5	(0.1)	401.6	0.5	(0.1)
Total cross-currency swaps – SPV	320.3	0.5	(0.1)	401.6	0.5	(0.1)
Total – SPV	332.7	0.5	(0.3)	419.9	0.5	(0.2)
Total derivative financial instruments[1]	71,314.3	762.5	(569.2)	51,198.7	421.1	(453.0)

[1] The Group's derivative financial instruments are subject to enforceable netting arrangements under International Swaps and Derivatives Association (ISDA) Master Agreements with derivative counterparties, 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 $342.2 million (30 June 2018: $235.3 million) and the derivative liabilities would reduce by $342.2 million (30 June 2018: $235.3 million).

Accounting policy

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.

Note 10 Derivative financial instruments (continued)

Accounting policy (continued)

Fair value hedges (continued)

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.

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 the statement of 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 2019, a post-tax loss of $34.7 million (30 June 2018: post-tax loss of $16.6 million) was recognised in other comprehensive income (OCI) 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 OCI.

For the year ended 30 June 2019, a post-tax loss of $0.2 million (30 June 2018: post-tax gain of $0.5 million) was recognised in OCI for cash flow hedges with no statement of comprehensive income impact in relation to any ineffective portions during either the current or prior comparative period.

Note 11 Notes to statement of cash flows

Reconciliation of profit to operating cash flow	30 June 2019 $m	30 June 2018 $m
Profit for the year	310.7	323.8
Adjusted for		
Net realised and unrealised gains on investment assets	(731.0)	(172.9)
Share of associates' net profit	(22.2)	(30.0)
Change in life contract liabilities[1]	881.2	364.3
Depreciation and amortisation expense	15.3	16.0
Impairment in associates and other investments	(20.4)	13.3
Share-based payments	21.4	23.7
Dividends from associates	31.6	21.9
Change in operating assets and liabilities		
Decrease in receivables	36.9	24.1
(Increase)/decrease in other assets	(6.4)	1.8
(Decrease)/increase in payables	(21.8)	5.3
(Decrease)/increase in provisions	(1.4)	7.1
Increase in life contract liabilities	260.7	1,041.8
(Decrease)/increase in external unit holders' liabilities	(168.8)	447.2
Increase/(decrease) in net tax liabilities	66.5	(110.0)
Net cash flows from operating activities	652.3	1,977.4

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

Reconciliation of cash	30 June 2019 $m	30 June 2018 $m
Cash at bank and on hand	725.4	741.7
Cash at bank and on hand – SPV	66.5	97.3
Total cash and cash equivalents[1]	791.9	839.0

[1] All cash and cash equivalents are considered current.

Accounting policy

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 and carried at fair value. 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 2019		30 June 2018	
	No. of shares m	Value of shares $m	No. of shares m	Value of shares $m
Analysis of contributed equity				
Ordinary shares issued and fully paid	611.6	2,155.3	610.9	2,148.5
CPP Trust shares treated as Treasury shares	(3.0)	(30.5)	(4.4)	(40.4)
CPP deferred share purchases treated as Treasury shares	(2.8)	(31.1)	(4.8)	(56.4)
Total contributed equity	**605.8**	**2,093.7**	**601.7**	**2,051.7**
Movements in contributed equity				
Ordinary shares				
Balance at the beginning of the year	610.9	2,148.5	572.0	1,641.9
Equity placement	-	-	38.3	499.7
Issued under dividend reinvestment plan	0.7	6.8	0.6	6.9
Balance at the end of the year	**611.6**	**2,155.3**	**610.9**	**2,148.5**
CPP Trust				
Balance at the beginning of the year	4.4	40.4	5.3	39.5
Shares purchased (including settled forwards)	2.8	32.8	4.8	49.4
Vested shares released to employees	(4.2)	(42.7)	(5.7)	(48.5)
Balance at the end of the year	**3.0**	**30.5**	**4.4**	**40.4**
CPP deferred share purchases				
Balance at the beginning of the year	4.8	56.4	4.8	47.9
CPP deferred share purchases	0.8	7.5	4.0	47.4
Settled forward purchases	(2.8)	(32.8)	(4.0)	(38.9)
Balance at the end of the year	**2.8**	**31.1**	**4.8**	**56.4**

Accounting policy

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. All of the Group regulated entities have at all times during the current and prior financial year complied with the externally imposed capital requirements to which they are subject.

Internal Capital Adequacy Assessment Process (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 the measurement, management, monitoring and reporting of 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. There has been no further update from APRA in relation to this position.

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+' (positive) and 'A' (positive) respectively (30 June 2018: 'BBB+' (positive) and 'A' (positive) 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 between 45% - 50% of normalised profit after tax over the medium term, subject to prevailing market conditions and alternate uses of capital.

The dividend payout ratio for the year ended 30 June 2019 was 54.2% of normalised profit after tax (30 June 2018: 52.1%). The payout ratio is currently above the target reflecting the resilience during the year of Challenger's business and strong capital position.

Dividend Reinvestment Plan (DRP)

The Company maintained a DRP during the period. On 26 September 2018, the Company issued 329,710 ordinary shares to shareholders under the DRP. The DRP issue price per share for the 2018 final dividend was $10.4334 and represents the volume weighted average share price over the ten trading days from 5 to 18 September 2018. The DRP participation rate was 3.1% of all issued shares, resulting in proceeds of $3.4 million.

For the interim 2019 dividend, the Company issued 411,192 ordinary shares on 26 March 2019. The DRP issue price per share for the interim 2019 dividend was $8.1695 and represents the volume weighted average share price over the 10 trading days from 1 to 14 March 2019. The interim DRP participation rate was 3.1% of all issued shares, resulting in proceeds of $3.4 million.

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 in accordance with prudential capital 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 2019 was 1.53 times (30 June 2018: 1.53 times), reflecting changes in asset allocation, net AUM growth, increased common equity Tier 1 capital and changes in retained earnings.

Note 12 Contributed equity (continued)

Capital management (continued)

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 2019 $m	30 June 2018 $m
CLC's regulatory capital		
Common Equity Tier 1 regulatory capital	2,789.4	2,677.8
Additional Tier 1 regulatory capital	805.0	805.0
Tier 2 regulatory capital – subordinated debt[1]	405.3	405.4
CLC total regulatory capital base	**3,999.7**	**3,888.2**
Prescribed capital amount		
Asset risk charge[2]	2,539.5	2,484.8
Insurance risk charge[3]	135.3	70.0
Operational risk charge	51.8	46.4
Aggregation benefit	(104.0)	(54.8)
CLC prescribed capital amount	**2,622.6**	**2,546.3**
CLC excess over prescribed capital amount	**1,377.1**	**1,341.9**
Capital adequacy ratio (times)	**1.53**	**1.53**

[1] Differs from $403.8 million (30 June 2018: $403.7 million) disclosed in Note 13 Interest bearing financial liabilities due to $1.5 million (30 June 2018: $1.7 million) of accrued interest.
[2] Asset risk charge includes the combined stress scenario adjustment and default stress.
[3] During the period, reinsurance of certain lifetime risk was cancelled resulting in an increased insurance risk charge and aggregation benefit at 30 June 2019 when compared to 30 June 2018.

Note 13 Interest bearing financial liabilities

	30 June 2018		Cash flows	Non-cash movements			30 June 2019	
	Facility $m	Opening balance $m	Proceeds/ (repayments) $m	Foreign exchange $m	Fair value changes $m	Other $m	Closing balance $m	Facility $m
Bank loans								
Corporate	400.0	-	-	-	-	-	-	400.0
Controlled property trusts[1]	551.2	548.4	(118.6)	32.4	1.4	(3.8)	459.8	459.8
Controlled infrastructure trusts	197.2	197.2	(5.2)	-	-	-	192.0	192.0
Repurchase agreements	3,816.0	3,816.0	632.5	-	-	-	4,448.5	4,448.5
Total bank loans	4,964.4	4,561.6	508.7	32.4	1.4	(3.8)	5,100.3	5,500.3
Non-bank loans								
Subordinated debt	400.0	403.7	-	-	0.1	-	403.8	400.0
Challenger Capital Notes 1	345.0	341.9	-	-	-	1.7	343.6	345.0
Challenger Capital Notes 2	460.0	450.9	-	-	-	1.8	452.7	460.0
Other finance	15.0	15.0	(2.3)	-	-	-	12.7	12.7
Total non-bank loans	1,220.0	1,211.5	(2.3)	-	0.1	3.5	1,212.8	1,217.7
Total interest bearing financial liabilities	6,184.4	5,773.1	506.4[2]	32.4	1.5	(0.3)	6,313.1	6,718.0
Current		3,839.5					4,473.2	
Non-current		1,933.6					1,839.9	
		5,773.1					6,313.1	

[1] Total facility limit consists of redraw loan facility limits totalling nil (30 June 2018: $101.0 million) and non-redraw loan facilities limits totalling $459.8 million (30 June 2018: $450.2 million).
[2] Differs to Statement of cash flows due to $189.0 million (30 June 2018: $258.2 million) net repayments relating to SPVs. Total net cash proceeds comprise $632.8 million (30 June 2018: $988.7 million) proceeds from borrowings and $315.4 million (30 June 2018: $708.3 million) repayments of borrowings, inclusive of SPVs.

	30 June 2017		Cash flows	Non-cash movements			30 June 2018	
	Facility $m	Opening balance $m	Proceeds/ (repayments) $m	Foreign exchange $m	Fair value changes $m	Other $m	Closing balance $m	Facility $m
Bank loans								
Corporate	400.0	-	-	-	-	-	-	400.0
Controlled property trusts[1]	537.0	520.0	8.4	17.6	1.6	0.8	548.4	551.2
Controlled infrastructure trusts	201.1	201.1	(3.9)	-	-	-	197.2	197.2
Repurchase agreements	3,287.5	3,287.5	528.5	-	-	-	3,816.0	3,816.0
Total bank loans	4,425.6	4,008.6	533.0	17.6	1.6	0.8	4,561.6	4,964.4
Non-bank loans								
Subordinated debt	400.0	393.6	10.6	-	(0.5)	-	403.7	400.0
Challenger Capital Notes 1	345.0	340.2	-	-	-	1.7	341.9	345.0
Challenger Capital Notes 2	460.0	449.2	-	-	-	1.7	450.9	460.0
Other finance	17.0	17.0	(2.0)	-	-	-	15.0	15.0
Total non-bank loans	1,222.0	1,200.0	8.6	-	(0.5)	3.4	1,211.5	1,220.0
Total interest bearing financial liabilities	5,647.6	5,208.6	541.6[2]	17.6	1.1	4.2	5,773.1	6,184.4
Current		3,336.1					3,839.5	
Non-current		1,872.5					1,933.6	
		5,208.6					5,773.1	

[1] Total facility limit consists of redraw loan facilities limits totalling $101.0 million (30 June 2017: $101.0 million) and non-redraw loan facility limits totalling $450.2 million (30 June 2017: $436.0 million).
[2] Differs to Statement of cash flows due to $258.2 million (30 June 2017: $392.6 million) net repayments relating to SPVs and $3.0 million debt issue costs. Total net cash proceeds comprise $988.7 million (30 June 2017: $860.9 million) proceeds from borrowings and $708.3 million (30 June 2017: $611.4 million) repayments of borrowings, inclusive of SPVs.

Note 13 Interest bearing financial liabilities (continued)

Accounting policy

All borrowings and subordinated debt are financial liabilities and are initially recognised at fair value. For borrowings and subordinated debt which are subsequently measured at fair value through profit or loss, directly attributable transaction costs are expensed with movements on fair value recognised in the statement of comprehensive income.

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.

Repurchase agreements are all short-term in nature, and are therefore valued at amortised cost which approximates fair value.

Details of liabilities

Bank loans

Bank loans	Type	Maturity	Rate type	Ranking/security
Corporate	Facility	Tranche 1: $150m expiring on 30 June 2022 Tranche 2: $250m expiring on 30 June 2024	Floating	Secured by guarantees between members of the Group
Controlled property trusts[1]	Loan	July 2019 to October 2024	Variable	1) First ranking mortgages over Japanese investment properties: $420.9 million (30 June 2018: $399.4 million) 2) First ranking mortgage over County Court, VIC: $38.6 million (30 June 2018: $50.2 million)
Controlled infrastructure trusts	Facility	June 2022	Variable	First ranking mortgages over infrastructure assets

[1] Controlled property trusts consist of multiple loans with maturity dates from July 2019 to October 2024.

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 2019 are current and all except $1,265.0 million matured in July 2019. The remaining agreements mature in August 2019. They will continue to be rolled into new agreements in the future.

CLC uses Australian Government and Semi-Government Bonds with repurchase agreements, interest rate swaps and bond futures to hedge movements in interest rates on its asset portfolio, annuity policy liabilities, Guaranteed Index Return mandates and the Challenger Index Plus Fund.

Non-bank loans

Subordinated debt

CLC issued subordinated notes of $400.0 million on 24 November 2017 with a call date on 24 November 2022. Holders of the subordinated notes have the option to convert their holding into ordinary shares of Challenger Limited on 24 November 2024 if CLC has not exercised its call option on 24 November 2022. If holders do not elect to convert the subordinated notes to ordinary shares of Challenger Limited, the subordinated notes will be fully eligible as Tier 2 regulatory capital of CLC until 24 November 2038.

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

Notes 1 and Notes 2 have similar structural characteristics, 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.

Note 13 Interest bearing financial liabilities (continued)

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

	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 to the Company 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 $12.7 million (30 June 2018: $15.0 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 ask price observable in the market at balance date.

The change recognised in the statement of comprehensive income in respect of valuation changes for the year ended 30 June 2019 was a loss of $0.1 million (30 June 2018: gain of $0.5 million).

Note 14 Reserves and retained earnings

	30 June 2019 $m	30 June 2018 $m
Share-based payments reserve		
Balance at the beginning of the year	(43.0)	(23.2)
Share-based payments for the period	21.4	23.7
Releases from share-based payments reserve	(42.7)	(48.5)
Tax in equity	6.6	5.0
Balance at the end of the year	**(57.7)**	**(43.0)**
Cash flow hedge reserve – SPV[1]		
Balance at the beginning of the year	0.3	(0.2)
(Loss)/gain on cash flow hedges	(0.2)	0.5
Balance at the end of the year	**0.1**	**0.3**
Foreign currency translation reserve[1]		
Balance at the beginning of the year	(3.3)	(5.2)
Gain on translation of foreign entities[2]	35.4	18.5
Loss on hedge of net investment in foreign entities[2]	(34.7)	(16.6)
Balance at the end of the year	**(2.6)**	**(3.3)**
Adjusted controlling interests reserve[1]		
Balance at the beginning of the year	12.7	12.1
Change in holdings in controlled entities	(4.9)	0.6
Balance at the end of the year	**7.8**	**12.7**
Total reserves	**(52.4)**	**(33.3)**
Retained earnings		
Balance at the beginning of the year	1,467.0	1,350.1
Profit attributable to equity holders	307.8	322.5
Dividends paid	(215.8)	(205.6)
Total retained earnings	**1,559.0**	**1,467.0**

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

Note 14 Reserves and retained earnings (continued)

Accounting policy

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.

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.

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.

Note 15 Finance costs

	30 June 2019 $m	30 June 2018 $m
Interest expense	313.7	184.4
Interest expense – SPV	23.1	28.1
Interest expense – property trusts[1]	6.8	10.6
Interest expense – Challenger Capital Notes 1 and 2	36.5	32.3
Other finance costs	5.5	10.1
Total finance costs	385.6	265.5

[1] $4.9 million of interest was capitalised in the period (30 June 2018: $2.2 million).

Accounting policy

Finance costs represent interest incurred on interest bearing financial liabilities (primarily external unit holders' liabilities distributions, repurchase agreements, 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 of 3.9% (30 June 2018: 3.8%) 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 2019 $m	30 June 2018 $m
Dividends declared and paid during the year		
Final 30 June 2018 100% franked dividend: 18.0 cents (30 June 2017: 17.5 cents 100% franked dividend)	109.4	99.5
Interim 30 June 2019 100% franked dividend: 17.5 cents (30 June 2018: 17.5 cents 100% franked dividend)	106.4	106.1
Total dividends paid	215.8	205.6
Dividend proposed (not recognised as a liability at 30 June)		
Final 30 June 2019 100% franked dividend: 18.0 cents (30 June 2018: 100% franked 18.0 cents)	109.5	109.4

Refer to Note 12 Contributed equity for details of the dividend policy. A dividend reinvestment plan will be in operation for the 30 June 2019 final dividend.

Dividend franking credits

Franking credits available to shareholders are $87.5 million (30 June 2018: $132.2 million), based on a tax rate of 30%. This amount is calculated from the balance of the franking account as at the end of the reporting period, adjusted for franking credits that will arise from the settlement, after the end of the reporting period, of current liabilities for income tax and interest on Challenger Capital Notes 1 and 2.

The impact of the proposed dividend will be to reduce the balance of the franking credit account by $46.7 million. All dividends are franked at a tax rate of 30%.

Note 17 Earnings per share

	30 June 2019 cents	30 June 2018 cents
Basic earnings per share	50.9	54.0
Diluted earnings per share	44.8	52.2
	$m	**$m**
Profit attributable to ordinary shareholders	307.8	322.5
Add back interest expense on Challenger Capital Notes 1 and 2	32.9	32.3
Add back interest expense net of tax on CLC Subordinated Notes	11.2	6.5
Total earnings used in the calculation of diluted earnings per share	351.9	361.3
Number of shares	**Number**	**Number**
Weighted average of ordinary shares issued	611,216,128	605,226,219
Weighted average of Treasury shares	(6,205,078)	(8,511,558)
Weighted average ordinary shares for basic earnings per share	605,011,050	596,714,661
Adjusted for potential ordinary shares:		
Weighted average effect of Challenger Performance Plan	4,481,432	10,711,069
Weighted average effect of Challenger Capital Notes 1 and 2	117,792,197	65,575,106
Weighted average effect of CLC Subordinated Notes	58,479,532	19,550,342
Weighted average ordinary shares for diluted earnings per share	785,764,211	692,551,178

Accounting policy

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 6,205,078 (2018: 8,511,558).

Diluted earnings per share is calculated by dividing the total adjusted 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 117.8 million shares (2018: 65.6 million), CLC Subordinated Notes of 58.5 million shares (2018: 19.6 million shares) and shares granted under the CPP of 4.5 million shares (2018: 10.7 million).

Note 17 Earnings per share (continued)

Accounting policy (continued)

The dilutive share count for Challenger's convertible debt (Challenger Capital Notes and subordinated debt) is based on the following formula:

$$\frac{\text{Face value of debt}}{\text{Conversion factor x Challenger's 20-day VWAP share price}}$$

The conversion factor on all Challenger's convertible debt is 99% of the weighted average Challenger share price over the last 20 days of trading in each reporting period.

The profit attributable to ordinary shareholders is adjusted by \$44.1 million interest on the Notes and CLC Subordinated Notes (2018: \$38.8 million) for the diluted calculation when the Notes and CLC Subordinated 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.

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of authorisation of these financial statements.

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 reasonably possible 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, inflation 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 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 and other alternatives or credit spreads) and currency risk (due to fluctuations in foreign currency exchange rates).

Interest rate risk

Interest rate risk is the risk of fluctuations in the Group's earnings and equity arising from movements in market interest rates, including changes in the absolute levels of interest rates, the shape of the yield curve, the margin between the different yield curves and the volatility of interest rates.

It is the Group's policy to minimise the impact of interest rate movements on debt servicing capacity, Group profitability, business requirements and company valuation. The Group targets hedging of between 30-70% of drawn net recourse interest bearing liabilities of the corporate segment. The amount of drawn net recourse corporate interest bearing liabilities, and their duration, is determined with reference to the annual budget and the most current forecasts. The Group's strategy is to have no interest rate hedges with a duration of greater than five years and targets average hedge duration of three years.

CLC's market risk policy is approved by the CLC Board and sets out the relevant risk limits for interest rate exposure. It is CLC's policy to minimise the impact of interest rate movements on its projected future cash flows. The management of the risks associated with life investment and life insurance contracts, including interest rate risk, are subject to the prudential requirements of the Life Act and APRA. This includes satisfying capital adequacy requirements, which in turn include consideration of how the interest rate sensitivity of assets and liabilities are matched.

For the SPV entities, the impact of a rising/falling bank bill swap rate (BBSW) benchmark over the Reserve Bank of Australia's target cash rate results in an increase/decrease in the cost of funding and therefore on the profit of the trusts. This interest rate risk is mitigated by actively adjusting the interest rates charged to borrowers if a sustained adverse differential to the benchmark is evidenced. SPV entities are also exposed to the risks arising from borrowers fixing the rates on their mortgage. This interest rate risk is managed by using cash flow hedges to swap the fixed rate to a floating rate exposure at an amount equal to the notional value of the mortgages being fixed.

Note 18 Financial risk management (continued)

Interest rate risk (continued)

Interest rate sensitivity

The Group's sensitivity to movements in interest rates in relation to the value of financial assets and liabilities is shown in the table below. It is assumed that the change happens at the statement of financial position date and that there are concurrent movements in interest rates and parallel moves in the yield curve. All material underlying exposures and related hedges are included in the analysis which includes investment properties with leases, where the future income stream is duration-hedged for interest rate movements. The impact on profit and equity is post-tax at a rate of 30%. The risks faced and methods used in the sensitivity analysis are the same as those applied in the comparative period. As shown below, 100 basis points (1%) movements in interest rates would have only a small net impact on the Group's financial position as upside risks in CLC and the property trusts largely offset downside risk in the SPV entities, and vice versa:

	Change in variable	Profit/(loss) 30 June 2019 $m	Change in equity 30 June 2019 $m	Profit/(loss) 30 June 2018 $m	Change in equity 30 June 2018 $m
Non-SPV	+100bps	1.2	1.2	2.9	2.9
	-100bps	(1.2)	(1.2)	(2.9)	(2.9)
SPV	+100bps	(0.7)	(0.7)	(0.9)	(0.9)
	-100bps	0.7	0.7	0.9	0.9
Total	+100bps	0.5	0.5	2.0	2.0
	-100bps	(0.5)	(0.5)	(2.0)	(2.0)

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. Equity prices can be driven by a range of risk factors specific to an individual exposure including broad macro-economic and instrument specific factors which may be uncorrelated with broader equity markets. 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.

Equities and other alternatives	Change in variable	Profit/(loss) 30 June 2019 $m	Change in equity 30 June 2019 $m	Profit/(loss) 30 June 2018 $m	Change in equity 30 June 2018 $m
Property securities	+10%	8.9	8.9	26.8	26.8
	-10%	(8.9)	(8.9)	(26.8)	(26.8)
Infrastructure investments	+10%	56.5	56.5	33.6	33.6
	-10%	(56.5)	(56.5)	(33.6)	(33.6)
Other equities and alternative	+10%	164.9	164.9	92.7	92.7
assets	-10%	(164.9)	(164.9)	(92.7)	(92.7)
Total assets	+10%	230.3	230.3	153.1	153.1
	-10%	(230.3)	(230.3)	(153.1)	(153.1)

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) and policy liabilities. As at 30 June 2019, 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 $73.9 million (30 June 2018: $61.4 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 2019					
Financial assets	503.9	2,506.8	1,031.5	899.3	624.9
Financial liabilities	(5.8)	-	(3.2)	(419.0)	-
Foreign currency contracts and cross currency swaps	(497.0)	(2,506.6)	(1,019.1)	(486.1)	(624.3)
Net exposure in Australian dollars	1.1	0.2	9.2	(5.8)	0.6
30 June 2018					
Financial assets	739.2	2,363.3	834.7	742.8	476.0
Financial liabilities	(11.9)	-	(8.2)	(399.4)	-
Foreign currency contracts and cross currency swaps	(730.6)	(2,353.4)	(828.0)	(331.8)	(473.8)
Net exposure in Australian dollars	(3.3)	9.9	(1.5)	11.6	2.2

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 2019 $m	Change in equity 30 June 2019 $m	Profit/(loss) 30 June 2018 $m	Change in equity 30 June 2018 $m
British Pound (GBP)	+10%	0.1	0.1	(0.4)	(0.4)
	-10%	(0.1)	(0.1)	0.4	0.4
US Dollar (USD)	+10%	-	-	0.7	0.7
	-10%	-	-	(0.7)	(0.7)
Euro (EUR)	+10%	0.7	0.7	(0.1)	(0.1)
	-10%	(0.7)	(0.7)	0.1	0.1
Japanese Yen (JPY)	+10%	-	(0.4)	0.2	0.8
	-10%	-	0.4	(0.2)	(0.8)
Other	+10%	-	-	0.2	0.2
	-10%	-	-	(0.2)	(0.2)
Total	+10%	0.8	0.4	0.6	1.2
	-10%	(0.8)	(0.4)	(0.6)	(1.2)

Credit default risk

The Group makes use of external ratings agencies (Standard & Poor's, Fitch, Moody's or other reputable credit rating agency) to determine credit ratings. Where a counterparty or debt obligation is rated by multiple external rating agencies, the Group will use Standard & Poor's ratings where available. 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 2019							
Cash and cash equivalents	725.4	-	-	-	-	-	725.4
Cash and cash equivalents – SPV	66.5	-	-	-	-	-	66.5
Receivables	16.5	12.5	212.4	21.5	3.7	313.4	580.0
Mortgage assets – SPV	431.1	144.5	222.2	55.4	7.9	(0.5)	860.6
Fixed income securities	7,530.8	3,022.7	2,191.6	2,629.5	2,112.1	115.8	17,602.5
Derivative assets	-	611.9	60.3	14.6	75.7	-	762.5
Total assets with credit exposures	8,770.3	3,791.6	2,686.5	2,721.0	2,199.4	428.7	20,597.5
30 June 2018							
Cash and cash equivalents	741.7	-	-	-	-	-	741.7
Cash and cash equivalents – SPV	97.3	-	-	-	-	-	97.3
Receivables	26.4	26.3	212.8	23.5	2.0	145.5	436.5
Mortgage assets – SPV	555.4	186.9	237.9	59.7	5.9	(1.3)	1,044.5
Fixed income securities	7,293.5	1,548.9	1,805.5	2,579.4	1,893.6	160.8	15,281.7
Derivative assets	-	347.1	24.9	3.6	45.5	-	421.1
Total assets with credit exposures	8,714.3	2,109.2	2,281.1	2,666.2	1,947.0	305.0	18,022.8

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.

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.

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.

Ageing and impairment of amortised cost financial assets

The table below gives information regarding the carrying value of the Group's financial assets measured at amortised cost. The analysis splits these assets by those that are neither past due nor impaired, those that are past due and not impaired (including an ageing analysis), and those past due and impaired at the statement of financial position date:

		Past due but not impaired				
Amortised cost financial assets	Not past due/not impaired $m	0-1 months $m	1-3 months $m	3-6 months $m	Past due and impaired $m	Total $m
30 June 2019						
Receivables	580.0	-	-	-	-	580.0
Mortgage assets – SPV	742.9	44.8	29.0	14.5	29.4	860.6
Total receivables	1,322.9	44.8	29.0	14.5	29.4	1,440.6
30 June 2018						
Receivables	436.2	-	0.1	0.2	-	436.5
Mortgage assets – SPV	923.5	50.2	37.8	11.5	21.5	1,044.5
Total receivables	1,359.7	50.2	37.9	11.7	21.5	1,481.0

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 fair values, a counterparty failing on repayment of a contractual obligation, the inability to generate cash inflows as anticipated or unexpected increase in cash outflows.

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.

The Group 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 (ALCo). From 1 July 2019, ALCo is replaced by the Financial Risk Committee (FRC) and the Investment Committee (IC). The IC is a committee of investment professionals from within CLC and represents the first line. The FRC is a committee of professionals mainly from the Risk division that is independent from the investment team of CLC. The FRC represents the second line for CLC. 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 2019					
Payables	1,077.2	6.1	-	26.2	1,109.5
Payables – SPV	2.3	10.2	46.2	-	58.7
Interest bearing financial liabilities	4,885.8	154.5	1,341.9	185.7	6,567.9
Interest bearing financial liabilities – SPV	236.5	326.3	185.1	222.9	970.8
External unit holders' liabilities	1,356.4	609.8	-	-	1,966.2
Life investment contract liabilities	2,822.7	2,866.7	830.7	510.2	7,030.3
Life insurance contract liabilities[1]	672.7	1,129.0	871.6	4,449.5	7,122.8
Derivative liabilities	135.2	75.2	51.7	307.1	569.2
Total undiscounted financial liabilities[1]	11,188.8	5,177.8	3,327.2	5,701.6	25,395.5
30 June 2018					
Payables	589.4	24.4	-	26.1	639.9
Payables – SPV	2.2	-	-	-	2.2
Interest bearing financial liabilities	3,906.2	926.0	978.2	232.0	6,042.4
Interest bearing financial liabilities – SPV	295.3	396.2	226.9	279.5	1,197.9
External unit holders' liabilities	1,451.0	684.0	-	-	2,135.0
Life investment contract liabilities	2,518.3	3,191.1	820.9	532.7	7,063.0
Life insurance contract liabilities[1]	598.7	1,029.6	769.1	3,953.1	6,350.5
Derivative liabilities	79.0	136.2	99.4	138.4	453.0
Total undiscounted financial liabilities[1]	9,440.1	6,387.5	2,894.5	5,161.8	24,883.9

[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 9 *Financial Instruments*.

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 and amount of cash flows, discount rates, earnings multiples and internal credit ratings.

Valuation techniques

The majority of the Group's listed and unlisted fixed income securities, over-the-counter derivative financial instruments and interest bearing liabilities including the subordinated debt issuance are 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.

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

Externally rated unlisted fixed income securities are valued by applying market observable credit spreads on similar assets with an equivalent credit rating and are classified as Level 2. Internally-rated fixed income securities are Level 3 as the determination of an equivalent credit rating is a significant non-observable input.

Equity, infrastructure and property securities that are exchange traded are generally classified as Level 1. Where quoted prices are available, but are not from an active market, they are classified as Level 2. If market observable inputs are not available, they are classified as 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.

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 residual income unitholders (RIU) holders at amortised cost of $0.2 million (2018: $0.3 million). The fair value of this RIU holders' asset is $62.4 million (2018: $73.7 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 $350.3 million and $485.7 million respectively and are classified as Level 1 in the fair value hierarchy.

Valuation process

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

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

The table on the following page summarises the financial instruments and investment properties measured at fair value at each level of the fair value hierarchy as at the statement of financial position date.

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

Valuation process (continued)

	Level 1 $m	Level 2 $m	Level 3 $m	Total $m
30 June 2019				
Derivative assets	-	761.9	0.6	762.5
Fixed income securities[1]	-	15,604.8	1,997.7	17,602.5
Equity and other alternatives	6.9	1,025.7	299.6	1,332.2
Infrastructure investments[1]	210.6	234.9	421.6	867.1
Property securities	-	-	127.8	127.8
Investment and development property[2]	-	155.8	3,573.4	3,729.2
Total assets	**217.5**	**17,783.1**	**6,420.7**	**24,421.3**
Derivative liabilities	-	569.1	0.1	569.2
Interest bearing financial liabilities	836.0	443.1	12.5	1,291.6
External unit holders' liabilities	-	1,966.2	-	1,966.2
Life investment contract liabilities	-	58.1	6,699.6	6,757.7
Total liabilities	**836.0**	**3,036.5**	**6,712.2**	**10,584.7**
30 June 2018				
Derivative assets	-	420.5	0.6	421.1
Fixed income securities	-	13,347.0	1,934.7	15,281.7
Equity and other alternatives	38.4	738.3	366.6	1,143.3
Infrastructure investments[1]	165.8	204.4	413.7	783.9
Property securities	240.4	-	142.3	382.7
Investment and development property[2]	-	452.2	3,583.0	4,035.2
Total assets	**444.6**	**15,173.8**	**6,440.9**	**22,047.9**
Derivative liabilities	0.6	452.3	0.1	453.0
Interest bearing financial liabilities	818.2	454.6	14.8	1,287.6
External unit holders' liabilities	-	2,135.0	-	2,135.0
Life investment contract liabilities	-	64.9	6,570.4	6,635.3
Total liabilities	**818.8**	**3,106.8**	**6,585.3**	**10,510.9**

[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 Company assesses, at inception and at each reporting date, whether a structured entity should be consolidated based on the accounting policy. 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 2019 the carrying value of asset-backed financing assets was $81.8 million (30 June 2018: $57.3 million) with $39.5 million undrawn commitments (30 June 2018: none) and securitisations was $3,276.0 million (30 June 2018: $3,010.8 million) plus $81.2 million undrawn commitments (30 June 2018: $88.2 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 2019		30 June 2018	
	Assets $m	Liabilities $m	Assets $m	Liabilities $m
Balance at the beginning of the year	6,440.9	6,585.3	6,521.6	6,691.2
Fair value gains/(losses)	72.4	312.0	317.7	190.6
Acquisitions	2,723.3	2,354.0	2,463.7	2,510.2
Maturities and disposals	(2,772.3)	(2,539.1)	(2,357.8)	(2,806.7)
Transfers to other categories[1,2]	(43.6)	-	(504.3)	-
Balance at the end of the year	**6,420.7**	**6,712.2**	**6,440.9**	**6,585.3**
Unrealised gains/(losses) included in the statement of comprehensive income for assets and liabilities held at the statement of financial position date	76.3	(312.0)	266.7	(177.1)

[1] The Group transfers between levels of the fair value hierarchy when there is a change in the observability of the pricing inputs or a change to valuation methodology.

[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. There were $216.0 million (30 June 2018: $35.1 million) of transfers into Level 3 and $259.6 million (30 June 2018: $539.4 million) of transfers out of Level 3 during the reporting period.

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 reasonably possible 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	Reasonably possible change in non-observable input[2,3]
30 June 2019					
Derivative assets	0.6	0.1	(0.1)	Discounted cash flow	Primarily credit spreads
Derivative liabilities	(0.1)	0.2	0.1	Discounted cash flow	Primarily credit spreads
Fixed income securities	1,997.7	10.5	(37.2)	Discounted cash flow	Primarily credit spreads
Interest bearing financial liabilities	(12.5)	0.2	(0.4)	Discounted cash flow	Primarily credit spreads
Equity and other alternatives	299.6	22.7	(24.2)	Pricing model	Earnings multiple, Mortality rate
Infrastructure investments	421.6	4.9	(4.9)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Property securities	127.8	6.4	(6.4)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Investment contract liabilities	(6,699.6)	3.5	(3.5)	Discounted cash flow	Primarily expense assumptions
Investment and development property	3,573.4	166.7	(152.7)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Total Level 3	(291.5)	215.2	(229.3)		
30 June 2018					
Derivative assets	0.6	0.1	(0.1)	Discounted cash flow	Primarily credit spreads
Derivative liabilities	(0.1)	0.3	(0.2)	Discounted cash flow	Primarily credit spreads
Fixed income securities	1,934.7	10.2	(77.1)	Discounted cash flow	Primarily credit spreads
Interest bearing financial liabilities	(14.8)	-	-	Discounted cash flow	Primarily credit spreads
Equity and other alternatives	366.6	25.5	(27.5)	Pricing model	Earnings multiple, Mortality rate
Infrastructure investments	413.7	7.3	(7.2)	Discounted cash flow, External financial report	Primarily discount rate on cash flow models
Property securities	142.3	7.1	(7.1)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Investment contract liabilities	(6,570.4)	3.6	(3.6)	Discounted cash flow	Primarily expense assumptions
Investment and development property	3,583.0	151.3	(138.6)	Market capitalisation, Discounted cash flow	Primarily capitalisation rate
Total Level 3	(144.4)	205.4	(261.1)		

[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 reasonably 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%.

Note 20 Collateral arrangements

Accounting policy

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. Cash received of $415.1 million (30 June 2018: $173.8 million) 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 2019 $m	30 June 2018 $m
Cash	220.1	241.3
Other financial assets[1]	5,991.0	5,110.8
Total collateral pledged	6,211.1	5,352.1

[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 for related parties is also provided in this section.

Note 21 Parent entity

Company	30 June 2019 $m	30 June 2018 $m
Statement of comprehensive income for the year ended		
Dividends and interest from controlled entities	322.7	390.5
Finance costs	(36.5)	(35.8)
Profit before income tax	286.2	354.7
Income tax benefit	3.3	6.5
Total comprehensive income for the year	**289.5**	**361.2**
Statement of financial position as at		
Assets		
Cash and cash equivalents	2.8	2.5
Receivables	1,224.1	1,393.0
Financial asset – fixed income securities[1]	805.0	805.0
Current tax asset	6.0	-
Deferred tax assets	-	2.4
Investment in controlled entities	2,088.9	2,067.5
Total assets	**4,126.8**	**4,270.4**
Liabilities		
Payables	344.7	548.9
Interest bearing financial liabilities	796.5	793.0
Current tax liability	-	1.0
Total liabilities	**1,141.2**	**1,342.9**
Net assets	**2,985.6**	**2,927.5**
Equity		
Contributed equity	2,155.3	2,148.5
Share-based payments reserve	(113.6)	(92.3)
Retained earnings	943.9	871.3
Total equity	**2,985.6**	**2,927.5**

[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 2019:

Entity name	Principal activity
Challenger Limited	
Challenger Group Holdings Limited	Corporate
Challenger Group Services Pty Limited	Corporate
Challenger Treasury Limited	Corporate
Challenger Japan Holdings Pty Limited	Corporate
Challenger Funds Management Holdings Pty Limited	Funds management
Fidante Partners Holdings Pty Limited	Funds management
Fidante Partners Holdings Europe Limited (incorporated in the UK)	Funds management
Challenger Investment Partners Limited	Funds management
Challenger Life Company Holdings Limited	Life
Challenger Life Company Limited	Life
Challenger Wholesale Finance Holdings Pty Limited	Life

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 $22.5 million (30 June 2018: $0.4 million).

Accounting policy

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. There have been no material acquisitions or disposals of controlled entities during the year.

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. The Company assesses, at inception and at each reporting date, whether an entity should be consolidated based on the accounting policy.

All intercompany balances and transactions, including unrealised profits arising from intra-group transactions, are eliminated in full. Non-controlling interests represent the share in the net assets of subsidiaries attributable to equity interests not owned directly or indirectly by the Group.

Note 23 Investment in associates

Name of company	Principal activity	Country of domicile	30 June 2019 %[1]	30 June 2018 %[1]	30 June 2019 $m	30 June 2018 $m
Alphinity Investment Management Pty Ltd	Funds Management	Australia	30	30	1.3	2.0
Ardea Investment Management Pty Ltd	Funds Management	Australia	30	30	3.1	3.2
Avenir Capital Pty Ltd	Funds Management	Australia	40	40	2.7	1.6
Bentham Asset Management Pty Ltd	Funds Management	Australia	49	49	0.7	0.7
Eiger Capital Pty Ltd	Funds Management	Australia	40	-	0.8	-
FME Asset Management Ltd	Funds Management	UK	20	-	2.0	-
Greencape Capital Pty Ltd	Funds Management	Australia	50	50	34.2	39.8
Lennox Capital Partners Pty Ltd	Funds Management	Australia	40	40	2.1	1.6
Merlon Capital Partners Pty Ltd	Funds Management	Australia	30	30	1.7	1.6
Novaport Capital Pty Ltd	Funds Management	Australia	49	49	0.2	0.5
Resonance Asset Management Ltd[2]	Funds Management	UK	-	-	0.7	0.7
Structured Credit Research LLP	Funds Management	UK	50	50	0.4	2.2
Wavestone Capital Pty Ltd	Funds Management	Australia	33	33	2.3	2.5
Whitehelm Capital Pty Ltd	Funds Management	Australia	30	30	4.9	5.0
Wyetree Asset Management Pty Ltd	Funds Management	UK	49	49	1.0	1.0
Total investment in associates[3]					58.1	62.4

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 2019 $m	30 June 2018 $m
Movements in carrying amount of investment in associates		
Opening balance	62.4	53.5
Acquisition of investment in associates	2.2	-
Share of associates' net profit	22.2	30.0
Dividends and net capital redemptions	(28.7)	(18.6)
Reclassification as equity security	-	(0.6)
Impairment of investment in associates	-	(1.9)
Carrying amount at the end of the year	58.1	62.4
Share of associates' profit or loss		
Profit after tax for the year	22.2	30.0
Share of the associates' statement of financial position		
Current assets	36.3	35.9
Non-current assets	1.8	1.2
Total assets	38.1	37.1
Current liabilities	18.5	16.9
Non-current liabilities	1.8	1.3
Total liabilities	20.3	18.2
Net assets	17.8	18.9

Investments in associates held by Challenger Life Company (CLC)

CLC holds a 33.3% equity interest in Assetsecure Pty Ltd and is deemed to have significant influence. The investment ($8.0 million) is disclosed in Note 5 Financial assets – fair value through profit and loss (Shares in listed and unlisted corporations).

Accounting policy

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 Group.

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.

Investments in entities held to back investment contract liabilities and life insurance contract liabilities are exempt from the requirement to apply equity accounting and have been designated on initial recognition as financial assets measured at fair value through profit or loss.

Key estimates and assumptions

An assessment is performed at each statement of financial position date to determine whether there is any indication of impairment and whether it is necessary to recognise any impairment loss against the carrying value of the net investment in associates.

The Group determines the dates of obtaining or losing significant influence of another entity based on an assessment of all pertinent facts and circumstances that affect the ability to significantly influence the financial and operating policies of that entity.

Note 24 Related parties

Key management personnel

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

Directors	
Peter Polson	Independent Chair
Richard Howes (Appointed 2 January 2019)	Managing Director and Chief Executive Officer
Brian Benari (Retired 1 January 2019)	Former Managing Director and Chief Executive Officer
Graham Cubbin (Retired 26 October 2018)	Independent Non-Executive Director
Steven Gregg	Independent Non-Executive Director
John M Green	Independent Non-Executive Director
JoAnne Stephenson	Independent Non-Executive Director
Duncan West (Appointed 10 September 2018)	Independent Non-Executive Director
Melanie Willis	Independent Non-Executive Director
Leon Zwier	Independent Non-Executive Director

Key executives	
Richard Howes (Appointed 2 January 2019)	Managing Director and Chief Executive Officer
Brian Benari (Retired 1 January 2019)	Former Managing Director and Chief Executive Officer
Angela Murphy (Appointed 12 December 2018)	Chief Executive, Distribution, Product and Marketing
Chris Plater	Chief Executive & Chief Investment Officer, Life
Ian Saines	Chief Executive, Funds Management
Andrew Tobin	Chief Financial Officer

Controlled entities and associates

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 $46.0 million (2018: $45.8 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 2019 (30 June 2018: nil).

Group products

From time to time, Directors or key executives of the Company or their related entities may purchase products from the Group. These purchases are on the same arm's length terms and conditions as those offered to other employees or customers.

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 benefits $	Termination benefits $	Total $
Non-Executive Directors						
2019	1,812,945	100,580	-	-	-	1,913,525
2018	1,715,860	82,580	-	-	-	1,798,440
KMP						
2019	6,766,774	103,870	7,722,428	354,813	-	14,947,885
2018	7,373,153	100,245	8,815,992	644,673	-	16,934,063
All KMP and Non-Executive Directors						
2019	8,579,719	204,450	7,722,428	354,813	-	16,861,410
2018	9,089,013	182,825	8,815,992	644,673	-	18,732,503

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 2019 $m	30 June 2018 $m
Goodwill	557.3	571.6
Other intangible assets		
Software at cost	25.7	19.6
Less: accumulated amortisation	(7.7)	(4.1)
	18.0	15.5
Revenue sharing agreement	5.8	5.8
Less: accumulated amortisation	(0.5)	(0.1)
Foreign exchange gain	0.6	0.1
	5.9	5.8
Total other intangible assets	23.9	21.3

	Goodwill		Software		Revenue sharing agreement	
	30 June 2019 $m	30 June 2018 $m	30 June 2019 $m	30 June 2018 $m	30 June 2019 $m	30 June 2018 $m
Balance at the beginning of the year	571.6	571.6	15.5	16.8	5.8	5.8
Additions	-	-	6.1	14.5	-	-
Disposal of operation[1]	(14.3)	-	-	-	-	-
Impairment	-	-	-	(11.7)	-	-
Amortisation expense	-	-	(3.6)	(4.1)	(0.4)	(0.1)
Foreign exchange gain	-	-	-	-	0.5	0.1
Balance at the end of the year	557.3	571.6	18.0	15.5	5.9	5.8

[1] Disposal of infrastructure business operation (Oikos Storage Limited) within the Life CGU.

Accounting policy

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.

Note 25 Goodwill and other intangible assets (continued)

Accounting policy (continued)

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.

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 CGU 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. The recoverable amount of each CGU is determined based on value in use calculations, that utilise cash flow projections based on financial forecasts approved by senior management which cover an appropriate time horizon.

The discount rate is based on a number of factors. The relevant assumptions in deriving the value of the CGU 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 is of the view that reasonable changes in the key assumptions, such as an increase in the discount rate by 1% or a change in cash flow of 5%, would not cause the respective recoverable amounts for each CGU to fall short of the carrying amounts as at 30 June 2019. 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.

Intangible	Useful Life	Depreciation method
Goodwill	Indefinite	Not applicable
Software	3-10 years	Straight line basis over its useful life, usually a period of five years
Revenue sharing agreement	15 years	The life of the investment has been assessed as being 15 years

Impairment testing of goodwill

The following CGUs represent the carrying amounts of goodwill:

			Discount rate		
CGU	30 June 2019 $m	30 June 2018 $m	30 June 2019 %	30 June 2018 %	Cash flow horizon (years)
Life	429.7	444.0	10.0	10.5	5
Funds Management	127.6	127.6	10.0	10.5	5
Total	557.3	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 2019. 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

The Company 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 the Company'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 third party financial institutions 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 2019 there are potential future commitments totalling $398.0 million (30 June 2018: $408.8 million) in relation to these opportunities. The Group has made capital commitments to associates to subscribe for up to $10.0 million (30 June 2018: $10.5 million) of non-redeemable preference shares to enable them to meet their working capital requirements. Contractual obligations for future property repairs and maintenance are in place but cannot be quantified until required.

Subsidiary guarantees

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

Contingent tax assets and liabilities

In the normal course of business, the Group has interactions with the ATO in relation to the taxation treatment 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.

Analysis of credit commitments	30 June 2019 $m	30 June 2018 $m
Non-cancellable operating leases – Group as lessee		
Amounts due in less than one year	9.1	8.2
Amounts due between one and two years	8.2	8.1
Amounts due between two and five years	22.3	21.5
Amounts due in greater than five years	32.6	38.4
Total operating leases – Group as lessee	72.2	76.2
Contracted capital expenditure		
Amounts due in less than one year	32.1	233.3
Amounts due between one and two years	19.8	51.7
Amounts due between two and five years	0.8	30.1
Amounts due in greater than five years	-	-
Total capital expenditure commitments	52.7	315.1
Non-cancellable operating leases – Group as lessor		
Amounts due in less than one year	(223.7)	(248.8)
Amounts due between one and two years	(214.7)	(227.4)
Amounts due between two and five years	(549.1)	(593.2)
Amounts due in greater than five years	(789.0)	(1,137.7)
Total operating leases – Group as lessor	(1,776.5)	(2,207.1)
Other contracted commitments		
Amounts due in less than one year	15.9	54.0
Total other contracted commitments	15.9	54.0
Net commitments owed to Group	(1,635.7)	(1,761.8)

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

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.

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 12 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 fitout commitments and acquisition of investment properties that have exchanged prior to the balance date and will settle subsequent to the balance date.

Note 27 Employee entitlements

	30 June 2019 $m	30 June 2018 $m
Annual leave	5.9	5.3
Long service leave	7.2	7.4
Employee[1] entitlements provision	13.1	12.7

[1] The total number of employees of the Group at 30 June 2019 was 687 (30 June 2018: 676) on a full-time equivalent (FTE) basis.

Accounting policy

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 wholly 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.

Note 27 Employee entitlements (continued)

Accounting policy (continued)

Share-based payment transactions (continued)

In accordance with Australian Accounting Standards, the cost of equity-settled transactions is recognised in the statement of comprehensive income, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (vesting date).

At the Company level, the cost of Treasury shares is recognised as a reduction in equity. On vesting of the award they are subsequently recognised as an increase in equity and a reduction in share-based payment reserve at an average acquisition 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 one and three years on existing awards.

The table below sets out the details of the DPSRs granted under the CPP during 2019 and movements on previous issues.

Grant date	Latest date for vesting[1]	Reference price $	Fair value at grant $	Outstanding at 1 July 2018	Granted during the year	Vested during the year	Expired during the year	Outstanding at 30 June 2019
11 Sep 18	01 Sep 21	10.368	9.66	-	493,789	-	(33,802)	459,987
11 Sep 18	01 Sep 20	10.368	9.94	-	454,730	(4,122)	(12,752)	437,856
11 Sep 18	01 Sep 19	10.368	10.22	-	454,727	(4,122)	(12,751)	437,854
11 Sep 17	01 Sep 20	12.264	11.39	433,042	-	-	(41,559)	391,483
11 Sep 17	01 Sep 19	12.264	11.73	432,217	-	(36,974)	(11,201)	384,042
11 Sep 17	01 Sep 18	12.264	12.07	432,217	-	(430,991)	(1,226)	-
09 Jun 17	01 Sep 19	12.596	11.79	9,758	-	-	(7,319)	2,439
12 Sep 16	01 Sep 18	9.210	8.26	415,410	-	-	(38,541)	376,869
12 Sep 16	01 Sep 17	9.210	8.59	491,127	-	(489,939)	(1,188)	-
13 Sep 15	01 Sep 17	6.989	6.44	564,572	-	(564,572)	-	-
Total				2,778,343	1,403,246	(1,530,720)	(160,339)	2,490,530

[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)

Accounting policy (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 (TSR). 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 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 CPP during 2019 and movements on previous issues:

Grant date	Expected date for vesting[1]	Reference price $	Fair value at grant $	Outstanding at 1 July 2018	Granted during the year	Vested during the year	Expired during the year	Outstanding at 30 June 2019
11 Sep 18	01 Sep 22	11.720	3.94	-	829,121	-	(34,646)	794,475
11 Sep 18	01 Sep 21	11.720	4.56	-	1,432,709	-	(59,866)	1,372,843
11 Sep 17	01 Sep 21	12.732	5.42	713,971	-	-	(60,952)	653,019
11 Sep 17	01 Sep 20	12.732	6.11	1,266,646	-	-	(108,133)	1,158,513
09 Jun 17	01 Sep 20	9.017	8.55	14,376	-	-	(10,782)	3,594
09 Jun 17	01 Sep 19	9.017	9.71	25,317	-	-	(18,988)	6,329
12 Sep 16	01 Sep 20	9.017	3.80	862,144	-	-	(55,261)	806,883
12 Sep 16	01 Sep 19	9.017	4.33	1,513,254	-	-	(96,994)	1,416,260
13 Sep 15	01 Sep 19	7.013	2.84	1,102,267	-	-	(97,270)	1,004,997
13 Sep 15	01 Sep 18	7.013	3.27	1,914,609	-	(1,914,609)	-	-
04 Mar 15	01 Sep 18	6.439	3.34	74,850	-	(74,850)	-	-
16 Sep 14	01 Sep 18	7.698	2.96	674,892	-	(674,892)	-	-
Total				8,162,326	2,261,830	(2,664,351)	(542,892)	7,216,913

[1] At the date of vesting, fully-paid shares are transferred to the individual and released from the CPP Trust.

Key estimates and assumptions

Share-based payments

The Group measures the cost of equity-settled transactions with employees granted during the year by reference to the fair value of the 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	11 Sep 18 DPSR[1]	11 Sep 18 HPSR[1]
Dividend yield (%)	2.80	2.80
Risk-free rate (%)	2.00–2.02	2.00–2.20
Volatility[2] (%)	n/a	26
Valuation ($)	10.22–9.66	4.56–3.94

[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 2019 $	30 June 2018 $
Full year audit and half year review of the Group financial report	1,630,924	1,615,234
Other audit services – audit and review of trusts and funds	687,878	726,018
Other services in relation to the Group		
– taxation services	168,801	354,760
– other assurance services	495,113	631,248
Total auditor remuneration[1]	2,982,716	3,327,260

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

Note 29 Subsequent events

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

Directors' declaration

In accordance with a resolution of the Directors of Challenger Limited, we declare that, in the opinion of the Directors:

a) the financial statements and notes of Challenger Limited and its controlled entities (the Group) are in accordance with the *Corporations Act 2001*, including:

   (i) giving a true and fair view of the Group's financial position as at 30 June 2019 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 issued by the International Accounting Standards Board, which is disclosed in Section 1(i) Basis of preparation and statement of compliance;

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 2019.

On behalf of the Board

P Polson
Independent Chair

Sydney
12 August 2019

R Howes
Managing Director and Chief Executive Officer

Sydney
12 August 2019

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working world

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Independent auditor's report to the shareholders of Challenger Limited

Report on the Audit of the Financial Report

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 2019, 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 2019 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

Financial report reference: Note 8

Why significant to the audit	How our audit addressed the key audit matter
The Group recognised a provision for future claims associated with insurance policies. The valuation methodology to estimate the provision adopted by the Group involves complex and subjective judgments about future events. Key assumptions used in the Group's model to determine the value of the life contract liabilities include: • Discount rates • Inflation • Future claims administration expenses • Mortality rates and redemptions These assumptions, along with policy information, are used as inputs to the Group's model to calculate the Life Contract Liabilities. This was a key audit matter due to the size of the balance (30 June 2019: $12,870.2 million), relative to total assets and the degree of judgment and estimation uncertainty associated with the valuation.	Our audit procedures involved an assessment of the effectiveness of relevant controls over assumptions and policy information used as inputs into the Group's model. Our IT specialists were involved to assess whether policy information was extracted accurately from the Group's underlying administration system into the valuation process. Our audit procedures included the following in the evaluation of the assumptions used by the Group: • Considered the Group's governance process and controls 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 for a sample of the life contract liability valuations. Where appropriate we involved our life insurance actuarial specialists in the above procedures and overall assessment of the valuation methodology, key assumptions and models deriving the valuation of the life contract liabilities. We assessed the adequacy of the related financial report disclosures.

2 Valuation of Level 3 Assets

Financial report reference: Note 19

Why significant to the audit	How our audit addressed the key audit matter
The Group holds a portfolio of assets carried at fair value, for which an observable market value is not readily available. These assets are classified as Level 3 assets within the fair value hierarchy of the financial report and include: • Fixed income securities • Equities and other alternatives • Infrastructure investments • Property securities • Investment and development property 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 transactions or other readily available market data. The Group exercised judgment to arrive at their best estimates of fair value of these assets. There is complexity in this process, as well as uncertainty associated with the valuation and modelling methodologies and the assumptions adopted. This was a key audit matter due to the size of the balance relative to total assets (30 June 2019: $6,420.7 million), and the degree of judgment and estimation uncertainty associated with the valuation.	Our audit procedures included the following, using sampling techniques: • Considered the Group's controls over the valuation of Level 3 assets. • Tested the mathematical accuracy of the valuation models and consistency with the Group's documented methodology and assumptions. • Our valuation specialists assessed the Group's valuation and modelling methodologies and assessed the key judgmental inputs used in the year-end valuations, including the discount rate and the terminal value. • Assessed the competence, qualifications and objectivity of the external property valuation experts used by the Group for the property portfolio valuation. • Our real estate valuation specialists assessed the Group's property portfolio valuation against independent expectations based on property class, location and market of the underlying properties. • Obtained valuation statements provided by external investments managers in respect of 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 received. We assessed the adequacy of the related financial report disclosures.

3 Valuation of Goodwill

Financial report reference: Note 25

Why significant to the audit	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 date, the goodwill has been allocated to the applicable Cash Generating Units (CGUs). An impairment assessment is performed at each reporting period, comparing the carrying amount of each CGU containing goodwill with its recoverable amount. The recoverable amount of each CGU is determined on a value in use basis. This calculation incorporates a range of assumptions, including future cash flows, discount rate and terminal growth rate. This was a key audit matter due to the size of Goodwill relative to total assets (30 June 2019: $557.3 million), and the degree of judgment and estimation uncertainty associated with the impairment assessment.	Our audit procedures included the following: • Assessed the valuation methodology used to calculate the recoverable amount of each CGUs. • Agreed the projected cash flows used in the impairment models to the Board approved five year plan of the Group. • Compared the Group's implied growth rate assumption to comparable companies. • Considered the accuracy of historical cash flow forecasts. • Assessed the methodology and assumptions used in the calculation of the discount rate, including comparison of the rate to market benchmarks. • Tested the mathematical accuracy of the impairment model for each CGU. • Assessed the Group's sensitivity analysis and evaluated whether any reasonable foreseeable change in assumptions could lead to a material impairment. Our valuation specialists were involved in the above procedures where appropriate. We assessed the Group's determination of the CGUs to which goodwill is allocated and the adequacy of the related financial report disclosures.

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 2019 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, with the exception of the Remuneration Report and our related assurance opinion.

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 Group’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 Group 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 Remuneration Report

Opinion on the Remuneration Report

We have audited the Remuneration Report included in pages 24 to 47 of the Directors' report for the year ended 30 June 2019.

In our opinion, the Remuneration Report of Challenger Limited for the year ended 30 June 2019, 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

T Johnson
Partner

Sydney
12 August 2019

L Burns
Partner

Sydney
12 August 2019

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 2019		Number of shares	% of issued capital
MS&AD Insurance Group Holdings Inc		98,633,303	16.13
Caledonia (Private) Investments Pty Ltd		91,886,048	15.02
20 largest individual shareholders as at 31 July 2019			
1.	Citicorp Nominees Pty Ltd	158,725,502	25.95
2.	HSBC Custody Nominees (Australia) Limited	134,731,821	22.03
3.	J P Morgan Nominees Australia Pty Limited	79,009,067	12.92
4.	National Nominees Limited	15,419,679	2.52
5.	HSBC Custody Nominees (Australia) Limited – GSCO ECA	14,815,362	2.42
6.	BNP Paribas Nominees Pty Ltd <Agency Lending Collateral>	7,670,000	1.25
7.	HSBC Custody Nominees (Australia) Limited – A/C 2	7,335,942	1.20
8.	Warbont Nominess Pty Ltd <Unpaid Entrepot A/C>	6,467,834	1.06
9.	Argo Investments Limited	5,440,311	0.89
10.	BNP Paribas Nominees Pty Ltd < Agency Lending DRP A/C>	4,805,407	0.79
11.	HSBC Custody Nominees (Australia) Limited – GSI EDA	4,342,141	0.71
12.	BNP Paribas Nominees Pty Ltd <DRP>	3,795,726	0.62
13.	CS Third Nominees Pty Ltd <HSBC Cust Nom AU Ltd 13 A/C>	3,300,928	0.54
14.	CPU Share Plans Pty Ltd <CGF Performance Plan A/C>	2,673,363	0.44
15.	National Nominees Limited <N A/C>	2,010,449	0.33
16.	Australian United Investment Company Ltd	1,800,000	0.29
17.	AMP Life Limited	1,734,244	0.28
18.	Woodross Nominees Pty Ltd	1,705,376	0.28
19.	Citicorp Nominees Pty Ltd <Colonial First State INV A/C>	1,511,069	0.25
20.	BKI Investment Company Ltd	1,485,000	0.24
Total 20 largest individual shareholders – issued capital		458,799,221	75.02
Total remaining shareholders balance		152,797,412	24.98

Distribution of shares (as at 31 July 2019)

Range	Number of shareholders	Number of shares	% of issued capital
1 – 1,000	19,367	9,389,670	1.54
1,001 – 5,000	19,915	47,597,264	7.78
5,001 – 10,000	3,703	26,850,335	4.39
10,001 – 100,000	2,065	43,186,400	7.06
100,001 and over	101	484,572,964	79.23
Total	45,151	611,596,633	100.00

Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum $500.00 parcel at $7.09 per unit	71	1,241	40,376

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 2019

2.8 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 $11.71.

Top 20 noteholders of Challenger Capital Notes 1 as at 31 July 2019

20 largest individual noteholders as at 31 July 2019		Number of notes	% of issued notes
1.	HSBC Custody Nominees (Australia) Limited	304,835	8.84
2.	Australian Executor Trustee Ltd <IPS Super A/C>	99,636	2.89
3.	BNP Paribas Nominees Pty Ltd HUB24 Custodial Serv Ltd DRP	86,155	2.50
4.	National Nominees Limited	69,768	2.02
5.	Navigator Australia Ltd <MLC Investment Sett A/C>	52,815	1.53
6.	Citicorp Nominees Pty Limited	40,855	1.18
7.	Eastcoote Pty Ltd <Van Lieshout Family A/C>	40,000	1.16
8.	Australian Executor Trustee Ltd <IPS IDPS A/C>	37,453	1.09
9.	J P Morgan Nominees Australia Ltd	37,343	1.08
10.	Netwealth Investments Limited <Wrap Services A/C>	34,276	0.99
11.	GCF Investments Pty Ltd	33,200	0.96
12.	Taverners No 11 Pty Ltd <Brencorp No 11 A/C>	30,586	0.89
13.	MF Investments No 1 Pty Ltd	30,000	0.87
14.	Willimbury Pty Ltd	22,000	0.64
15.	Nulis Nominees (Australia) Limited <Navigator Mast Plan Sett A/C>	21,735	0.63
16.	GCF Investments Pty Ltd	20,000	0.58
17.	270 King Street Pty Ltd	17,600	0.51
18.	Taverners No 11 Pty Ltd <Stoneyville Invest Unit A/C>	17,550	0.51
19.	Picko Pty Ltd	17,549	0.51
20.	Dakshina Pty Ltd <Dakshina A/C>	17,381	0.50
Total 20 largest individual noteholders – issued notes		1,030,737	29.88
Total remaining noteholders balance		2,419,263	70.12

Distribution of notes (as at 31 July 2019)

Range	Number of holders	Number of notes	% of notes
1 – 1,000	3,105	1,120,715	32.48
1,001 – 5,000	409	860,501	24.94
5,001 – 10,000	41	308,187	8.93
10,001 – 100,000	29	855,762	24.80
100,001 and over	1	304,835	8.85
Total	3,585	3,450,000	100.00

Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum $500.00 parcel at $102.14 per unit	5	1	4

Investor information (continued)

Top 20 noteholders of Challenger Capital Notes 2 as at 31 July 2019

20 largest individual noteholders as at 31 July 2019		Number of notes	% of issued notes
1.	HSBC Custody Nominees (Australia) Limited	415,276	9.03
2.	BNP Paribas Nominees Pty Ltd HUB24 Custodial Serv Ltd DRP	119,367	2.59
3.	Australian Executor Trustees Ltd <IPS Super A/C>	113,985	2.48
4.	Citicorp Nominees Pty Ltd	89,356	1.94
5.	National Nominees Limited	70,919	1.54
6.	Navigator Australia Ltd <JB Were List Fix Int SMA A/C>	45,067	0.98
7.	Netwealth Investments Limited <Wrap Services A/C>	41,769	0.91
8.	HSBC Custody Nominees (Australia) Limited – A/C 2	39,818	0.87
9.	Taverners J Pty Ltd <Taverners Int Unit A/C	38,760	0.84
10.	Navigator Australia Ltd <MLC Investment Settlement A/C>	37,001	0.80
11.	Australian Executor Trustees Ltd <IPS IDPS A/C>	35,876	0.78
12.	Taverners No 11 Pty Ltd <Brencorp No 11 Unit A/C >	35,821	0.78
13.	Taverners J Pty Ltd <Scanlon Foundation RC A/C >	32,538	0.71
14.	LBL Investment Pty Ltd <L&B Family A/C>	30,000	0.65
15.	Trustees of Church Property, Diocese of Newcastle <Savings & Development A/C>	29,270	0.64
16.	Nulis Nominees (Australia) Limited <Navigator Mast Plan Sett A/C>	23,607	0.51
17.	Australian Executor Trustees Ltd <Charitable Foundation>	23,129	0.50
18.	Taverners No 11 Pty Ltd <Stoneyville Invest Unit A/C >	21,604	0.47
19.	Mutual Trust Pty Ltd	21,514	0.47
20.	Citicorp Nominees Pty Limited <DPSL A/C>	21,425	0.47
Total 20 largest individual noteholders – issued notes		1,286,102	27.96
Total remaining noteholders balance		3,313,898	72.04

Distribution of notes (as at 31 July 2019)

Range	Number of holders	Number of notes	% of notes
1 – 1,000	5,084	1,658,321	36.05
1,001 – 5,000	548	1,160,009	25.22
5,001 – 10,000	34	256,007	5.57
10,001 – 100,000	35	877,035	19.06
100,001 and over	3	648,628	14.10
Total	5,704	4,600,000	100.00

Unmarketable parcels	Minimum parcel size	Holders	Units
Minimum $500.00 parcel at $106.15 per unit	5	2	2

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 3, 60 Carrington Street, Sydney NSW 2000
Telephone: 1800 780 782

Website: › www.computershare.com.au

To assist with all enquiries, please quote your unique Security Reference Number (SRN) and your current address when dealing with Computershare.

Additional information

Principal place of business and registered office in Australia

Level 2
5 Martin Place
Sydney NSW 2000

Telephone: 02 9994 7000
Facsimile: 02 9994 7777

Investor services: 13 35 66

Directors

Peter Polson (Chair)
Richard Howes (Managing Director and Chief Executive Officer)
John M Green
Steven Gregg
JoAnne Stephenson
Duncan West
Melanie Willis
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 3, 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 2019 Annual Report is available at:

› challenger.com.au/annualreport2019