

Challenger Life Company Limited and its controlled entities

2014 Annual Financial
Report

Annual Financial report for the year ended 30 June 2014

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Directors' report

The Directors of Challenger Life Company Limited (the Company or CLC) present their report, together with the financial report of the Consolidated Entity consisting of the Company and its controlled entities (the Group), for the year ended 30 June 2014.

1. Directors

The Directors of the Company holding office during the financial year ended 30 June 2014 and up to the date of this report are listed below. Directors were in office for this entire period unless otherwise stated.

Name	Position
Peter L Polson	Independent Chair
Brian R Benari	Chief Executive Officer
Graham A Cubbin	Independent Non-Executive Director
Steven Gregg	Independent Non-Executive Director
Jonathan H Grunzweig	Independent Non-Executive Director
Russell R Hooper	Independent Non-Executive Director
Brenda M Shanahan	Independent Non-Executive Director
JoAnne M Stephenson	Independent Non-Executive Director
Leon Zwier	Independent Non-Executive Director

2. Company secretary

Michael Vardanega was appointed to the position of Company Secretary in March 2011.
Andrew Brown was jointly appointed to the position of Company Secretary in October 2012.

3. Principal activities and change in the state of affairs

The principal activities of the Company during the year were the provision of a range of life insurance, annuity, superannuation and investment products in Australia, backed by a diverse portfolio of assets.

There has been no significant change in the nature of these activities during the year.

4. Operating and financial review

The statutory profit after tax for the year attributable to the equity holders was \$351.1 million compared to \$512.7 million in the prior year.

5. Dividends

On 15 August 2013 the Directors of the Company declared a dividend on ordinary shares of \$70.0 million. The dividend was subsequently paid on 29 September 2013.

On 17 February 2014 the Directors of the Company declared a dividend on ordinary shares of \$125.0 million. The dividend was subsequently paid on 26 February 2014.

6. Likely developments and expected results

The Group's business has been growing strongly. The growth is supported by favourable macroeconomic trends, including more baby boomers (those born between 1943–1960) retiring each year and retirees becoming more risk averse as life expectancy increases.

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

30 June 2014 Directors' report

The Group is also well positioned to benefit from changes in retiree risk preferences. The risk aversion of retirees is leading to increased demand for long-term protection from the risks they face in retirement, including longevity, inflation and market risks. Annuities address these concerns. The Group continues to experience increased demand for its products, particularly lifetime annuities.

These very favourable macroeconomic trends are helping drive demand for the Group's retirement income products. The Group is leveraging this demand through:

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

7. Significant events after the balance date

CLC is growing strongly and expects to continue to increase the size of its retail annuity business. In order to support CLC's growth profile, the CLC Board has approved the intention to raise \$250 million¹ in perpetual, subordinated, unsecured notes (Notes) issued to Challenger Limited.

Upon issue, the Notes will count as Additional Tier 1 capital under APRA Prudential Standard LPS112 Capital Adequacy: Measurement of Capital.

Further on 19 August 2014, the Board of Challenger Limited (CLC's ultimate parent entity) approved the following capital initiatives:

- Equity placement of Challenger ordinary shares to institutional holders raising \$250 million;
- Share Purchase Plan (SPP) allowing retail investors to participate and is expected to raise \$30 million; and
- The intention to launch Challenger Capital Notes (Challenger Notes) targeting to raise \$250 million². The Challenger Notes will be issued by Challenger Limited with the proceeds used to purchase the Notes.

The majority of the proceeds from the equity placement and SPP are planned to be injected into CLC as Common Equity Tier 1 capital.

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

8. Indemnification and insurance of officers and directors

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

To facilitate the indemnification, in accordance with the provisions of the *Corporations Act 2001*, the Company has insured the Directors and officers against liabilities incurred in their role as Directors and officers of the Company and its subsidiaries. The terms of the insurance policy, including the premium, are subject to confidentiality clauses and as such the Company is prohibited from disclosing the nature of the liabilities covered and the premium. The Company has not given, nor agreed to give, any indemnity to an auditor of the Group for any matters not permissible under the *Corporations Act 2001* and has not paid any premium for insurance against any auditor's liabilities for legal costs.

¹ Targeting \$250 million with ability to raise more or less, subject to market conditions.

² Subordinated, unsecured convertible notes issued by Challenger Limited (in Australia). Targeting \$250 million with ability to raise more or less, subject to market conditions.

9. Environmental regulation and performance

The Company owns a number of trusts, which own assets both in Australia and overseas. Some of these assets are subject to environmental regulations under both national and state legislation. The Directors are satisfied that adequate systems are in place for the management of its environmental responsibilities and compliance with various legislative, regulatory and licence requirements. Further, the Directors are not aware of any breaches to these requirements and to the best of their knowledge all activities have been undertaken in compliance with environmental requirements.

10. Rounding

The amounts contained in this report and the financial report have been rounded off to the nearest \$100,000 under the option available to the Group under the Australian Securities and Investments Commission (ASIC) class order 98/100. The Group is an entity to which the class order applies.

11. Corporate Reporting Reform Act – Parent entity reporting

On 30 June 2010 a change was made to the *Corporations Act 2001* to allow companies preparing consolidated accounts to move to a two column, consolidated-only disclosure in the financial report. After discussions with ASIC it was determined that, as an Australian Financial Services Licence holder, the Company was still required to produce parent entity information. On 29 July 2010 ASIC issued class order 10/654 to ensure that a company still required to produce parent entity accounts could do so without being in breach of the *Corporations Amendment (Corporate Reporting Reform) Act 2010*.

12. Auditor's independence declaration

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

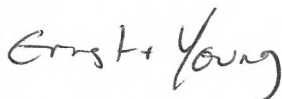


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Auditor's Independence Declaration to the Directors of Challenger Life Company Limited

In relation to our audit of the financial report of Challenger Life Company Limited for the year ended 30 June 2014, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.



Ernst & Young



D J Handley-Greaves

Partner

19 August 2014

Liability limited by a scheme approved under Professional Standards Legislation.

13. Authorisation

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



G A Cubbin
Director
Sydney
19 August 2014



B R Benari
Director
Sydney
19 August 2014

2014 Financial report

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

Income statements

For the year ended 30 June

		Consolidated		Parent	
	Note	2014 \$M	2013 \$M	2014 \$M	2013 \$M
Revenue	3	1,481.7	1,439.3	1,127.5	1,044.2
Expenses	4	(760.1)	(603.2)	(600.8)	(474.6)
Finance costs	5	(257.8)	(295.1)	(40.6)	(28.6)
Profit before income tax		463.8	541.0	486.1	541.0
Income tax (expense) / benefit	6	(90.3)	16.2	(105.7)	-
Profit for the year		373.5	557.2	380.4	541.0
Profit attributable to equity holders		351.1	512.7	380.4	541.0
Profit attributable to non-controlling interests	25	22.4	44.5	-	-
Profit for the year		373.5	557.2	380.4	541.0

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

Statements of comprehensive income

For the year ended 30 June

	Note	Consolidated		Parent	
		2014 \$M	2013 \$M	2014 \$M	2013 \$M
Profit for the year		373.5	557.2	380.4	541.0
Other comprehensive (expense) / income:					
Translation of foreign entities ¹		(16.7)	(9.9)	-	-
Recycled to the profit and loss		(5.4)	-	-	-
Income tax benefit		4.9	4.6	-	-
	23	(17.2)	(5.3)	-	-
Hedge of net investment in foreign operations ¹		17.6	19.4	-	-
Income tax expense		(2.4)	(8.7)	-	-
	23	15.2	10.7	-	-
Cash flow hedges ¹	23	(4.0)	4.5	-	-
Other comprehensive (expense) / income for the year		(6.0)	9.9	-	-
Total comprehensive income for the year		367.5	567.1	380.4	541.0
Comprehensive income attributable to equity holders		345.1	522.6	380.4	541.0
Comprehensive income attributable to non-controlling interests	25	22.4	44.5	-	-
Total comprehensive income for the year		367.5	567.1	380.4	541.0

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

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

Statements of financial position

As at 30 June

	Note	Consolidated		Parent	
		2014 \$M	2013 \$M	2014 \$M	2013 \$M
Assets					
Cash and cash equivalents	8	300.2	923.7	8.3	225.9
Cash and cash equivalents – SPV ¹	8	216.6	260.4	-	-
Receivables	9	304.1	607.5	671.3	799.9
Receivables – SPV	9	3,106.1	4,191.6	-	-
Derivative assets	28	313.3	325.5	341.3	374.9
Financial assets – fair value through profit and loss	10	9,977.3	8,524.5	10,835.2	8,950.2
Investment property held for sale	11	222.7	-	-	-
Investment and development property	11	2,222.1	2,431.4	-	-
Finance leases	12	39.4	-	39.4	-
Property, plant and equipment	13	125.7	123.1	-	-
Current tax assets		-	2.7	-	-
Deferred tax assets	6	2.6	0.6	-	-
Other assets	14	25.5	33.4	-	-
Goodwill	15	61.1	61.1	46.8	46.8
Other intangible assets	15	12.5	12.1	-	-
Total assets		16,929.2	17,497.6	11,942.3	10,397.7
Liabilities					
Payables	17	359.3	214.3	299.1	126.5
Payables – SPV	17	76.7	96.6	-	-
Derivative liabilities	28	201.5	369.8	178.0	345.7
Interest bearing liabilities	18	2,370.7	2,035.7	1,504.2	958.9
Interest bearing liabilities – SPV	21	2,856.3	3,728.2	-	-
External unit holders' liabilities	19	1,072.4	1,751.4	-	-
Current tax liabilities		1.8	-	-	-
Deferred tax liabilities	6	150.9	182.5	196.6	194.3
Life contract liabilities	20	7,824.3	7,123.3	7,824.3	7,123.3
Total liabilities		14,913.9	15,501.8	10,002.2	8,748.7
Net assets		2,015.3	1,995.8	1,940.1	1,649.0
Equity					
Contributed equity	22	1,046.5	1,046.5	1,046.5	1,046.5
Reserves	23	107.9	20.5	105.7	-
Retained earnings	24	738.0	581.9	787.9	602.5
Total equity attributable to equity holders		1,892.4	1,648.9	1,940.1	1,649.0
Non-controlling interests	25	122.9	346.9	-	-
Total equity		2,015.3	1,995.8	1,940.1	1,649.0

¹ SPV = Special Purpose Vehicles

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

Statements of changes in equity

For the year ended 30 June

Consolidated	Note	Attributable to equity holders							Non-controlling interests \$M	Total equity \$M
		Contributed equity \$M	Cash flow hedge reserve – SPV \$M	Foreign currency translation reserve \$M	Adjusted controlling interest reserve \$M	Other reserve \$M	Retained earnings \$M	Total shareholder equity \$M		
2014										
Balance at the beginning of the year		1,046.5	3.6	(1.3)	18.2	-	581.9	1,648.9	346.9	1,995.8
Profit for the year		-	-	-	-	-	351.1	351.1	22.4	373.5
Other comprehensive income for the year		-	(4.0)	(2.0)	-	-	-	(6.0)	-	(6.0)
Total comprehensive income for the year		-	(4.0)	(2.0)	-	-	351.1	345.1	22.4	367.5
Change in holding in controlling interest reserves		-	-	-	1.1	-	-	1.1	(257.7)	(256.6)
Dividends paid	7	-	-	-	-	-	(195.0)	(195.0)	-	(195.0)
Deconsolidation of entities		-	-	-	-	-	-	-	1.2	1.2
Distributable reserves		-	-	-	-	92.3	-	92.3	-	92.3
Non-controlling interests movements		-	-	-	-	-	-	-	10.1	10.1
Balance at the end of the year		1,046.5	(0.4)	(3.3)	19.3	92.3	738.0	1,892.4	122.9	2,015.3
2013										
Balance at the beginning of the year		1,046.5	(0.9)	(6.7)	17.7	-	319.2	1,375.8	352.3	1,728.1
Profit for the year		-	-	-	-	-	512.7	512.7	44.5	557.2
Other comprehensive income for the year		-	4.5	5.4	-	-	-	9.9	-	9.9
Total comprehensive income for the year		-	4.5	5.4	-	-	512.7	522.6	44.5	567.1
Change in holding in controlling interest reserves		-	-	-	0.5	-	-	0.5	-	0.5
Dividends paid	7	-	-	-	-	-	(250.0)	(250.0)	-	(250.0)
Consolidation of new controlled entities		-	-	-	-	-	-	-	9.6	9.6
Non-controlling interests movements		-	-	-	-	-	-	-	(59.5)	(59.5)
Balance at the end of the year		1,046.5	3.6	(1.3)	18.2	-	581.9	1,648.9	346.9	1,995.8

Statements of changes in equity

For the year ended 30 June

	Note	Attributable to equity holders							Non-controlling interests \$M	Total equity \$M
		Contributed equity \$M	Cash flow hedge reserve – SPV \$M	Foreign currency translation reserve \$M	Adjusted controlling interest reserve \$M	Other reserve \$M	Retained earnings \$M	Total shareholder equity \$M		
Parent										
2014										
Balance at the beginning of the year		1,046.5	-	-	-	-	602.5	1,649.0	-	1,649.0
Profit for the year		-	-	-	-	-	380.4	380.4	-	380.4
Other comprehensive income for the year		-	-	-	-	-	-	-	-	-
Total comprehensive income for the year		-	-	-	-	-	380.4	380.4	-	380.4
Dividends paid	7	-	-	-	-	-	(195.0)	(195.0)	-	(195.0)
Distributable reserves		-	-	-	-	105.7	-	105.7	-	105.7
Balance at the end of the year		1,046.5	-	-	-	105.7	787.9	1,940.1	-	1,940.1
2013										
Balance at the beginning of the year		1,046.5	-	-	-	-	311.5	1,358.0	-	1,358.0
Profit for the year		-	-	-	-	-	541.0	541.0	-	541.0
Other comprehensive income for the year		-	-	-	-	-	-	-	-	-
Total comprehensive income for the year		-	-	-	-	-	541.0	541.0	-	541.0
Dividends paid	7	-	-	-	-	-	(250.0)	(250.0)	-	(250.0)
Balance at the end of the year		1,046.5	-	-	-	-	602.5	1,649.0	-	1,649.0

The statements of changes in equity should be read in conjunction with the accompanying note.

Statements of cash flows

For the year ended 30 June

	Note	Consolidated		Parent	
		2014	2013	2014	2013
		\$M	\$M	\$M	\$M
Operating activities					
Annuity and premium receipts		2,806.2	2,179.9	2,806.2	2,180.7
Receipts from external unit holders		581.6	951.7	-	-
Annuity and claim payments		(2,526.0)	(1,895.2)	(2,526.0)	(1,895.2)
Payments to external unit holders		(1,292.6)	(993.2)	-	-
Payments to vendors		(348.9)	(390.9)	(102.2)	(86.8)
Dividends received		45.1	35.7	137.7	345.7
Interest received		541.7	532.2	503.6	484.9
Interest paid		(67.6)	(59.4)	(38.4)	(28.8)
Interest paid to external unit holders		(34.1)	(108.6)	-	-
Other income received		441.7	524.0	8.2	14.0
Income tax paid		(5.1)	(4.1)	-	-
Payments to reinsurer		(4.0)	(3.9)	(4.0)	(3.9)
Net cash flows from operating activities	33	138.0	768.2	785.1	1,010.6
Investing activities					
Payments on net purchases of investments		(1,041.2)	(888.9)	(1,329.1)	(1,041.0)
Payments for purchases of controlled entities		(270.7)	-	-	-
Payments for purchases of property, plant and equipment		(3.7)	(14.9)	-	-
Mortgage loan repayments		1,055.7	1,331.9	-	-
Net proceeds on sale of investment properties		126.4	149.3	-	-
Net cash (used in) / from investing activities		(133.5)	577.4	(1,329.1)	(1,041.0)
Financing activities					
Proceeds from interest bearing liabilities		571.1	528.3	529.4	448.9
Repayments of interest bearing liabilities		(1,033.4)	(1,466.2)	-	-
Dividends paid		(195.0)	(250.0)	(195.0)	(250.0)
Dividends paid to non-controlling interests		(17.7)	(16.7)	-	-
Proceeds from loans		3.2	1.8	(8.0)	(0.6)
Payments to non-controlling interests for redemption of units		-	(1.3)	-	-
Net cash (used in) / from financing activities		(671.8)	(1,204.1)	326.4	198.3
Net (decrease) / increase in cash and cash equivalents		(667.3)	141.5	(217.6)	167.9
Cash and cash equivalents at the beginning of the year		1,184.1	1,042.6	225.9	58.0
Cash and cash equivalents at the end of the year	8	516.8	1,184.1	8.3	225.9
Comprising:					
Cash		300.2	923.7	8.3	225.9
Cash – SPV		216.6	260.4	-	-
Cash and cash equivalents at the end of the year	8	516.8	1,184.1	8.3	225.9

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

Notes to the financial statements

For the year ended 30 June 2014

1. Basis of preparation and summary of significant accounting policies

Challenger Life Company Limited (the Company or CLC) is a company limited by shares, incorporated in Australia. The parent entity financial report and the financial report for the Company and its controlled entities (the Group or the Consolidated Entity) for the year ended 30 June 2014 were authorised for issue in accordance with a resolution of the Directors of the Company on 19 August 2014.

(i) Basis of preparation

This general purpose financial report has been prepared in accordance with the requirements of the *Corporations Act 2001* and Australian Accounting Standards (including Australian Interpretations).

As described in the accounting policies below, the financial report has been prepared primarily on a fair value basis as assets backing life contract liabilities, subordinated debt financial liabilities, other interest bearing liabilities relating to property trusts and life investment contract liabilities are shown on this basis. All other assets and liabilities are recognised on an historical cost basis, except where stated otherwise.

Unless stated otherwise, the financial report is presented in Australian dollars and amounts are rounded to the nearest \$100,000 in terms of class order 98/100.

The Group operates predominantly in the financial services industry. As such, the assets and liabilities disclosed in the statements of financial position are grouped by nature and listed in an order that reflects their relative liquidity.

(ii) Statement of compliance

This financial report complies with Australian Accounting Standards as issued by the Australian Accounting Standards Board (AASB) and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

(iii) New and revised accounting standards and interpretations

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

Changes in accounting policy or disclosure

AASB 2012-2 Amendments to Australian Accounting Standards - Offsetting Financial Assets and Financial Liabilities Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statement of financial position if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis and realise the assets and settle the liabilities simultaneously. This has resulted in increased disclosure in the 30 June 2014 annual financial report (refer to Note 30 Derivative financial instruments).

AASB 10 Consolidated Financial Statements and *AASB 12 Disclosure of Interests in Other Entities* AASB 10 and AASB 12 have been applied in the period. AASB 10 provides further clarity on the concept of control and AASB 12 enhances disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. Application of AASB 10 has not resulted in changes to those entities controlled by the Group and AASB 12 has resulted in increased disclosure in the 30 June 2014 annual financial report (refer to Note 32 Structured entities).

AASB 13 Fair Value Measurement

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

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

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

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

Accounting standards and interpretations issued but not yet effective

AASB 9 *Financial Instruments* is effective for annual periods beginning on or after 1 January 2018, however early adoption is permitted in certain circumstances. The standard makes changes to the classification of financial assets for the purpose of determining their measurement basis, as well as to the amounts relating to fair value changes to be taken directly to equity. There are also significant changes to hedge accounting requirements and disclosures.

The Group is currently assessing the impact of this new standard. The classification of a financial instrument will be assessed on the facts at the date of initial application and it is possible that the classification of some financial assets may change upon adoption of the new standard.

AASB 2012-3 Amendments to *Australian Accounting Standards – Offsetting Financial Assets and Financial Liabilities* effective for annual periods beginning on or after 1 January 2014. This amendment adds application guidance to AASB 132 *Financial Instruments: Presentation* to address inconsistencies identified in applying some of the offsetting criteria for AASB 132, including clarifying the meaning of “currently has a legally enforceable right of set-off” and that some gross settlement systems may be considered equivalent to net settlement. Initial application is not expected to result in any material impact.

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

(iv) Principles of consolidation

The consolidated financial statements comprise the financial statements of the Company and its controlled entities. Interests in associates other than those backing life contracts, are equity accounted and are not part of the Group (see Investments in associates below).

Controlled entities are all those entities over which the Group has the power to govern the financial and operating policies so as to obtain benefits from their activities. The statement of financial position date and the accounting policies of controlled entities are consistent with that of the Company.

All intercompany balances and transactions, including unrealised profits arising from intra-group transactions, are eliminated in full. Unrealised losses are eliminated unless costs cannot be recovered. For controlled entities where the Group owns less than 100% of the issued capital or units, the share of the results and equity attributable to non-controlling interests are shown separately in the consolidated financial statements.

The life contract operations of the Company are conducted within separate statutory funds as required by the *Life Insurance Act 1995* (the Life Act). Both the shareholder and policyholder interests in these statutory funds are reported in aggregate in the financial report of the Group (see Note 1(xxviii) Life contract liabilities).

Controlled entities are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. The acquisition method of accounting is applied on acquisition or initial consolidation. This method ascribes fair values to the identifiable assets and liabilities acquired. The difference between the net fair value of assets and liabilities acquired and the fair value of the consideration paid (including the fair value of any pre-existing investment in the entity) is recognised as either goodwill on the statement of financial position, or a discount on acquisition through the income statement.

Goodwill is subject to impairment testing as described in Note 1(xxii) Goodwill and other intangible assets.

Investments in associates

Associates are entities over which the Group has significant influence over the financial and operating policies but not control. Investments in associates, other than those backing life contracts, are accounted for under the equity method whereby investments are carried at cost adjusted for post-acquisition changes in the Group's share of the net assets of the entity. Investments in associates that back life contracts are designated as financial assets at fair value through profit and loss.

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

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

Special Purpose Vehicles

The Group manages and services trusts that hold residential mortgage-backed securities (RMBS) and securitised financial liabilities. As the Group retains the right to the residual income of these trusts, it is deemed to control them and, as a result, they are consolidated.

(v) Comparatives

Where necessary comparative figures have been reclassified to conform to any changes in presentation made in these financial statements.

(vi) Rounding of amounts

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

(vii) Segment reporting

Operating segments are identified on the basis of internal reports to senior management and comprise of component parts of the Group that are regularly reviewed by senior management in order to allocate resources and assess performance. This financial report focuses on the single core reportable segment as disclosed in Note 2 Segment information.

(viii) Revenue

Revenue is recognised and measured as the fair value of the consideration received or receivable to the extent that it is probable that economic benefits will flow to the Group and the revenue can be reliably measured. Revenues and expenses are generally recognised on an accrual basis. The following specific policies are applied:

- Interest revenue is recognised as it accrues using an effective interest rate method, taking into account the effective yield of the financial asset.
- Dividends on listed equity shares are recognised as income on the date the share is quoted ex-dividend. Dividends from unlisted companies are recognised when the dividend is declared.
- Gains or losses arising from changes in the fair value of financial instruments classified as fair value through profit and loss are recognised as revenue in the income statement when the change in value is recognised on the statement of financial position.
- Rental revenue from investment properties is accounted for on a straight-line basis over the lease term. Contingent rental income is recognised as income in the period in which it is earned. Lease incentives granted are recognised as an integral part of the total rental income.
- Operating lease rental income is earned on a straight line basis over the life of the contract.
- Interest revenue on finance leases is recognised on a basis that reflects a constant periodic return on the net investment in the finance lease. Secondary lease income (inertia income) is recognised on a cash basis (as-and-when it is received). Proceeds from the sale of rental assets are recognised upon disposal of the relevant assets.
- Life insurance premiums are recognised as revenue when received.
The portion of the change in life contract liabilities recognised in the income statement that relates to the net deposit component of life investment contracts, changes in discount rates, inflation rates and other assumption changes is classified as revenue. The remaining change is classified as an expense. See Note

1(xxviii) Life contract liabilities for further detail on the recognition and measurement of life contract liabilities.

(ix) Expenses

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

- 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 towards the carrying value of the asset.
- Life insurance claims expenses are recognised in expenses when the liability to the policyholder under the contract has been established.
- Changes in life contract liabilities recognised as an expense consist of the interest expense on the liability and any loss on the initial recognition of new business less the release of expenses in the period. The interest on the liability represents the unwind of the discount on the opening liability over the period, whereas the impacts of the changes in discount rate applied for the current valuation are included in the change in life contract liabilities disclosed in Revenue. See Note 1(xxviii) Life contract liabilities for further detail on the recognition and measurement of life contract liabilities.

(x) Finance costs

Finance costs represent interest on interest bearing financial liabilities (primarily the securitised residential mortgage-backed securities issued by the Special Purpose Vehicles, bank loans and other borrowings) and are recognised as an expense in the period in which they are incurred.

Finance costs that are directly attributable to the acquisition, construction or production of qualifying property assets (being assets that take a substantial period of time to develop for their intended use or sale) are capitalised as part of the cost of that asset. Revenue earned on the investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

To the extent that the Group allocates general borrowed funds for the purpose of obtaining a qualifying property asset, the borrowing costs eligible for capitalisation are determined by applying a capitalisation rate to the expenditure on that asset. The capitalisation rate is the weighted average of the borrowing costs applicable to the borrowings that are outstanding during the period, other than borrowing made specifically for the purpose of obtaining the qualifying asset.

(xi) Goods and services tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of the GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of the acquisition of the asset or as part of the expense.

Receivables and payables are stated with the applicable amount of GST included. The net amount of GST recoverable from or payable to the Australian Taxation Office (ATO) is included as an asset or liability on the statement of financial position.

Cash flows are included in the statement of cash flows on a gross (GST inclusive) basis. The GST components of cash flows arising from investing and financing activities which are recoverable from or payable to the ATO are classified as operating cash flows.

(xii) Income tax

Income tax shown on the income statement for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax assets and liabilities for the current and comparative periods are measured at the amount expected to be recovered from or paid to the taxation authorities based on the period's taxable income. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the statement of financial position date.

Deferred income tax is provided on all temporary differences at the statement of financial position date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences except:

- when the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss in the income statement; or
- when the taxable temporary difference is associated with investments in subsidiaries, associates or joint arrangements, the timing of the reversal of the temporary difference can be controlled, and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, and carry-forwards of unused tax credits and unused tax losses to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry-forwards of unused tax credits and unused tax losses can be utilised, except:

- when the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss in the income statement; or
- when the deductible temporary difference is associated with investments in subsidiaries, associates or joint arrangements in which case a deferred tax asset is only recognised to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilised.

The carrying amount of deferred income tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Unrecognised deferred income tax assets are reassessed at each statement of financial position date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered. Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the statement of financial position date.

Income taxes relating to items recognised directly in equity are recognised in equity and not in profit or loss in the income statement.

Deferred income tax assets and liabilities are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to the same taxable entity or tax consolidated group and the same taxation authority.

Tax consolidation

The Company and its wholly-owned Australian resident subsidiaries formed part of a tax consolidated group effective from 1 July 2002. Challenger Limited, the Company's ultimate parent entity, is the head entity of this tax consolidated group. The tax consolidated group is taxed as a single entity.

Tax effect accounting by members of the tax consolidated group

Members of the tax consolidated group have applied tax funding principles under which all members of the tax consolidated group agree to pay tax equivalent payments to or receive 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 or payable between each member and the head entity. This group allocation approach is applied in determining the appropriate amount of current tax liability or current tax asset to allocate to members of the tax consolidated group.

(xiii) Foreign currency

Both the presentation currency and the functional currency of the Company and its controlled Australian entities are Australian dollars. A number of foreign controlled entities have a functional currency other than Australian dollars.

Transactions in foreign currency are translated into the presentation currency, Australian dollars, at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into Australian dollars at the foreign exchange rate ruling at the statement of financial position date.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the historical 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 rate ruling at the date when the fair value was determined.

Derivatives are used to hedge the foreign exchange risk relating to certain transactions. Refer to Note 1(xvi) Derivative financial instruments and hedging for further details.

Foreign controlled entities

On consolidation, the assets and liabilities of foreign subsidiaries whose functional currencies differ from the presentation currency of the Company are translated into Australian dollars at the foreign exchange rate ruling at the statement of financial position date. Exchange differences arising on the translation are recognised in the foreign currency translation reserve in equity. The change in fair value of derivative financial instruments designated as a hedge of the net investment in a foreign controlled entity is also recognised in the foreign currency translation reserve.

On disposal of a foreign controlled entity, the deferred cumulative exchange differences recognised in equity relating to that particular foreign operation are recognised in the statement of comprehensive income.

(xiv) Cash and cash equivalents

Cash and cash equivalents are financial assets and comprise cash at bank and in hand plus short-term deposits with an original maturity of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents are recognised at fair value being the principal amount. For the purposes of the statement of cash flows, cash and cash equivalents are stated net of bank overdrafts.

(xv) Receivables

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

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

(xvi) Derivative financial instruments and hedging

The Group largely uses derivative financial instruments to hedge its risks associated with interest rate and foreign currency fluctuations and to manage its level of exposure to credit risk but does not hold derivative financial instruments for trading purposes. All derivative financial instruments are stated at fair value. Gains or losses arising from fair value changes on derivatives that do not qualify for hedge accounting are recognised in the income statement.

For the purpose of hedge accounting, hedges are classified as:

- fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability; or
- cash flow hedges when they hedge the exposure to variability in cash flows that are 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 a foreign controlled entity when they are translated from their functional currency to the presentation currency.

At the inception of a hedge relationship to which the Group wishes to apply hedge accounting, the Group formally designates and documents the hedge relationship and the risk management objectives and strategies for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the effectiveness of the instrument in offsetting the exposure to changes in the hedged item.

Such hedges are expected to be highly effective in achieving offsetting changes in fair values, cash flows or foreign exchange difference and are assessed on an ongoing basis to determine that they actually have been highly effective over the period that they were designated.

Fair value hedges

Fair value hedges are hedges of the Group's exposure to changes in the fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment that is attributable to a particular risk and could affect profit or loss.

For fair value hedges, the carrying amount of the hedged item is adjusted for gains and losses attributable to the risk being hedged and the derivative is remeasured to fair value. Gains and losses from both are recognised in the income statement.

When an unrecognised firm commitment is designated as a hedged item, the subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognised as an asset or liability with a corresponding gain or loss recognised in the income statement. The changes in the fair value of the hedging instrument are also recognised in the income statement.

The Group discontinues fair value hedge accounting if the hedging instrument expires or is sold, terminated or exercised, the hedge no longer meets the criteria for hedge accounting or the Group revokes the designation.

Cash flow hedges

Cash flow hedges are hedges of the Group's exposure to variability in cash flows attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecast transaction, and that could affect the income statement. The effective portion of the gain or loss on the hedging instrument is recognised through other comprehensive income on the cash flow hedge reserve in equity, while the ineffective portion is recognised immediately in the income statement.

Amounts recognised in equity are transferred to the income statement when the hedged transaction affects profit or loss, such as when hedged income or expenses are recognised or when a forecast sale or purchase occurs. When the hedged item is the cost of a non-financial asset or liability, the amounts taken to equity are transferred to the initial carrying amount of the non-financial asset or liability.

If the forecast transaction is no longer expected to occur, amounts previously recognised in equity are immediately transferred to the income statement. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, amounts previously recognised in equity remain in equity until the forecast transaction is recognised in the income statement.

Hedges of net investments in foreign operations

The gain or loss on the effective portion of the hedging instrument is recognised directly in equity and the gain or loss on the ineffective portion is recognised immediately in the income statement. The cumulative gain or loss previously recognised in equity is recognised in other comprehensive income on disposal or partial disposal of the foreign operation.

(xvii) Financial assets

The Group categorises its financial assets into either financial assets at fair value through profit or loss (being either held for the purpose of trading or initially designated as such) or available-for-sale. The classification depends on the definition and the purpose for which the investments were acquired. The classification of investments is determined at initial recognition and evaluated at each reporting date.

Purchases and sales of financial assets are recognised on the date on which the Group commits to purchase or sell the asset. Financial assets are initially recognised at fair value (plus transaction costs for available-for-sale assets). Financial assets are derecognised when the rights to receive cash flows from the assets has expired or when the risks and rewards of ownership have been substantially transferred.

The fair value of financial assets that are actively traded in organised financial markets are determined by reference to quoted market bid prices at the close of business on the statement of financial position date.

For assets for which no active market exists, fair values are determined using valuation techniques. Such techniques include: using recent arm's length market transactions; reference to the current market value of another instrument that is substantially the same; discounted cash flow analysis; and, option pricing models refined to reflect the issuer's specific circumstances making as much use of available and supportable market data as possible and keeping judgemental inputs to a minimum.

Financial assets at fair value through profit and loss

Financial assets classified in this category are assets either held for the purpose of trading or designated as fair value through profit and loss on initial recognition. Held for trading assets consist of fixed income or equity securities. They are carried at fair value with unrealised gains and losses being recognised through the income statement. Assets designated as fair value through profit and loss consist of infrastructure and property securities. Assets backing life contract liabilities are required to be designated as fair value through profit and loss in accordance with AASB 1038 *Life Insurance Contracts*.

(xviii) Investment property

Investment property is initially recognised at cost, including transaction costs. Subsequent to initial recognition, investment property is recognised at fair value. Independent valuations for all investment properties are conducted at least annually by suitably qualified independent valuers, and the Directors make reference to these valuations when determining fair value. When a sale price for a property has been agreed prior to the period end for a sale subsequent to the period end, the agreed sale price is taken as the fair value and the property is classified as investment property held for sale.

Gains or losses arising from changes in the fair values of investment properties are included in the income statement in the period in which they arise.

Investment properties are derecognised when they have either been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognised in the income statement in the year of retirement or disposal.

Investment property under development

When redevelopment of an existing investment property commences, it continues to be classified and measured as investment property when the asset is being redeveloped for continued future use as an investment property. Investment property under construction is held at cost until an estimate of the fair value can be reliably determined.

Development property held for resale

Development properties held for the purpose of resale are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling costs. Cost includes cost of acquisition, development costs, holding costs and directly attributable interest on borrowed funds where the development is a qualifying asset. Capitalisation of borrowing costs ceases during extended periods in which active development is interrupted. When a development is completed and ceases to be a qualifying asset, borrowing costs and other costs are expensed as incurred.

(xix) Finance leases

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

(xx) Property, plant and equipment

Items of property, plant and equipment are stated at cost, or deemed cost, less accumulated depreciation and impairment losses. Depreciation is calculated on a straight-line basis to write off 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 estimated useful life of 40 years. This is done on an asset-by-asset basis with amortisation commencing when the Group starts receiving income from the asset.

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

(xxi) Operating leases

Leases where the lessor retains substantially all the risk and benefits of ownership are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognised as an expense over the term of the lease on the same basis as the lease income.

Incentives received on entering into operating leases are recognised as liabilities and are amortised over the life of the lease.

Where the Group acquires, as part of a business combination, an operating lease over land, the fair value of the operating lease over land is recognised separately from goodwill. See Note 1(xxii) Goodwill and other intangible assets. Other operating lease payments are charged to the income statement in the periods in which they are incurred.

(xxii) Goodwill and other intangible assets

Goodwill

Goodwill acquired in a business combination is initially measured at cost, being the excess of the fair value of the consideration for the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to the Group's single cash-generating unit that is expected to benefit from the synergies of the combination.

The unit to which the goodwill is so allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. When the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised.

When goodwill forms part of a cash-generating unit and an operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this manner is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained. Impairment losses recognised for goodwill are not subsequently reversed.

Other intangible assets

Other intangible assets acquired are recorded at cost less accumulated amortisation and impairment losses. The cost of an intangible asset acquired in a business combination is its fair value as at the date of acquisition.

As stated in Note 1(xxi) Operating leases, where the Group acquires, as part of a business combination, an operating lease over land, the fair value of this lease is recognised separately from goodwill. This intangible asset is recorded at fair value less accumulated amortisation. Amortisation is calculated using the straight-line method over the effective life of the lease, being 25 years.

(xxiii) Impairment of assets

At each reporting date, the Group assesses whether there is any indication that an asset not carried at fair value may be impaired. If any such indication exists, the Group makes a formal estimation of the asset's recoverable amount.

An asset's recoverable amount is the greater of the fair value, less costs to sell, and its value in use. It is determined for individual assets unless the asset's recoverable amount cannot be estimated separately as it does not generate cash flows independent of those from other assets or groups of assets. In such cases, the asset is tested for impairment as part of the cash-generating unit to which it belongs. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset.

When the carrying amount of an asset or cash-generating unit exceeds its recoverable amount, the asset or cash-generating unit is considered impaired and is written down to its recoverable amount. Impairment losses are recognised in the income statement, unless an asset has previously been revalued, in which case the impairment loss is recognised as a reversal of that previous revaluation with any excess recognised through the income statement as impairment losses.

Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to that cash-generating unit, then to reduce the carrying amount of the other assets in the unit on a pro rata basis.

An assessment is also made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have diminished. If such indication exists, the recoverable amount is estimated. A reversal of the impairment loss may only increase the asset's value up to its carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement unless the asset is carried at revalued amount, in which case it is treated as a revaluation increase.

(xxiv) 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 creditors and other creditors and are recognised at amortised cost.

(xxv) Interest bearing financial liabilities

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

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

Capital market issuances of interest bearing financial liabilities by the Group, including property debt issued by controlled property trusts and the subordinated debt issued by the statutory funds, are recognised at fair value with unrealised gains and losses recognised through the income statement.

Non-capital market borrowings of controlled property and infrastructure trusts of the statutory funds are initially recognised at fair value and are subsequently measured at amortised cost. These borrowings are measured at amortised cost in this financial report with a difference between the proceeds (net of transaction costs) and the redemption amount recognised in the income statement over the period of the contract using the effective interest rate method.

(xxvi) External unit holders' liabilities

The Group controls a number of guaranteed index return trusts that contain funds pertaining to fixed term wholesale mandates. The fixed term and guaranteed nature of the mandates effectively places the balance of the risks related to the performance of the trusts with the Group. As a result, the Group is deemed to control these trusts. The contributed funds for these trusts are classed as a liability and shown as External unit holders' liabilities on the statement of financial position which represents the funds owing to third parties on these mandates. The liability is recorded at fair value.

(xxvii) Restrictions on assets

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

(xxviii) Life contract liabilities

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

Life investment contract liabilities

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

For fixed-term policies the liability is based on the fair value of the income payments and associated expenses, being the net present value using an appropriate discount rate curve as determined by the Appointed Actuary.

Life insurance contract liabilities

Life insurance contracts are contracts regulated under the Life Act that involve the acceptance of significant insurance risk. Insurance risk is defined as significant if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (i.e. have no discernible effect on the economics of the transaction).

The financial reporting methodology used to determine the value of life insurance contract liabilities is referred to as Margin on Services (MoS). Under MoS, the excess of premiums received over payments to customers and expenses (the margin) is recognised over the life of the contracts in a manner that reflects the pattern of risk accepted from the policyholder (the service) unless future margins are negative, in which case the future losses are recognised. The planned release of this margin is recognised in the income statement as part of the movement in life insurance contract liabilities.

Life insurance contract liabilities are usually determined using a projection method, whereby estimates of policy cash flows (payments and expenses) are projected using best-estimate assumptions about the future. The liability is calculated as the net present value of these projected cash flows using a risk-free discount rate curve.

Life insurance premium revenue

Life insurance premiums are recognised as revenue when received.

Life insurance claims expense

Life insurance claims are recognised in expenses when the liability to the policyholder under the contract has been established.

Reinsurance

The Group has maintained reinsurance arrangements during the period that meet the definition of life insurance contracts. 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.

(xxix) Contributed equity

Ordinary shares are classified as equity. Issued capital in respect of ordinary shares is recognised at 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.

(xxx) 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 may have had a significant impact on recognised amounts on the income statement had different assumptions been adopted are:

Life insurance contract liabilities

Life insurance contract liabilities are recognised under the MoS methodology described in Note 1(xxviii) Life contract liabilities. Significant judgement is applied in the MoS liability valuation as it involves the application of actuarial assumptions.

The key areas of judgement in the determination of the actuarial assumptions are the duration of claims / policy payments, acquisition and maintenance expense levels, mortality rates and economic assumptions for discount and inflation rates. Additional information on the life insurance contract liabilities is set out in Note 20 Life contract liabilities.

Property valuations

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

The independent valuer is authorised to practise under the law of the relevant jurisdiction where the valuation takes place and is required to have at least five years of continuous experience in the valuation of property of a similar type to the property being valued. The valuer has no pecuniary interest that could conflict with the valuation of the property and complies with the Australian Property Institute (API) Code of Ethics and Rules of Conduct (or international equivalent).

Fair value for the purposes of the independent valuation is market value as defined by The International Valuation Standards Committee. In determining market value, valuers examine available market evidence and apply this analysis to both the traditional capitalisation rate and discounted cash flow approach.

Interest bearing financial liabilities

Subordinated debt is recognised at fair value. The determination of fair value includes the assessment of movements in interest rates, credit spreads and foreign exchange. These movements are reviewed at each reporting date to take into account market conditions.

Deferred tax assets

Deferred tax assets are recognised when it is considered probable that future taxable profits will be available to utilise those temporary differences. Factors considered include the ability to offset tax losses against taxable profits between members of the tax consolidated group within an appropriate future timeframe, and whether the level of future taxable profit is expected to be sufficient to allow for recovery of deferred tax assets.

Unlisted investment valuations

Investments for which there is no active market or external valuation available are valued either by reference to the current market value of another instrument that is substantially the same, a discounted cash flow analysis or other method consistent with market best practice. Refer Note 26 Financial risk management for further details.

Impairment of goodwill

The Group assesses at least annually whether goodwill is impaired in accordance with the accounting policy in Note 1(xxii) Goodwill and other intangibles. These calculations involve an estimation of the recoverable amount of the cash-generating unit to which the goodwill is allocated.

2. Segment information

Business segment

The Group as a regulated life company operates solely in the CLC segment. The management view of this segment, as reported to the chief decision maker, is as follows:

	CLC Segment	
	30 June 2014 \$M	30 June 2013 \$M
Management view of income statement for the year ended		
Net income	466.0	414.5
Operating expenses	(66.9)	(60.4)
Normalised EBIT	399.1	354.1
Interest and borrowing costs	-	-
Normalised net profit before tax	399.1	354.1
Tax on normalised profit	-	-
Normalised net profit after tax	399.1	354.1
Investment experience before tax	42.3	141.7
Tax and other items	(90.3)	16.9
Profit attributable to equity holders	351.1	512.7
Management view of statement of financial position as at		
Segment assets	11,560.7	11,215.1
Segment liabilities	9,668.3	9,566.2
Total equity attributable to equity holders	1,892.4	1,648.9
Non-controlling interests	122.9	346.9
Total equity	2,015.3	1,995.8
	30 June 2014 \$M	30 June 2013 \$M
Statutory view of specific income and expense items for the year ended		
Revenue from external customers	743.2	625.7
Interest income	738.5	813.6
Finance costs	257.8	295.1
Depreciation and amortisation	12.3	7.6

Definitions

Net income and operating expenses differ from revenue and expenses as disclosed in the income statement as certain direct costs (including commissions and management fees) included in expenses are netted off against gross revenues in deriving the management view of the income statement above. In addition, the revenues, expenses and finance costs from SPV are separately disclosed in the statutory view but are netted off in the management view above.

Revenue also includes investment gains and losses which are excluded from the management view as they form part of investment experience (see below).

Normalised earnings before interest and tax (Normalised EBIT) is the net of the management view of revenue and operating expenses, as defined above. It excludes investment experience, tax and other items.

Interest and borrowing costs differ from finance costs as disclosed in the income statement for similar reasons to revenue and expenses, with the major difference arising from the netting of SPV finance costs against SPV revenue in the management view.

Investment experience before tax: the Group is required by AASB 1038 *Life Insurance Contracts* to value assets and liabilities supporting the life insurance business at fair value where this is permitted by other accounting standards. This can give rise to fluctuating valuation movements being recognised in the income statement, particularly during periods of market volatility. As the Group is generally a long-term holder of assets, due to assets being held to match the term of the Group's life contract obligations, the Group takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term volatility. Investment experience is a mechanism employed to remove the volatility arising from asset and liability valuation from the normalised management 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 (see below) plus actuarial assumption changes.

Normalised capital growth is determined by multiplying the normalised capital growth rate for each asset class by the average investment assets for the period. The normalised growth rates represent the Group's medium to long-term capital growth expectations for each asset class over the investment cycle. The normalised growth rates are 6.0% for Equity investments, 4.0% for Infrastructure, 2.0% for Property and (0.35%) for Cash and Fixed income. The rates have been set with reference to medium to long-term market growth rates and are reviewed to ensure consistency with prevailing market conditions.

Actuarial assumption changes represent the impact of changes in macro-economic variables, including bond yields and inflation factors, expense assumptions, losses on new business and other factors applied in the valuation of life contract liabilities. It also includes the attribution of interest rate derivatives used to hedge interest rate volatility.

Segment assets and liabilities: the assets and liabilities from the mortgage SPV are separately disclosed in the statutory view but are netted off in the management view of segment assets and liabilities.

Operating segments

The format of the segment information is the same as that provided to the chief operating decision maker of CLC. CLC solely operates in the CLC segment.

Operating segments are organised and managed according to the nature of the products and services provided. The CLC segment manages a portfolio of assets backing long-term guaranteed income streams to policyholders and predictable, through-the-cycle, returns to shareholders. Segment information has been prepared in conformity with the segment reporting accounting policy.

Major customers

The Group does not rely on any major customers so there is no concentration risk.

Geographical areas

The Group operates predominantly in Australia and, as a result, no geographical split is provided.

Reconciliation of management view of revenue to statutory revenue for the year ended

Net income (management view of revenue)

Expenses and finance costs offset against revenue in management view

SPV interest costs and fees offset against SPV revenue

Commission expenses offset against revenue

Changes in life contract liabilities and reinsurance recognised in expenses and offset against revenue

Property-related expenses offset against property income

Interest and loan amortisation costs

Management fees

Adjustment for non-controlling interests and other items

Difference between management view of investment experience and statutory recognition

Actual capital growth

Normalised capital growth

Actuarial assumption changes

Revenue (statutory view of revenue)

Reconciliation of segment to statutory profit for the year ended

Normalised net profit before tax (management view of pre-tax profit)

Investment experience before tax

Profit attributable to non-controlling interests excluded from management view

Other

Profit before tax (statutory view of pre-tax profit)

Reconciliation of segment assets to statutory assets as at year end

Management view of assets

SPV assets

Impact of derivative gross-up

Other items shown net for management / minorities excluded

Statutory view of assets

Reconciliation of segment liabilities to statutory liabilities as at year end

Management view of liabilities

SPV liabilities

Impact of derivative gross-up

Other items shown net for management / minorities excluded

Statutory view of liabilities

CLC Segment	
30 June 2014	30 June 2013
\$M	\$M
466.0	414.5
128.9	198.6
29.7	25.0
490.2	376.7
90.3	73.9
117.8	89.6
42.4	28.1
74.1	91.2
122.1	210.2
(55.6)	(36.1)
(24.2)	(32.4)
1,481.7	1,439.3
399.1	354.1
42.3	141.7
22.4	44.5
-	0.7
463.8	541.0
11,560.7	11,215.1
2,933.0	3,824.8
201.5	366.2
2,234.0	2,091.5
16,929.2	17,497.6
(9,668.3)	(9,566.2)
(2,933.0)	(3,824.8)
(201.5)	(366.2)
(2,111.1)	(1,744.6)
(14,913.9)	(15,501.8)

3. Revenue

	Consolidated		Parent	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
Investment revenue				
<i>Fixed income securities and cash</i>				
Interest revenue	556.6	544.2	520.1	476.6
Interest revenue – SPV	181.9	269.4	-	-
Net realised gain on fixed income securities	151.1	189.2	84.9	196.3
Net unrealised gain / (loss) on fixed income securities ¹	104.1	36.2	71.9	(42.8)
<i>Investment property and property securities</i>				
Dividend revenue	25.3	11.2	13.7	4.8
Property rental revenue	239.9	228.9	-	-
Net realised gain on property investments	6.1	3.3	3.0	-
Net unrealised gain / (loss) on property investments	3.8	12.1	(6.4)	8.2
Revenue from sale of development properties	17.3	11.5	-	-
<i>Equity and infrastructure investments</i>				
Dividend revenue	24.1	18.1	11.8	13.7
Dividend revenue from controlled entities	-	-	251.3	331.0
Net realised gain / (loss) on equity investments	38.0	(5.7)	41.0	(6.4)
Net unrealised gain on equity investments	0.4	32.8	2.1	64.3
Net realised gain / (loss) on infrastructure investments	-	19.2	-	(12.9)
Net unrealised gain / (loss) on infrastructure investments	47.0	(12.7)	38.3	18.4
<i>Other</i>				
Net realised loss on foreign exchange translation and hedges	(45.4)	(15.9)	(43.4)	(32.4)
Net unrealised gain on foreign exchange translation and hedges	99.8	56.4	102.2	5.5
Net realised loss on interest rate derivatives	(10.7)	(15.6)	(11.3)	(15.4)
Net unrealised loss on interest rate derivatives	(35.9)	(51.1)	(26.9)	(61.7)
Net realised gain on equity swap derivatives	0.7	-	-	-
Net unrealised gain on equity swap derivatives	0.1	-	-	-
Fee revenue				
Infrastructure revenue	3.3	10.3	-	-
Fee income – SPV	1.5	2.4	-	-
Management fee income	7.3	7.9	9.8	9.8
Other revenue				
Life insurance premiums and related revenue	620.5	257.6	620.5	257.6
Change in life insurance contract liabilities ²	(549.7)	(163.1)	(549.7)	(163.4)
Change in life investment contract liabilities ²	(5.9)	(5.0)	(5.9)	(4.7)
Change in reinsurance contract liabilities ²	0.5	(2.3)	0.5	(2.3)
Total revenue	1,481.7	1,439.3	1,127.5	1,044.2

¹ Includes fair value movements on the CLC subordinated debt (Note 26 Financial risk management).

² Changes in life contract liabilities arising from discount rates, inflation rates and other assumptions are recognised as revenue, with other movements being included in Note 4 Expenses.

4. Expenses

	Consolidated		Parent	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
Life insurance claims and related expenses	109.0	60.1	109.0	60.1
Cost of life insurance contract liabilities ¹	93.4	65.0	93.4	65.0
Cost of life investment contract liabilities ¹	285.5	251.6	285.5	251.6
Reinsurance contracts ¹	2.3	-	2.3	-
Investment property-related expenses	74.7	62.9	0.3	0.9
Development properties' cost of sales	15.6	11.0	-	-
Management fee expense	42.4	28.1	11.8	12.5
Expenses – SPV	16.1	22.2	-	-
Infrastructure overheads	8.2	8.6	-	-
Depreciation and amortisation expense	12.3	7.6	-	-
Commission expenses	29.7	25.0	29.7	24.6
Other expenses	70.9	61.1	68.8	59.9
Total expenses	760.1	603.2	600.8	474.6

¹ Cost of life contract liabilities and reinsurance contracts recognised as an expense consists of the interest expense on the liabilities and any loss on the initial recognition of new business less the release of expenses relating to the current period. The interest expense on the liabilities represents the unwind of the discount on the opening liability over the period, whereas the impacts of changes in the discount rate applied for the current valuation are included in the change in life contract liabilities disclosed in Note 3 Revenue.

5. Finance costs

	Consolidated		Parent	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
Interest expense - SPV	112.8	176.4	-	-
Interest expense - other entities	117.8	89.6	40.6	28.6
Property trusts finance costs	27.2	29.1	-	-
Total finance costs	257.8	295.1	40.6	28.6

6. Income tax

Analysis of income tax (expense) / benefit

Current income tax expense for the year
Current income tax benefit / (expense) prior year adjustment

Tax indemnity agreement transfer to CLCHL¹

Deferred income tax benefit / (expense)

Income tax (expense) / benefit

Income tax benefit on translation of foreign entities

Income tax expense on hedge of net investment in foreign entities

Income tax benefit / (expense) from items in other comprehensive income

Reconciliation of income tax (expense) / benefit

Profit before income tax

Prima facie income tax based on the 30% Australian company tax rate

Tax effect of amounts which are not assessable / deductible in calculating taxable income:

Non-assessable and non-deductible items

Tax indemnity agreement transfer to CLCHL

Rate differential

Other items

Net income tax (expense) / benefit per income statements

Consolidated		Parent	
30 June 2014	30 June 2013	30 June 2014	30 June 2013
\$M	\$M	\$M	\$M
(121.1)	(112.0)	(105.4)	(105.6)
1.9	(0.5)	2.0	(0.1)
-	120.0	-	127.6
28.9	8.7	(2.3)	(21.9)
(90.3)	16.2	(105.7)	-
4.9	4.7	-	-
(2.4)	(8.7)	-	-
2.5	(4.0)	-	-
463.8	541.0	486.1	541.0
(139.1)	(162.3)	(145.8)	(162.3)
49.1	56.8	37.3	34.0
-	120.0	-	127.6
(1.0)	(3.7)	(1.5)	(0.1)
0.7	5.4	4.3	0.8
(90.3)	16.2	(105.7)	-

Analysis of deferred tax

Consolidated

Deferred tax assets

Accruals and provisions

Unrealised foreign exchange movements

Unrealised losses on investments

Deferred tax liabilities

Unrealised foreign exchange movements

Unrealised gains on investments

Other

Net deferred tax liability

Deferred income tax benefit

Statement of financial position		Income statement	
30 June 2014	30 June 2013	30 June 2014	30 June 2013
\$M	\$M	\$M	\$M
3.2	2.3	0.9	(2.6)
19.6	26.2	(6.6)	23.8
(20.2)	(27.9)	7.7	(21.4)
2.6	0.6	2.0	(0.2)
(8.8)	(11.2)	(2.3)	(7.0)
(141.0)	(170.2)	29.2	6.8
(1.1)	(1.1)	-	9.1
(150.9)	(182.5)	26.9	8.9
(148.3)	(181.9)		
		28.9	8.7

¹ CLCHL: Challenger Life Company Holdings Pty Limited, CLC's immediate parent.

	Statement of financial position		Income statement	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
Analysis of deferred tax				
Parent				
Deferred tax assets				
Accruals and provisions	3.2	4.8	(1.6)	(0.1)
Unrealised foreign exchange movements	10.6	33.0	(22.4)	30.6
Unrealised losses on investments	57.0	23.2	33.8	(5.3)
	70.8	61.0	9.8	25.2
Deferred tax liabilities				
Unrealised foreign exchange movements	(1.4)	(2.8)	1.4	1.4
Unrealised gains on investments	(266.0)	(251.3)	(14.7)	(52.6)
Other	-	(1.2)	1.2	4.1
	(267.4)	(255.3)	(12.1)	(47.1)
Net deferred tax liability	(196.6)	(194.3)		
Deferred income tax expense			(2.3)	(21.9)

On 30 June 2005 the Company entered into a Tax Indemnity Agreement (the Agreement) with Challenger Life Company Holdings Pty Limited (CLCHL) and Challenger Limited (Challenger). Under the terms of the Agreement, CLCHL has agreed to take responsibility for the majority of the Company's current and future tax related liabilities and the Company assigns to CLCHL all of the current and future rights and benefits conferred on the Company by Challenger under the Tax Funding Arrangements in respect of the Company's Statutory Fund No.2 (SF2) and Shareholders' Fund (SHF).

Additionally, CLCHL is responsible for, and indemnifies the Group for, actual, contingent and tax-related liabilities of SF2 and SHF. Amounts receivable by the Group from CLCHL under the tax indemnity agreement total \$188.3 million (2013: \$298.7 million). Transactions under this agreement are treated as contributions from or distributions to CLCH.

7. Dividends paid and proposed

	30 June 2014	30 June 2013
	\$M	\$M
Consolidated and parent		
Unfranked dividends declared and paid during the year	195.0	250.0
Unfranked dividend proposed (not recognised as a liability at year end)	-	70.0

8. Cash and cash equivalents

	Consolidated		Parent	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
Cash at bank and on hand	274.9	710.0	-	225.9
Conditional cash reserves ¹	8.4	9.2	-	-
Cash equivalents	16.9	204.5	8.3	-
Total cash and cash equivalents	300.2	923.7	8.3	225.9
Total cash and cash equivalents – SPV	216.6	260.4	-	-
Total	516.8	1,184.1	8.3	225.9

¹ Conditional cash reserves are insurance premium and trust bank fee reserves required to be maintained in accordance with requirements of the Japanese Trust Banks. A portion of cash held by the Trust Bank is transferred to cash at bank quarterly and is then available for appropriation.

9. Receivables

	Consolidated		Parent	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
Trade receivables	7.7	5.2	-	-
Accrued investment income	80.9	87.0	426.4	307.7
Derivative credit support	-	120.4	-	120.1
Tax indemnity agreement – related entity ¹	188.3	298.7	196.4	293.4
Amounts recoverable from related entities	2.8	-	14.7	-
Other receivables	24.4	96.2	33.8	78.7
Total receivables	304.1	607.5	671.3	799.9
Current	301.6	597.9	671.3	799.9
Non-current	2.5	9.6	-	-
	304.1	607.5	671.3	799.9
Total receivables - SPV	3,106.1	4,191.6	-	-
Current	691.1	945.9	-	-
Non-current	2,415.0	3,245.7	-	-
	3,106.1	4,191.6	-	-

¹ See Note 6 Income tax for more details on the Tax indemnity agreement.

10. Financial assets – fair value through profit and loss

	Consolidated		Parent	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
<i>Fixed income securities</i>				
Domestic sovereign bonds & semi-government bonds	1,584.6	391.7	1,327.2	391.7
Floating rate notes and corporate bonds	4,536.8	4,645.2	3,898.1	3,464.6
Residential mortgage and asset-backed securities	2,199.4	1,980.6	1,740.1	1,590.5
Non-SPV mortgage assets	153.2	155.2	-	-
Controlled entities	-	-	1,030.9	600.8
	8,474.0	7,172.7	7,996.3	6,047.6
<i>Equity securities</i>				
Shares in controlled entities	-	-	657.1	455.1
Shares in listed and unlisted corporations	73.9	94.5	40.7	79.4
Unit trusts, managed funds and other	307.9	227.9	160.8	102.0
	381.8	322.4	858.6	636.5
<i>Infrastructure investments</i>				
Units in listed and unlisted infrastructure trusts	360.7	302.3	121.0	102.2
Other infrastructure investments	291.5	278.8	-	-
	652.2	581.1	121.0	102.2
<i>Property securities</i>				
Indirect property investments in listed and unlisted trusts	469.3	448.3	158.3	147.1
	469.3	448.3	158.3	147.1
<i>Controlled trusts</i>				
Infrastructure	-	-	270.5	265.9
Property	-	-	1,146.5	1,259.5
Other	-	-	284.0	491.4
	-	-	1,701.0	2,061.8
Total financial assets at fair value through profit and loss¹	9,977.3	8,524.5	10,835.2	8,950.2
Current	2,474.3	4,203.4	2,332.3	3,182.0
Non-current	7,503.0	4,321.1	8,502.9	5,768.2
	9,977.3	8,524.5	10,835.2	8,950.2

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

11. Investment and development property

Consolidated

Investment property held for sale¹

Investment property in use

Investment property under development²

Total investment property

Development property³

Total investment and development property⁴

30 June 2014 \$M	30 June 2013 \$M
222.7	-
2,125.5	2,333.6
18.8	18.6
2,367.0	2,352.2
77.8	79.2
2,444.8	2,431.4
Reconciliation of carrying amounts:	
<i>Investment property in use</i>	
Balance at the beginning of the year	2,333.6
Acquisitions ⁵	176.2
Disposals ⁶	(131.1)
Transfer to investment property held for sale	(222.7)
Capital expenditure	12.3
Foreign currency exchange loss	(26.5)
Net revaluation loss	(16.3)
Balance at the end of the year	2,125.5
<i>Investment property under development</i>	
Balance at the beginning of the year	18.6
Capital expenditure	1.6
Net revaluation loss	(1.4)
Balance at the end of the year	18.8
<i>Development property³</i>	
Balance at the beginning of the year	79.2
Sales of development properties	(15.6)
Capital expenditure	14.2
Balance at the end of the year	77.8

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

² Investment properties under development are shown at fair value.

³ Development property is held at the lower of cost or net realisable value, being fair value on completion less costs to complete and estimated selling costs.

⁴ Investment property in use, investment property under development and development property are considered non-current.

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

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

Analysis of investment property

	Acquisition Date ²	Total Cost ³ \$M	Carrying value 2014 \$M	Cap Rate 2014 ⁴ %	Last external valuation	Carrying value 2013 \$M	Cap Rate 2013 ⁴ %
Investment property in use							
<i>Australia</i>							
Century City Walk, VIC	16-Oct-06	29.9	34.5	8.00	30-Jun-14	31.7	8.00
Innaloo Cinema, WA	17-Dec-01	32.1	44.4	7.50	30-Jun-14	43.5	8.00
Jam Factory, VIC	04-Jul-00	126.6	126.0	7.25	31-Dec-13	128.0	7.50
Lennox, NSW ¹	27-Jul-13	26.5	26.6	7.50	30-Jun-14	-	7.75
Karratha, WA ¹	28-Jun-13	52.3	53.7	7.75	30-Jun-14	52.5	7.75
Bunbury Forum, WA	03-Oct-13	151.1	145.2	6.75	30-Jun-14	-	-
Kings Langley, NSW	29-Jul-01	15.9	19.2	7.50	30-Jun-14	16.8	8.50
County Court, VIC	30-Jun-00	209.8	281.5	7.50	31-Dec-13	277.1	7.78
CSIRO, NSW	27-Jun-01	150.6	170.0	8.38	30-Jun-14	160.0	8.00
Kraft, Port Melbourne, VIC	28-Jun-02	-	-	-	-	21.8	9.00
ABS Building, ACT	01-Jan-00	119.5	132.5	8.00	30-Jun-14	140.0	8.50
DIAC Building, ACT	01-Dec-01	102.7	120.5	8.25	30-Jun-14	118.5	8.25
Discovery House, ACT	28-Apr-98	87.2	100.0	8.00	31-Dec-13	99.0	8.00
Elders House, SA	21-Jun-02	47.7	37.0	9.00	30-Jun-14	43.9	9.50
Executive Building, Hobart, TAS	30-Mar-01	30.1	32.9	8.50	31-Dec-13	33.0	8.50
Makerston, QLD	14-Dec-00	67.4	72.5	9.00	31-Dec-13	73.6	9.00
31 Queen Street, VIC	31-Mar-11	94.5	97.5	7.75	30-Jun-14	95.5	8.00
Taylors Institute, Waterloo, NSW	16-May-01	42.7	42.6	9.25	31-Dec-13	42.0	9.25
The Forum, Cisco, NSW	05-Jan-01	108.8	110.6	8.25	31-Dec-13	111.2	8.25
The Forum, Verizon, NSW	05-Jan-01	71.7	68.9	8.75	31-Dec-13	69.9	8.75
6 Foray St, Fairfield, NSW	31-Dec-08	18.0	13.1	10.50	31-Dec-13	14.9	10.50
Cosgrove Industrial Park, Enfield, NSW	31-Dec-08	57.8	56.9	7.75	30-Jun-14	55.4	8.13
Spotlight, Laverton North, VIC	31-Dec-08	16.9	18.5	8.00	31-Dec-13	17.0	8.25
12-30 Toll Drive, Altona North, VIC	31-Dec-08	13.9	13.8	8.50	30-Jun-14	14.0	8.75
2-10 Toll Drive, Altona North, VIC	31-Dec-08	6.5	5.9	8.50	31-Dec-13	5.8	8.50
1-9 Toll Drive, Altona North, VIC	31-Dec-08	3.3	3.9	8.25	30-Jun-14	3.9	8.50
Total Australia		1,683.5	1,828.2			1,669.0	
<i>Hungary</i>							
Rozalia park	12-Apr-07	80.4	13.9	10.71	30-Jun-14	20.9	12.00
<i>France</i>							
Rue Charles Nicolle, Villeneuve les Beziers	31-Dec-08	18.3	11.9	8.50	30-Jun-14	11.7	8.47
Avenue de Savigny, Aulnay sous Bois	31-Dec-08	20.3	15.4	6.95	30-Jun-14	15.1	6.95
105 Route d'Orleans, Sully sur Loire	31-Dec-08	27.1	11.6	9.75	30-Jun-14	11.6	9.75
140 Rue Marcel Paul, Gennevilliers	31-Dec-08	14.0	10.7	7.25	30-Jun-14	10.5	7.25
ZAC Papillon, Parçay-Meslay	31-Dec-08	10.1	7.1	8.65	30-Jun-14	6.9	8.65
<i>Japan</i>							
Carino Chitosedai	31-Jan-10	118.3	97.7	5.10	31-Dec-13	101.3	5.20
Carino Tokiwadai	31-Jan-10	77.0	64.5	5.20	30-Jun-14	66.6	5.20
Izumiya Hakubaicho	31-Jan-10	68.4	56.2	5.50	31-Dec-13	60.0	5.30
Unicus Ina	31-Jan-10	-	-	-	-	49.3	5.30
Valor Toda	31-Jan-10	42.5	34.3	6.00	30-Jun-14	36.2	5.90
Life Higashinakano	31-Jan-10	32.8	28.4	5.00	31-Dec-13	29.3	5.10
Life Asakusa	31-Jan-10	27.8	24.3	5.20	30-Jun-14	25.1	5.10

Analysis of investment property (continued)

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

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

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

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

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

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

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

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

CSIRO and County Court are each financed via separate capital markets bond issuances. Security has been granted over these properties under the bond issuances, which include mortgages over the properties. Maitland is partially funded by external debt. Security has been granted over each development in relation to that funding, which includes a mortgage over each property.

As at 30 June 2014 the investment property portfolio occupancy rate was 96.4% (excluding Japan) and 95.3% (Japan) with a weighted average lease expiry of 4.8 years (excluding Japan) and 8.7 years (Japan).

12. Finance leases

Consolidated and parent

Gross finance lease receivable	
Due within one year	
Due between one and five years	
Due later than five years	
Less: unearned future finance income on finance lease assets	

Net finance lease receivables

Present value of net investment in finance lease receivables

Due within one year	
Due between one and five years	
Due later than five years	

Total finance leases

30 June 2014	30 June 2013
\$M	\$M
51.3	-
9.6	-
29.5	-
12.2	-
(11.9)	-
39.4	-
	-
6.2	-
22.1	-
11.1	-
39.4	-

13. Property, plant and equipment

Consolidated

Leasehold improvements at cost	
Less: accumulated depreciation	

Total leasehold improvements

Infrastructure property, plant and equipment at cost	
Less: accumulated depreciation	

Total infrastructure property, plant and equipment

Total property, plant and equipment¹

30 June 2014	30 June 2013
\$M	\$M
12.8	12.5
(1.5)	(0.5)
11.3	12.0
135.1	124.1
(20.7)	(13.0)
114.4	111.1
125.7	123.1

Movements in property, plant and equipment

2014

Balance at the beginning of the year	
Additions ²	
Amortisation of capitalised borrowing cost	
Disposals	
Depreciation expense	
Foreign exchange gains	
Balance at the end of the year	

2013

Balance at the beginning of the year	
Additions ²	
Amortisation of capitalised borrowing cost	
Disposals	
Depreciation expense	
Foreign exchange gains	

Infrastructure \$M	Leasehold \$M	Total \$M
111.1	12.0	123.1
3.3	0.1	3.4
(3.3)	-	(3.3)
(0.3)	-	(0.3)
(6.5)	(0.8)	(7.3)
10.1	-	10.1
114.4	11.3	125.7
94.1	12.0	106.1
14.5	0.3	14.8
(0.5)	-	(0.5)
(0.4)	-	(0.4)
(4.7)	(0.3)	(5.0)
8.1	-	8.1
111.1	12.0	123.1

¹ All property, plant and equipment is non-current.

² 30 June 2014 additions do not include capitalised borrowing costs (30 June 2013: \$3.3 million at 6.2% interest rate).

14. Other assets

	30 June 2014	30 June 2013
	\$M	\$M
Consolidated		
Rental bond deposits	17.7	22.6
Prepayments	5.0	5.3
Other	2.8	5.5
Total other assets	25.5	33.4
Current	5.0	7.7
Non-current	20.5	25.7
	25.5	33.4

15. Goodwill and other intangible assets

	Consolidated		Parent	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
Total goodwill	61.1	61.1	46.8	46.8
Other intangible assets				
Other intangible assets at cost	22.8	22.8	-	-
Less: accumulated amortisation	(5.4)	(4.7)	-	-
Less: foreign exchange losses	(4.9)	(6.0)	-	-
Total other intangible assets	12.5	12.1	-	-
	Goodwill		Operating lease	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
Movements in goodwill and other intangible assets				
Consolidated				
Balance as the beginning of the year	61.1	60.0	12.1	11.7
Amortisation expense	-	-	(0.7)	(0.6)
Foreign exchange gains	-	1.1	1.1	1.0
Balance at the end of the year	61.1	61.1	12.5	12.1

16. Impairment testing of goodwill

The recoverable amount of the Life cash-generating unit has been determined based on a value in use calculation. The calculation involves cash flow projections based on financial budgets approved by the Board. A discount rate of 11.0% (2013: 10.5%) and a five year cash flow horizon plus terminal value have been applied to the cash flow projections.

The following describes the key assumptions used in the cash flow projections:

- Budgeted gross margins – The value assigned to the budgeted gross margins is the difference between expected future earnings rates on assets, determined based on the yield on existing assets plus management's expectation of rates achievable on new asset purchases, less the expected future rates payable to policyholders, determined based on the yield payable on existing policies and management's expectation of future policy rates taking into account competitive pressures.
- Interest rates – Future interest rates have been determined based on curves derived from market sources.
- Expenses – Expenses have been based on the expense budget for the forthcoming year, with allowance for expense growth in future years.
- Growth rates – The growth rates used have been determined based on expectations of future industry growth taking into account historic experience and expected drivers.

The cash flow projections derived a value for CLC that was in excess of the carrying value of goodwill. Consequently, no impairment of goodwill was recorded.

Sensitivity to changes in assumptions

Management is of the view that reasonably possible changes in the key assumptions, such as an increase in the discount rate by 1%, would not cause the respective recoverable amounts for CLC to fall below the carrying amounts as at 30 June 2014. All goodwill is considered to be non-current.

17. Payables

	Consolidated		Parent	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
Trade creditors and accruals	80.2	73.6	11.6	4.7
Amounts payable to related entities	-	96.5	-	92.7
Security deposits	18.3	23.3	-	-
Unsettled trades	230.8	16.0	259.5	26.0
Derivative credit support	24.5	-	24.5	-
Accrued interest	5.5	4.9	3.5	3.1
Total payables	359.3	214.3	299.1	126.5
Current	357.6	210.9	299.1	126.5
Non-current	1.7	3.4	-	-
	359.3	214.3	299.1	126.5
Total payables - SPV	76.7	96.6	-	-
Current	11.2	19.2	-	-
Non-current	65.5	77.4	-	-
	76.7	96.6	-	-

18. Interest bearing liabilities

	30 June 2014	30 June 2014	30 June 2013	30 June 2013
	Facility	Out- standing	Facility	Out- standing
	\$M	\$M	\$M	\$M
Consolidated¹				
<i>Bank loans</i>				
Controlled property trusts ²	809.0	646.0	827.2	771.6
Controlled infrastructure trusts	206.1	206.1	206.1	206.1
Repurchase agreements	978.3	978.3	448.9	448.9
Total bank loans	1,993.4	1,830.4	1,482.2	1,426.6
<i>Non-recourse non-bank loans</i>				
Subordinated debt issuance	525.9	525.9	510.1	510.1
Loan note finance	3.9	3.9	88.2	88.2
Controlled property trusts	10.5	10.5	10.9	10.8
Total non-recourse non-bank loans	540.3	540.3	609.2	609.1
Total interest bearing liabilities	2,533.7	2,370.7	2,091.4	2,035.7
Current		1,043.1		472.3
Non-current		1,327.6		1,563.4
Total		2,370.7		2,035.7

¹ The amounts held directly by the parent entity are the repurchase agreements (current) and subordinated debt issuance (non-current).

² Total facility limit consists of redraw loan facilities limits totalling \$300.0 million and non-redraw loan facilities limits totalling \$509.0 million.

Bank loans

Controlled property trusts – the loans have variable terms and are generally secured by way of first-ranking mortgages over the investment properties. The 30 June 2014 balance includes \$246.0 million (30 June 2013: \$346.4 million) of ¥ denominated loans in the Japanese property trusts. Other controlled property trusts loans

total \$400.0 million (June 2013: \$425.2 million). A total of \$64.8 million of these liabilities are secured against properties available for sale and so have been classified as current.

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

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

Non-bank loans

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

The December 2006 notes are unsecured and were issued in two maturities (\$US125.0 million at 10 years with a non-call period of five years and \$US25.0 million at 20 years with a non-call period of 10 years). A portion of this subordinated debt has a fixed interest rate with the remaining portion being at a floating rate of interest. The November 2007 issuance was unsecured and matures at 30 years with a non-call period of 10 years. The proceeds of both issuances were made available to Statutory Fund No.2 (SF2) and rank in right of payment either pari passu with, or senior to, all other unsecured and subordinated indebtedness of SF2, except for such indebtedness preferred by operation of bankruptcy laws or similar laws of general application. Subordinated debt is measured at fair value through the profit and loss and adjusted for movements in interest rates, credit spreads and foreign exchange rates.

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

Loan note finance – the Group entered into a restricted recourse £25.0 million loan in September 2006 that is secured against properties. The loan balance plus all capitalised interest has been marked to fair value at 30 June 2014, consistent with the treatment of the corresponding (offsetting) asset.

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

19. External unit holders' liabilities

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

The Group controls a number of guaranteed index return trusts which contain funds pertaining to fixed-term wholesale mandates. The external unit holders' liabilities represent the balance owing to third parties on these mandates.

20. Life contract liabilities

Consolidated and parent

Life investment contract liabilities – at fair value	
Life insurance contract liabilities – at MoS valuation	
Outwards reinsurance contract liabilities – at MoS valuation	
Total life contract liabilities	

30 June 2014	30 June 2013
\$M	\$M
6,210.1	6,150.0
1,556.6	913.5
57.6	59.8
7,824.3	7,123.3

Movement in life contract liabilities	Life investment contract liabilities		Life insurance contract liabilities		Outwards reinsurance contract liabilities		Total life contract liabilities	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M
Balance at the beginning of the year	6,150.0	5,806.2	913.5	685.4	59.8	61.4	7,123.3	6,553.0
Deposits and premium receipts	2,185.7	1,922.3	620.5	257.6	-	-	2,806.2	2,179.9
Payments and withdrawals	(2,417.0)	(1,835.1)	(109.0)	(60.1)	(4.0)	(3.9)	(2,530.0)	(1,889.1)
Revenue per Note 3	5.9	5.0	(70.8)	(94.5)	(0.5)	2.3	(65.4)	(87.2)
Expense per Note 4	285.5	251.6	202.4	125.1	2.3	-	490.2	376.7
Closing balance	6,210.1	6,150.0	1,556.6	913.5	57.6	59.8	7,824.3	7,123.3

Analysis of life insurance contract liability and expenses

Best estimate liability

Value of future life insurance contract benefits	
Value of future expenses	
Value of future premiums	

Total best estimate liability

Value of future profit margins	
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Net life insurance contract liability

Life insurance contract operating expenses

Maintenance expenses – commission	
Maintenance expenses – other	

Total life insurance contract operating expenses

30 June 2014	30 June 2013
\$M	\$M
1,554.1	930.0
67.1	43.4
(112.2)	(5.4)
1,509.0	968.0
105.2	5.4
1,614.2	973.4
0.7	0.6
5.6	3.8
6.3	4.4

Analysis of life contract profit

Profit margin release on life insurance contracts

Loss recognition in respect of life insurance contracts¹

Loss recognition in respect of life investment contracts

Difference in actual and assumed experience in respect of life insurance contracts

Difference in actual and assumed experience in respect of life investment contracts

Profit before tax arising from difference between actual and assumed experience

Investment earnings on assets in excess of life insurance and investment contract liabilities and tax

Life contract profit after tax

30 June 2014	30 June 2013
\$M	\$M
6.5	0.7
(72.9)	(48.2)
(111.6)	(103.7)
77.4	59.1
297.6	373.5
197.0	281.4
154.1	231.3
351.1	512.7

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

Methodology applied in the valuation of life contract liabilities

Life investment contracts are policies regulated by the Life Act that do not meet the definition of an insurance contract (under AASB 4 *Insurance contracts*) and are measured at fair value through profit and loss. Life insurance contracts are policies regulated by the Life Act that meet the definition of an insurance contract under AASB 4 and are measured using the MoS methodology. This includes inwards reinsurance of longevity and mortality risks.

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

Key assumptions applied in the valuation of life contract liabilities

Discount rates – under APRA Prudential Standards, life insurance contract liabilities are calculated by discounting expected future cashflows at a risk-free rate, set at the Commonwealth Government Bond curve (or for foreign-denominated liabilities, a curve derived from the yields of highly liquid AAA-rated sovereign risk securities in the currency of the policy liabilities) plus an illiquidity premium where applicable. The illiquidity premium is determined by reference to observable market rates including Australian sovereign debt, corporate, securitised and collateralised debt publically placed in the domestic market, and market swap rates. Life investment contract liabilities are measured under the fair value through profit and loss provisions of AASB 139 *Financial Instruments: Recognition and Measurement*. The discount rates are determined based on the current observable, objective rates that relate to the nature, structure and term of the future liability cash flows.

For both insurance and investment contracts the approach is the same as adopted at 2013. Discount rates applied for Australian liabilities were between 3.0-4.7% (2013: 3.2-4.8%) per annum.

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

Inflation estimates are based on long-term expectations and reviewed annually for changes in the market environment based on a comparison of real and nominal yields of instruments of equivalent term and credit risk. The current assumption for Australia is 1.7% for short-term inflation and 2.7% for long-term (2013: 1.7% short-term, 2.5% long-term) per annum.

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

Mortality – base mortality rates for individual lifetime annuities are determined as a multiple of annuitant experience based on IML00¹ and IFL00¹ tables, adjusted for Challenger's own recent experience. Base mortality rates for wholesale mortality and longevity reinsurance are determined as a multiple of pensioner mortality rates (SAPS2² tables) or population rates as appropriate. Rates are adjusted for expected future mortality improvements based on observed and expected improvements. Rates of future mortality improvement for individual lifetime annuities applied are between 1.0- 4.0% (2013: 1.0-4.0%).

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 on life insurance contract liabilities. Changes in future profit margins are released over future periods unless that product group is in an expected net loss position (loss recognition), in which case changes in assumptions are recognised in the income statement in the period in which they occur. The valuation impact of changes to discount rate assumptions as a result of market and economic conditions, such as changes in benchmark market yields, are recognised in the income statement in the period in which they occur.

Restrictions on assets

The Life Act requires the Group to hold investments to back life contract liabilities in separate statutory funds. The assets in a statutory fund can only be used to meet the liabilities and expenses of that fund, to acquire investments to further the business of the fund or make distributions when capital adequacy requirements are met.

Statutory fund information

The Company has three statutory funds. Fund 1 is a non-investment-linked fund and fund 3 is investment-linked. Both of these are closed to new business. Fund 2 contains non-investment-linked contracts, including the Group's term annuity business, lifetime annuity policies and the related reinsurance, plus the wholesale mortality and longevity reinsurance. Life contract liabilities for funds 1, 2 and 3 are \$4.8 million, \$7,815.6 million and \$3.9 million respectively (2013: \$4.9 million, \$7,114.7 million, \$3.7 million).

Current / non-current split for total life contracts

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

Life insurance risk

The Group is exposed to longevity risk on its individual lifetime annuities and wholesale longevity reinsurance, being the risk that policyholders may live longer than expectations, and mortality risk on the wholesale mortality reinsurance, being the risk that death rates in the reference portfolios exceed expectations. The Group manages the longevity risk by regular reviews of the portfolio to confirm continued survivorship of policyholders receiving income plus regular reviews of longevity experience to ensure that longevity assumptions remain appropriate. In addition, the Group has entered into reinsurance arrangements to manage longevity risk in respect of closed books of individual lifetime annuities. The Group manages the mortality risk by regular reviews of the portfolio to ensure that mortality assumptions remain appropriate.

Insurance risk sensitivity analysis

The table below discloses the sensitivity of life insurance contract liabilities, profit after tax and equity to changes in the key assumptions relating to insurance risk, both gross and net of reinsurance:

	Increase in life insurance contract liabilities				Profit before tax and equity impact			
	Gross		Net		Gross		Net	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M
50% increase in the rate of mortality improvement	92.0	61.0	57.3	19.6	(92.0)	(61.0)	(57.3)	(19.6)
10% increase in maintenance expenses	4.2	2.9	4.2	2.9	(4.2)	(2.9)	(4.2)	(2.9)

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

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

Liquidity risk for insurance contracts

The following table summarises the undiscounted maturity profile of the Group's life insurance contracts. The analysis is based on undiscounted estimated cash outflows, including interest and principal payments. The undiscounted maturity profile of life investment contracts is disclosed in Note 26 Financial risk management.

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

Actuarial information

Mr Anthony Bofinger FIAA, as the Appointed Actuary of Challenger Life Company Limited, 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.

21. Special Purpose Vehicles

Special Purpose Vehicles (SPV) are entities that fund pools of residential mortgage-backed loans via the issuance of RMBS. All borrowings of these SPV are limited in recourse to the assets of the SPV. The Group is deemed to control these entities as a consequence of holding the beneficial interest to the residual income streams. The Group is not originating any significant new mortgage assets or securitised liabilities but is continuing to manage the run-off of the loan book portfolio.

The assets and liabilities of the SPV have been separately disclosed in the financial report as this presentation is considered to provide a more transparent view of the Group's financial position. Transactions between the SPV and other entities within the Group are eliminated on consolidation. The amounts in respect of the SPV included in the consolidated Group are as follows:

	30 June 2014	30 June 2013
Consolidated	\$M	\$M
Cash and cash equivalents	216.6	260.4
Receivables	3,106.1	4,191.7
Derivative assets	1.3	5.5
Total assets	3,324.0	4,457.6
Payables	79.7	104.3
Derivative liabilities	1.7	1.9
Interest bearing liabilities	3,061.1	4,124.7
Total liabilities	3,142.5	4,230.9
Net assets	181.5	226.7
Cash flow hedge reserve	0.4	(3.6)
Total equity attributable to residual income unit holders	181.9	223.1

22. Contributed equity

30 June 2014		30 June 2013	
Number	Value	Number	Value
M	\$M	M	\$M
1,046.5	1,046.5	1,046.5	1,046.5

Ordinary shares

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.

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.

Internal Capital Adequacy Assessment Process (ICAAP) Summary Statement

CLC is a life insurance company regulated under the Life Act. The Life Act, via Prudential Standards issued by APRA, imposes minimum statutory capital requirements on all life insurance companies. CLC complied with these requirements at all times during the period.

APRA introduced new Prudential Standards that took effect from 1 January 2013 (the Life and General Insurance Capital or LAGIC standards). Under these new standards a life company must have in place an ICAAP, documented in an ICAAP Summary Statement. The CLC ICAAP Summary Statement replaced the CLC Group Capital Management Plan from the effective date of LAGIC.

Prescribed capital amount (PCA)

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

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

CLC's excess capital above the PCA at 30 June 2014 was \$902.6 million, up \$5.2 million for the year. CLC's PCA ratio at 30 June 2014 was 1.7 times and the common equity Tier 1 (CET1) ratio was 1.3 times.

The introduction of the LAGIC standards increased CLC's regulatory capital requirement by \$322.8 million on 1 January 2013. APRA has provided a 3 year transition period to meet these new requirements. Therefore CLC's 30 June 2014 excess capital position includes a LAGIC transition balance of \$215.2 million (30 June 2013 includes \$322.8 million). A further \$107.6 million of the remaining LAGIC transition balance will amortise on each of 1 January 2015 and 1 January 2016.

Subordinated debt

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

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

The largest tranche of CLC's existing subordinated debt is a \$371.7 million tranche with a call date in November 2017. As such, this tranche will continue to be fully eligible as Tier 2 regulatory capital until its call date in November 2017 and will continue to be partially eligible until November 2021.

Tier 1 and Tier 2 regulatory capital

Under APRA's transition arrangements, CLC's statutory funds have three years to transition to the minimum requirement of Tier 1 capital representing 80% of the PCA. At a CLC consolidated level, APRA has provided a 2 year transition period from 1 January 2013 to meet the 80% Tier 1 requirement. CLC is currently meeting these

requirements at both the statutory fund and consolidated level. The consolidated Tier 1 position was 131% of the PCA at 30 June 2014 (2013: 135%).

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 allocations and market conditions.

CLC's capital position contemplates the amortisation of the LAGIC transition balance over the next two years. Excluding the remaining LAGIC transition balance (\$215.2 million), CLC's PCA ratio at 30 June 2014 was 1.4 times.

Details of the CLC capital adequacy multiple are provided below:

	30 June 2014 \$M	30 June 2013 \$M
CLC's excess capital under LAGIC		
Common equity Tier 1 regulatory capital	1,783.1	1,563.5
Tier 2 regulatory capital – subordinated debt ¹	476.8	488.8
CLC total regulatory capital base	2,259.9	2,052.3
Prescribed capital amount – excluding transition relief	1,572.5	1,477.7
Transition relief ²	(215.2)	(322.8)
CLC PCA	1,357.3	1,154.9
CLC excess over PCA	902.6	897.4
Capital adequacy ratio (times)	1.7	1.8

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

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

See Note 31 Statutory fund information for disaggregated and capital adequacy information by Statutory Fund.

23. Reserves

	Consolidated		Parent	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
Movements in reserves				
Foreign currency translation reserve¹				
Balance at the beginning of the year	(1.3)	(6.7)	-	-
Loss on translation of foreign operation	(11.8)	(5.3)	-	-
Net gain on hedge of net investment	15.2	10.7	-	-
Recycled to the profit and loss	(5.4)	-	-	-
Balance at the end of the year	(3.3)	(1.3)	-	-
Adjusted controlling interest reserve				
Balance at the beginning of the year	18.2	17.7	-	-
Movement in adjusted controlling interest reserve	1.1	0.5	-	-
Balance at the end of the year	19.3	18.2	-	-
Cash flow hedge reserve – SPV¹				
Balance at the beginning of the year	3.6	(0.9)	-	-
Net (loss) / gain from change in fair value	(4.0)	4.5	-	-
Balance at the end of the year	(0.4)	3.6	-	-
Other reserve				
Balance at the beginning of the year	-	-	-	-
Movement in distributable reserves	92.3	-	105.7	-
Balance at the end of the year	92.3	-	105.7	-
Total reserves	107.9	20.5	105.7	-

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

Foreign currency translation reserve - The foreign currency translation reserve is used to record foreign exchange differences arising from the translation of the financial statements 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 interest 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 or 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.

Other reserve – Distributable reserves that relate to amounts indemnified to CLC by its parent.

Cash flow hedge reserve - SPV - This reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

24. Retained earnings

	Consolidated		Parent	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
Balance at the beginning of the year	581.9	319.2	602.5	311.5
Profit attributable to equity holders	351.1	512.7	380.4	541.0
Dividends paid	(195.0)	(250.0)	(195.0)	(250.0)
Balance at the end of the year	738.0	581.9	787.9	602.5

25. Non-controlling interests

Consolidated

Representing the following share of equity in the applicable entity

Contributed equity

Reserves

Opening retained profits / (losses)¹

Profit for the year

Total non-controlling interests

30 June 2014 \$M	30 June 2013 \$M
73.4	357.6
19.0	(22.8)
8.1	(32.4)
22.4	44.5
122.9	346.9

¹ Includes pre-acquisition retained losses.

26. Financial risk management

Governance and risk management framework

The Group's activities expose it to a variety of financial risks, such as market risk (including currency risk, interest rate risk, equity price risk and credit spread risk), credit default risk, and liquidity risk.

The Board has established the Life Risk and Audit Committee (LRAC) as a committee to assist in the discharge of certain of its responsibilities, in particular setting the risk appetite and ensuring the Company has an effective risk management framework incorporating management, operational and financial controls.

The Board has also established the Asset Liability Committee (ALCo) to identify, monitor and report on financial risks.

The ALCo is responsible for driving the required actions to ensure risks are managed in accordance with the Board-approved policies. The management of these risks is supported by a comprehensive range of policies and practice notes. These policies and practice notes set out the Company's approach to managing and monitoring its financial risk, and include that:

- It is the policy of the Company to minimise the impact of interest rate movements on the Company's projected future cash flows. Certain interest rate risk exposure limits are also set.
- The Company hedges the exposure of current statement of financial position items to movements in foreign exchange rates. Foreign exchange exposures exclude instruments considered to be Tier 2 capital under regulatory standards. Certain foreign exchange exposure limits are also set.
- The Company actively monitors its inflation risk and, where it deems appropriate, takes action to mitigate it.
- It is the policy of the Company to systematically control and monitor its credit exposures, including exposures arising from derivative transactions. Certain credit risk exposure limits are also set.
- The Company monitors and measures its liquidity in the short, medium and long-term to ensure that it has sufficient cash resources to meet its liquidity requirements as a going concern and during adverse market conditions.

Financial risks are managed by the Group in the context of the wider Challenger Group risk management framework. The Executive Risk Management Committee (ERMC), which is chaired by the Chief Risk Officer (CRO), assists the LRAC and the Board in the discharge of their risk management obligations by implementing the Board-approved Risk Management Framework.

The Challenger 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 Board who formally assess the effectiveness of the framework and internal controls on an annual basis.

The Group's principal financial instruments consist of derivatives, cash and cash equivalents, receivables, available-for-sale assets, financial assets at fair value through profit and loss, payables, life investment contract liabilities and other interest bearing financial liabilities.

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of

financial instruments, are disclosed in Note 1 Basis of preparation and summary of significant accounting policies.

Market risk

Market risk is the risk that the fair value 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 interest rates), price risk (due to fluctuations in the fair value of equities or credit spreads) and currency risk (due to fluctuations in foreign exchange rates).

Interest rate risk

Interest rate risk is the risk of fluctuations in the Group's earnings and equity arising from movements in 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.

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

For the Special Purpose Vehicles (SPV) the impact of a rising / falling Bank Bill Swap (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 rate charged to borrowers if a sustained adverse differential to the benchmark is evidenced. SPV are also exposed to the risks arising from borrowers fixing the rates on their mortgage. This interest rate risk is managed by using cash flow hedges to swap the fixed rate for a floating rate at an amount equal to the notional value of the mortgages being fixed.

Interest rate sensitivity

The Group's sensitivity to movements in interest rates in relation to the value of financial assets and liabilities is shown in the table below. It is assumed that the change happens at the statement of financial position date and that there are concurrent movements in interest rates and parallel moves in the yield curve. All material underlying exposures and related hedges are included in the analysis, which includes underlying exposures and related hedges for investment properties with leases, where the future income stream is duration-hedged for interest rate movements.

	Change in variable	Profit / (loss) 30 June 2014 \$M	Change in equity 30 June 2014 \$M	Profit / (loss) 30 June 2013 \$M	Change in equity 30 June 2013 \$M
Group (ex-SPV)	+100bps	6.7	6.7	9.6	9.6
	-100bps	(6.7)	(6.7)	(9.7)	(9.7)
SPV	+100bps	(2.6)	(2.6)	(3.6)	(3.6)
	-100bps	2.6	2.6	3.6	3.6
Total	+100bps	4.1	4.1	6.0	6.0
	-100bps	(4.1)	(4.1)	(6.1)	(6.1)

The impact on profit and equity is pre-tax. The risks faced and methods used in the sensitivity analysis are the same as those applied in the comparative period. As shown above, 100 basis points (1%) movements in interest rates would have only a small net impact on the Group's financial position as upside risks in CLC and the property trusts largely offset downside risk in the SPV, and vice versa.

Price risk

Price risk is the risk that the fair value of a financial instrument will fluctuate as a result of changes in market prices (other than those arising from interest rate or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded on the market. The Group is exposed to equity price risk on its holdings in equity securities and credit

spread risk on its fixed income securities. The Company is required to fair value all equities and fixed income securities held to back life contract liabilities.

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

Equity price risk sensitivity

The potential impact of movements in the market value of listed and unlisted equities on the Group's income statement and statement of financial position is shown in the below sensitivity analysis. This sensitivity analysis has been performed to assess the direct risk of holding equity instruments. It is assumed that the relevant change occurs as at the reporting date.

Asset class	Change in variable	Profit / (loss)	Change in equity	Profit / (loss)	Change in equity
		30 June 2014 \$M	30 June 2014 \$M	30 June 2013 \$M	30 June 2013 \$M
Property securities	+10%	46.9	46.9	44.8	44.8
	-10%	(46.9)	(46.9)	(44.8)	(44.8)
Infrastructure investment	+10%	36.1	36.1	30.2	30.2
	-10%	(36.1)	(36.1)	(30.2)	(30.2)
Other assets	+10%	29.4	29.4	22.6	22.6
	-10%	(29.4)	(29.4)	(22.6)	(22.6)

The impact on profit and equity is pre-tax. The risks faced and methods used in the sensitivity analysis are the same as those applied in the comparative period. As shown above a 10% movement in equity prices would have a material impact on the Group's financial position.

Credit spread risk sensitivity

The Group is exposed to movements in credit spreads above the interbank swap curve through its fixed income securities net of subordinated debt. As at 30 June 2014, a 50 basis point increase / decrease in credit spreads would result in an unrealised loss / gain in the income statement and equity of \$112.7 million pre-tax (2013: \$131.3 million) net of subordinated debt.

Currency risk

It is the Company's policy to hedge the exposure of all statement of financial position items to movements in foreign exchange rates other than instruments considered to be Tier 2 capital under regulatory standards. Currency exposure arises primarily as a result of investments in the Eurozone, Japan, the United Kingdom and the United States so currency risk therefore arises from fluctuations in the value of the Euro, British Pound, US Dollar and Japanese Yen against the Australian Dollar. In order to protect against exchange rate movements the Group has entered into foreign currency derivatives.

In addition, the Group has exposure to foreign exchange risk upon consolidation of its foreign denominated controlled entities. The Group mitigates the foreign exchange risk by designating foreign currency derivatives as hedges of net investments in foreign entities in equity to match its foreign currency translation reserve exposure. The policy is to monitor the hedges closely and rebalance for maturities and underlying changes to the net assets. Effectiveness is monitored on a regular basis to ensure that the hedge remains between 80% and 125% effective and any ineffective portion of the hedge is recognised directly in the income statement.

The SPV entities hedge exposure to foreign currency risk arising from issuing mortgage backed securities in foreign currency. The currencies impacted are primarily the British Pound, Euro and US Dollar. All derivatives in the SPV are designated as cash flow hedges. These hedges are effective and there is no material impact on the results.

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 ² \$M	JPY \$M	Other \$M
2014					
Financial assets	549.6	1,505.9	745.3	224.2	133.7
Financial liabilities	(107.3)	(281.9)	(38.2)	-	-
Foreign currency contracts and cross-currency swaps	(432.2)	(1,330.1)	(713.2)	(226.5)	(108.9)
Net exposure in Australian dollars¹	10.1	(106.1)	(6.1)	(2.3)	24.8
	GBP \$M	USD \$M	Euro ² \$M	JPY \$M	Other \$M
2013					
Financial assets	553.9	1,668.2	829.2	252.0	87.2
Financial liabilities	(196.5)	(303.5)	(108.2)	-	-
Foreign currency contracts and cross-currency swaps	(372.5)	(1,499.4)	(770.6)	(250.7)	(87.0)
Net exposure in Australian dollars¹	(15.1)	(134.7)	(49.6)	1.3	0.2

¹ The majority of the Company's net exposure in US dollar is in respect of US dollar denominated subordinated debt that qualifies as eligible Tier 2 capital. Under the Market Risk policy this exposure is not hedged within the Company. The Challenger Limited Group hedges this exposure separately.

² Net Euro exposure is primarily matched by an investment property. Investment properties are not included in this table.

The analysis below shows the pre-tax impact on the income statement and equity of a movement in foreign currency exchange rates against the Australian dollar on the Group's major currency exposures using the net exposure at the balance date. All underlying exposures and related hedges are included in the analysis. A sensitivity of 10% has been chosen as this is a reasonable measurement given the current level of exchange rates and the volatility observed on an historic basis.

	Movement in variable against \$A	Profit / (loss) 30 June 2014 \$M	Change in equity 30 June 2014 \$M	Profit / (loss) 30 June 2013 \$M	Change in equity 30 June 2013 \$M
British Pound (GBP)	+ 10%	1.0	1.0	(1.5)	(1.5)
	- 10%	(1.0)	(1.0)	1.5	1.5
US Dollar (USD)	+ 10%	(10.6)	(10.6)	(13.5)	(13.5)
	- 10%	10.6	10.6	13.5	13.5
European (EUR)	+ 10%	(0.6)	(0.6)	(5.0)	(5.0)
	- 10%	0.6	0.6	5.0	5.0
Japanese Yen (JPY)	+ 10%	-	(0.2)	-	0.1
	- 10%	-	0.2	-	(0.1)

The risks faced and methods used in the sensitivity analysis are the same as those applied in the comparative period. As shown above a 10% movement in exchange rates would have minimal impact on the Group's financial position.

Credit default risk

Credit default risk is the risk of loss in value of an asset due to a counterparty failing to discharge an obligation. The Group's credit risk framework is based on the following core principles:

- independence from risk originators;
- recognition of the different risks in the various Group businesses;
- credit exposures are systematically controlled and monitored;
- credit exposures are regularly reviewed in accordance with existing credit procedures; and
- credit exposures include exposures arising from derivative transactions.

The Group manages credit risks with input from a centralised Challenger Group credit risk management team.

Credit exposure by credit rating

The Group makes use of external ratings (Standard & Poor's, Fitch, Moody's or alternate reputable credit rating agency). Where a counterparty or fixed income obligation is rated by multiple external rating agencies, the Group will use Standard & Poor's ratings where available or otherwise in accordance with the current APRA Prudential Standards. Where external credit ratings are not available internal credit ratings are assigned by appropriately qualified and experienced credit personnel who are independent from the risk originators.

The following table provides information regarding the maximum credit risk exposure of the Group in respect of the major classes of financial assets by equivalent credit rating. The maximum credit exposure is deemed to be the carrying value of the asset. The analysis classifies the assets according to internal or external credit ratings. Assets rated investment grade are those rated S&P BBB- or above, with non-investment grade therefore being below BBB-.

	Investment grade				Non-inv grade	Other	Total
	AAA	AA	A	BBB			
	\$M	\$M	\$M	\$M	\$M	\$M	\$M
2014							
Cash and cash equivalents	300.2	-	-	-	-	-	300.2
Cash and cash equivalents – SPV	216.6	-	-	-	-	-	216.6
Receivables	17.1	1.4	3.7	6.3	15.1	260.5	304.1
Receivables – SPV	1,778.9	868.7	456.1	-	2.4	-	3,106.1
Fixed income securities	3,197.6	928.1	1,240.8	1,575.7	1,470.4	61.5	8,474.1
Derivative assets	-	312.1	0.9	0.2	-	0.1	313.3
Total credit exposure	5,510.4	2,110.3	1,701.5	1,582.2	1,487.9	322.1	12,714.3
	Investment grade				Non-inv grade	Other	Total
	AAA	AA	A	BBB			
	\$M	\$M	\$M	\$M	\$M	\$M	\$M
2013							
Cash and cash equivalents	923.7	-	-	-	-	-	923.7
Cash and cash equivalents – SPV	260.4	-	-	-	-	-	260.4
Receivables	4.6	4.6	17.0	9.9	3.4	568.0	607.5
Receivables – SPV	2,435.8	1,689.3	33.6	-	12.7	20.2	4,191.6
Fixed income securities	1,837.7	1,087.6	1,532.5	1,348.1	1,207.7	159.1	7,172.1
Derivative assets	-	48.7	264.0	12.8	-	-	325.5
Total credit exposure	5,462.2	2,830.2	1,847.1	1,370.8	1,223.8	747.3	13,480.3

The SPV receivables, or mortgage assets, are funded via securitised RMBS. The credit risk of the mortgage loans within the SPV is taken as being equivalent to that of the RMBS.

Ageing and impairment of amortised cost financial assets

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

	Not past due / not impaired \$M	Past due but not impaired				Past due and impaired \$M	Total \$M
		0-1 months	1-3 months	3-6 months	>than 6 months		
		\$M	\$M	\$M	\$M		
Receivables							
2014	303.3	0.7	-	0.1	-	-	304.1
2013	607.5	-	-	-	-	-	607.5

Collateral held over assets

In the event of a default against any of the mortgages in the SPV, the Trustee has the legal right to take possession of the secured property and sell it as a recovery action against settlement of the outstanding account

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. The Group has no significant concentrations of credit risk at the statement of financial position date.

Subordinated debt

The Company has subordinated debt liabilities with nominal value of \$400.0 million and \$US150.0 million that are required to be classified as financial liabilities through profit and loss. The change in fair value recognised in the income statement for the year ended 2014 was a loss of \$19.1 million (2013: loss \$42.0 million). The liability is valued with regard to a basket of similar instruments.

Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in raising funds to meet cash commitments associated with financial instruments. This may result from either the inability to sell financial assets at their face values, a counterparty failing on repayment of a contractual obligation, or the inability to generate cash inflows as anticipated.

The Company 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 actions depending on actual liquidity levels relative to those targets. Detailed forecast cash positions are reported regularly to the ALCo. At the reporting date, all requirements of the Board approved Liquidity Management Policy were satisfied.

Maturity profile of undiscounted liabilities

The table below summarises the maturity profile of the Group's undiscounted financial liabilities. This is based on contractual undiscounted repayment obligations. Totals differ to the amounts on the statement of financial position by the amount of discounting recognised in the statement of financial position values.

	1 year or less \$M	1-3 years \$M	3-5 years \$M	>5 years \$M	Total \$M
2014					
Payables	357.6	1.7	-	-	359.3
Payables – SPV	11.2	5.3	60.2	-	76.7
Interest bearing liabilities	1,066.6	1,029.4	171.7	1,064.3	3,332.0
Interest bearing liabilities - SPV	785.9	1,055.7	649.7	1,016.4	3,507.7
External unit holders' liabilities	1,072.4	-	-	-	1,072.4
Life investment contract liabilities	2,024.0	2,638.5	1,233.2	907.1	6,802.8
Derivative financial liabilities	47.7	85.6	64.8	156.9	355.0
Total undiscounted liabilities	5,365.4	4,816.2	2,179.6	3,144.7	15,505.9
2013					
Payables	210.9	3.4	-	-	214.3
Payables – SPV	19.3	11.1	66.2	-	96.6
Interest bearing liabilities	565.4	558.4	774.0	1,140.3	3,038.1
Interest bearing liabilities – SPV	1,073.2	1,378.3	873.5	1,689.3	5,014.3
External unit holders' liabilities	1,232.9	518.5	-	-	1,751.4
Life investment contract liabilities	2,269.5	2,114.5	1,419.1	982.1	6,785.2
Derivative financial liabilities	155.3	49.1	39.4	68.4	312.2
Total undiscounted liabilities	5,526.5	4,633.3	3,172.2	3,880.1	17,212.1

27. Fair values of financial assets and liabilities

Fair value determination and classification

Fair value reflects the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction. The majority of the Group's financial instruments are held in the life insurance statutory funds of the Company backing its life investment and life insurance liabilities, and, as a result, are required by AASB 1038 *Life Insurance Contracts* to be designated at fair value through profit and loss where this is permitted under AASB 139 *Financial Instruments: Recognition and Measurement*. All other financial instruments in the Group are either designated at fair value through profit and loss at initial recognition, or at a carrying value that materially approximates fair value.

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 for identical assets or liabilities (i.e. listed securities).
- Level 2 inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. prices) or indirectly (i.e. derived from prices).
- Level 3 there are inputs for the asset or liability valuation that are not based on observable market data (unobservable inputs).

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

Where different levels of inputs according to the hierarchy are used in a valuation, the instrument is classified according to the lowest level that is significant to the inputs.

Valuation techniques

The Group's listed fixed income securities, Government / Semi Government securities, over-the-counter derivative financial instruments and unlisted fixed income securities are all classified Level 2. This recognises the quoted price availability in a non-active market. Fixed income securities where market observable inputs are not available are classified Level 3.

Listed equity, infrastructure and property securities that are exchange traded are classified Level 1. Where quoted prices are available in a non-active market they are classified Level 2. If market observable inputs are not available they are classified Level 3. Valuations can make use of cash flow forecasts discounted using the applicable yield curve, earning-multiple valuations or, for managed funds, the net assets of the trust per the most recent financial report.

The interest bearing liabilities classified as Level 3 include the subordinated debt notes issued by CLC. These are valued using a benchmark credit spread based on a pool of similar securities. External unit holders' liabilities are valued at the face value of the amounts payable and classified as Level 2. The portion of life investment contract liabilities classified as Level 2 represents products or product options for which the liability is determined based on an unmodified account balance, rather than a discounted cash flow as applied to the rest of the portfolio.

Valuation process

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

All financial instruments are measured on a recurring basis. The below table summarises the financial instruments and investment properties measured at fair value at each level of the fair value hierarchy held at 30 June:

	Level 1	Level 2	Level 3	Total
	\$M	\$M	\$M	\$M
2014				
Derivative assets	-	313.3	-	313.3
Fixed income securities ¹	-	7,132.4	1,341.6	8,474.0
Equity securities	171.4	46.0	164.4	381.8
Infrastructure investments ¹	109.2	-	543.0	652.2
Property securities	364.9	-	104.4	469.3
Investment property ²	-	222.7	2,144.3	2,367.0
Receivables - SPV	-	3,106.1	-	3,106.1
Assets	645.5	10,820.5	4,297.7	15,763.7
Derivative liabilities	0.2	201.1	0.2	201.5
Interest bearing liabilities	-	141.6	529.1	670.7
Interest bearing liabilities - SPV	-	2,856.3	-	2,856.3
External unit holders' liabilities	-	1,072.4	-	1,072.4
Life investment contract liabilities	-	100.9	6,109.2	6,210.1
Liabilities	0.2	4,372.3	6,638.5	11,011.0
	Level 1	Level 2	Level 3	Total
	\$M	\$M	\$M	\$M
2013³				
Derivative assets	-	325.5	-	325.5
Fixed income securities	-	5,488.7	1,684.0	7,172.7
Equity securities	110.4	38.8	173.2	322.4
Infrastructure investments	89.7	-	491.4	581.1
Property securities	147.1	-	301.2	448.3
Receivables - SPV	-	4,191.6	-	4,191.6
Assets	347.2	10,044.6	2,649.8	13,041.6
Derivative liabilities	-	369.8	-	369.8
Interest bearing liabilities	-	147.2	598.3	745.9
Interest bearing liabilities - SPV	-	3,728.2	-	3,728.2
External unit holders' liabilities	-	1,751.4	-	1,751.4
Life investment contract liabilities	-	106.1	6,043.9	6,150.0
Liabilities	-	6,103.1	6,642.2	12,745.3

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

At 30 June 2014 the carrying value of asset-backed financing assets was \$70.8 million (plus \$47.4 million undrawn commitments) and securitisations was \$3,007.6 million (plus \$34.4 million undrawn commitments).

² Refer to Note 11 Investment and development property for valuation techniques and key unobservable inputs.

³ AASB 13 introduced fair value information disclosure requirements for non-financial assets and liabilities. Retrospective application was not required therefore comparatives have not been presented.

Level 3 reconciliation

The following table shows a reconciliation of the movement in the fair value of financial instruments categorised within Level 3 over the period and total gains or losses included in the income statement for assets and liabilities held at 30 June:

	30 June 2014		30 June 2013	
	Assets \$M	Liabilities \$M	Assets \$M	Liabilities \$M
Balance at the beginning of the year	2,649.8	6,642.2	2,160.6	6,216.5
Total gains and losses recognised in revenue	(29.9)	223.9	513.7	327.4
Acquisitions	784.9	2,043.6	1,672.6	1,811.7
Disposals	(1,106.1)	(2,271.2)	(1,592.8)	(1,715.5)
Transfers to / from other categories ^{1,2}	(145.3)	-	(104.3)	2.1
Balance at the end of the year³	2,153.4	6,638.5	2,649.8	6,642.2
Unrealised gains / (losses) included in the income statement for assets and liabilities held as at statement of financial position date.	(48.3)	(223.9)	214.1	(327.4)

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

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

³ Excluding non-financial assets and liabilities.

Level 3 sensitivity

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

2014	Level 3 value ¹ \$M	Positive Impact \$M	Negative impact \$M	Valuation technique	Key non-observable input ^{2,3}
Fixed income securities	1,341.6	66.2	(13.2)	Discounted cash flow	Credit spreads
Interest bearing liabilities	(529.1)	(22.9)	24.2	Discounted cash flow	Credit spreads
Net fixed income	812.5	43.3	11.0		
Equity securities	164.4	20.8	(21.1)	Discounted cash flow, External financial report	Credit spreads, Valuation of unlisted scheme
Infrastructure investments	543.0	16.3	(15.6)	Discounted cash flow, External financial report	Discount rate, Valuation of unlisted scheme
Property securities	104.4	5.2	(5.2)	External financial report	Valuation of unlisted scheme
Life investment contract liabilities	(6,109.2)	4.4	(4.4)	Discounted cash flow	Expense assumptions
Derivative liabilities	(0.2)	0.1	(0.1)	Discounted cash flow	Credit spreads
Total Level 3	(4,485.1)	90.1	(35.4)		
2013	Level 3 value ¹ \$M	Positive Impact \$M	Negative impact \$M	Valuation technique	Key non-observable input ^{2,3}
Fixed income securities	1,684.0	59.1	(16.0)	Discounted cash flow	Credit spreads
Interest bearing liabilities	(598.3)	(25.4)	23.5	Discounted cash flow	Credit spreads
Net fixed income	1,085.7	33.7	(7.6)		
Equity securities	173.2	17.9	(18.0)	Discounted cash flow, External financial report	Credit spreads, Valuation of unlisted scheme
Infrastructure securities	491.4	11.5	(11.1)	Discounted cash flow, External financial report	Discount rate, Valuation of unlisted scheme
Property securities	301.2	15.1	(15.1)	External financial report	Valuation of unlisted scheme
Investment contract liabilities	(6,043.9)	4.6	(4.6)	Discounted cash flow	Expense assumptions
Total Level 3	(3,992.4)	82.8	(41.2)		

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

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

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

28. Derivative financial instruments

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

	30 June 2014			30 June 2013		
	Notional value \$M	Fair value assets \$M	Fair value liabilities \$M	Notional value \$M	Fair value assets \$M	Fair value liabilities \$M
Interest rate swaps						
Less than one year	2,194.7	9.7	(0.5)	3,103.2	12.5	(0.9)
One to three years	2,930.7	61.2	(8.7)	1,830.3	53.9	(5.7)
Three to five years	1,610.9	51.6	(9.0)	1,522.6	77.5	(8.5)
Greater than five years	4,724.4	152.5	(86.3)	2,385.2	104.4	(68.7)
Total interest rate swaps	11,460.7	275.0	(104.5)	8,841.3	248.3	(83.8)
Index-linked swaps						
Less than one year	253.0	-	-	250.0	-	(6.3)
Greater than five years	7.7	-	(4.6)	5.8	-	(0.8)
Total index-linked swaps	260.7	-	(4.6)	255.8	-	(7.1)
Futures contracts						
Less than one year	4,757.2	-	(0.2)	997.7	-	(0.1)
One to three years	150.0	-	-	-	-	-
Total futures contracts	4,907.2	-	(0.2)	997.7	-	(0.1)
Forward currency contracts						
Less than one year	2,168.7	15.9	(3.3)	3,488.7	31.5	(142.5)
One to three years	-	-	-	28.7	6.5	(0.1)
Total forward currency contracts	2,168.7	15.9	(3.3)	3,517.4	38.0	(142.6)
Cross-currency swaps						
Less than one year	368.1	17.2	(22.3)	295.1	7.9	(22.3)
One to three years	245.6	1.7	(25.6)	593.3	19.3	(42.4)
Three to five years	96.4	-	(16.2)	210.4	-	(32.5)
Greater than five years	211.1	0.1	(22.1)	274.2	0.1	(33.5)
Total cross-currency swaps	921.2	19.0	(86.2)	1,373.0	27.3	(130.7)
Equity swaps						
Less than one year	-	-	-	-	2.2	-
One to three years	-	-	-	0.5	3.7	-
Total equity swaps	-	-	-	0.5	5.9	-
Credit default swaps						
Less than one year	37.1	0.1	-	27.3	0.1	-
One to three years	116.5	1.9	(0.1)	10.9	-	(3.6)
Three to five years	107.0	0.1	(0.9)	186.8	0.4	-
Total credit default swaps	260.6	2.1	(1.0)	225.0	0.5	(3.6)
Options						
One to three years	0.4	-	-	-	-	-
Three to five years	0.5	-	-	-	-	-
Total options	0.9	-	-	-	-	-
Total	19,980.0	312.0	(199.8)	15,210.7	320.0	(367.9)

	30 June 2014			30 June 2013		
	Notional value \$M	Fair value assets \$M	Fair value liabilities \$M	Notional value \$M	Fair value assets \$M	Fair value liabilities \$M
Cross-currency swaps – SPV						
Greater than five years	1,350.6	1.3	(1.3)	1,833.1	5.0	(0.8)
Interest rate swaps – SPV						
Less than one year	17.6	-	(0.1)	76.4	0.5	(0.7)
One to three years	24.6	-	(0.2)	22.3	-	(0.3)
Three to five years	1.7	-	(0.1)	1.6	-	(0.1)
Total interest rate swaps – SPV	43.9	-	(0.4)	100.3	0.5	(1.1)
Total cash flow hedge derivatives - SPV	1,394.5	1.3	(1.7)	1,933.4	5.5	(1.9)
Total derivative financial instruments		313.3	(201.5)		325.5	(369.8)

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

Derivatives designated as hedges of net investment in foreign currency operations

As described in Note 1(xvi) Derivative financial instruments and hedging, the Group hedges its exposure to accounting gains and losses arising from translation of foreign controlled entities from their functional currency into the Group's presentation currency on consolidation. A gain of \$15.2 million (2013: \$10.7 million) was recognised in equity for the hedging of exposure to the net investment in foreign currency operations.

Derivatives designated as cash flow hedges

As described in Note 1(xvi) Derivative financial instruments and hedging, the Group applies hedge accounting when it can demonstrate that all, or a portion of, the value movements of a derivative financial instrument effectively hedge the variability in cashflows attributable to a specific risk associated with a recognised asset or liability or probable future transaction. As described in Note 26 Financial risk management, SPV enter into interest rate swap agreements to hedge the interest rate risk between variable rate loans, which generally reprice with changes in official interest rates, and issued RMBS that reprice with changes in the 30-day and 90-day bank bill swap rate. Cross-currency swaps are also entered into to hedge currency movements on foreign denominated RMBS. The SPV apply hedge accounting to both types of transaction, with the fair value change on the effective portion of the derivative being recognised in equity.

For the year ended 30 June 2014 a loss of \$4.0 million (2013: gain \$4.5 million) was recognised in equity for cash flow hedges with no income statement impact of any ineffective portions during either the current or prior comparative period.

29. Commitments

Operating leases - group as lessee

The Group is committed to a further 19 years in an operating lease for the Domain Car Park with the Botanical Gardens Trust.

The Group has a controlling interest in Clashfern Investments (UK) Limited, which holds a lease for the rental of a site expiring in 2032.

Contracted capital expenditure commitments

These primarily relate to the investment property portfolio. Capital expenditure commitments at the reporting date are not recognised in liabilities.

Other contracted commitments

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

Operating leases - group as lessor

Investment properties owned by the Group are leased to third parties under operating leases.

	30 June 2014 \$M	30 June 2013 \$M
Commitments		
Non-cancellable operating leases – Group as lessee	(106.5)	(110.8)
Contracted capital expenditure commitments	(26.4)	(34.5)
Other contracted commitments	(12.9)	(22.6)
Non-cancellable operating leases – Group as lessor	1,167.1	1,386.9
Total commitments	1,021.3	1,219.0
Operating leases – Group as lessee		
Amount due in less than one year	(4.4)	(4.3)
Amount due between one and two years	(4.5)	(4.4)
Amount due between two and five years	(14.2)	(13.9)
Amount due in greater than five years	(83.4)	(88.2)
Total operating leases – Group as lessee	(106.5)	(110.8)
Contracted capital expenditure commitments		
Amount due in less than one year	(8.6)	(15.7)
Amount due between one and five years	(13.9)	(13.2)
Amount due in greater than five years	(3.9)	(5.6)
Total capital expenditure commitments	(26.4)	(34.5)
Other contracted commitments		
Amount due in less than one year	(12.9)	(22.6)
Total other contracted commitments	(12.9)	(22.6)
Operating leases – Group as lessor		
Amount due in less than one year	160.5	181.8
Amount due between one and two years	151.2	169.2
Amount due between two and five years	391.8	439.7
Amount due in greater than five years	463.6	596.2
Total operating leases – Group as lessor	1,167.1	1,386.9

30. Related parties

Controlling and controlled entities

The immediate parent entity of the Company is Challenger Life Company Holdings Pty Limited and the ultimate parent entity is Challenger Limited. The Group's interests in controlled entities are disclosed in Note 34 Controlled entities.

Directors

The Directors of Challenger Life Company Limited at any time during the financial year were as follows:

Peter L Polson	Independent Chairman
Brian B Benari	Chief Executive Officer
Graham A Cubbin	Independent Non-Executive Director
Steven Gregg	Independent Non-Executive Director
Jonathan H Grunzweig	Independent Non-Executive Director
Russell R Hooper	Independent Non-Executive Director
JoAnne M Stephenson	Independent Non-Executive Director
Brenda M Shanahan	Independent Non-Executive Director
Leon Zwier	Independent Non-Executive Director

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

Key management personnel compensation

The key management personnel (KMP) of the Company includes the Directors and those executives who have the authority and responsibility for planning, directing and controlling the activities of the Company, either directly or indirectly.

	30 June 2014 \$M	30 June 2013 \$M
Consolidated and parent		
KMP compensation		
Short-term benefits	5.2	5.0
Post-employment benefits	0.1	0.1
Share-based payments	5.0	3.2
Total	10.3	8.3

A KMP of the Company may also be considered a KMP of other entities in the wider Challenger Group and receive remuneration for activities spanning those entities. In this situation, an allocation of KMP compensation is made based on an apportionment of each KMP's activities attributable to the Company.

Transactions with entities in the wholly-owned group

The Company received accounting and administrative services from Challenger Group Services Pty Limited (a related entity). These services were paid for by the Company via a cost recharge.

The Company received investment management and advisory services from Challenger Management Services Limited (a related entity) for the year ended 30 June 2014. These services were provided on an arm's length basis at market rates.

The Company hedges foreign exchange and interest rate exposure with Challenger Treasury Limited (a related entity). These hedges are entered into on an arm's length basis at market rates.

The Company has a tax funding agreement with Challenger Limited (see Note 6 Income tax).

The Company is indemnified for actual, contingent and tax-related liabilities of SF2 and SHF by Challenger Life Company Holdings Pty Limited (see Note 6 Income tax).

Amounts paid under the above arrangements are reflected in the table below:

	Consolidated		Parent	
	30 June 2014 \$M	30 June 2013 \$M	30 June 2014 \$M	30 June 2013 \$M
Related party transactions				
Accounting and administrative services	69.6	57.1	69.6	57.1
Investment management and advisory fees	24.0	17.6	11.2	11.7
Realised hedge movements ¹	(13.1)	8.5	(13.1)	8.5

¹ The outstanding balance at 30 June 2014 was \$16.4 million (2013: \$11.8 million).

Amounts receivable and payable in respect of related entity transactions are disclosed in Note 9 Receivables and Note 17 Payables respectively.

31. Statutory fund information

Life insurance funds

The types of life contracts written within each statutory fund of the Company are as follows:

Type of business	Major products	Type of contract
<i>Statutory Fund No. 1</i>		
Unit-linked superannuation business	Capital guaranteed bonds ¹	Investment contract
	Performance annuity bonds ¹	Insurance / investment contract ²
<i>Statutory Fund No. 2</i>		
Non-linked superannuation business	Fixed-rate annuity	Investment contract
	Lifetime annuity	Insurance contract
	Allocated pension	Investment contract
	Personal super	Investment contract
	Wholesale longevity	Insurance contract
	Wholesale mortality	Insurance contract
<i>Statutory Fund No. 3</i>		
Unit-linked superannuation business	Investment-linked bonds	Investment contract
	Investment-linked allocated pensions	Investment contract
Unit-linked ordinary business	Investment-linked bonds	Investment contract

¹ These products are non-investment linked per the Life Act definitions.

² Performance annuity bonds have a portion of life insurance risk being a life time option component.

Disaggregated information by Statutory Fund

	Statutory Fund No.1 \$M	Statutory Fund No.2 \$M	Statutory Fund No.3 \$M	Statutory Fund Total \$M	Share- holder Fund \$M	Total \$M
Income statement						
2014						
Revenue	-	1,317.7	0.1	1,317.8	163.9	1,481.7
Expenses	(0.3)	(758.8)	-	(759.1)	(1.0)	(760.1)
Finance costs	-	(176.7)	-	(176.7)	(81.1)	(257.8)
Profit before tax	(0.3)	382.2	0.1	382.0	81.8	463.8
Income tax expense	0.1	(63.8)	(0.1)	(63.8)	(26.5)	(90.3)
Profit for the year	(0.2)	318.4	-	318.2	55.3	373.5
Profit attributable to non-controlling interest	-	22.4	-	22.4	-	22.4
Profit attributable to equity holders	(0.2)	296.0	-	295.8	55.3	351.1
2013						
Revenue	0.3	1,216.0	0.7	1,217.0	202.9	1,419.9
Expenses	(0.4)	(589.2)	(0.7)	(590.3)	(1.9)	(592.2)
Finance costs	-	(233.4)	-	(233.4)	(53.3)	(286.7)
Profit before tax	(0.1)	393.4	-	393.3	147.7	541.0
Income tax expense	0.2	16.2	(0.2)	16.2	-	16.2
Profit for the year	0.1	409.6	(0.2)	409.5	147.7	557.2
Profit attributable to non-controlling interest	-	44.5	-	44.5	-	44.5
Profit attributable to equity holders	0.1	365.1	(0.2)	365.0	147.7	512.7
Abbreviated statement of financial position						
As at 30 June 2014						
Cash and cash equivalents	4.8	480.2	2.0	487.0	29.8	516.8
Investment assets	3.1	11,012.7	4.1	11,019.9	1,715.5	12,735.4
Other assets	0.3	3,615.9	(0.1)	3,616.1	60.9	3,677.0
Total assets	8.2	15,108.8	6.0	15,123.0	1,806.2	16,929.2
Life contract liabilities	4.8	7,815.6	3.9	7,824.3	-	7,824.3
Other liabilities	0.1	5,581.5	0.2	5,581.8	1,507.8	7,089.6
Total liabilities	4.9	13,397.1	4.1	13,406.1	1,507.8	14,913.9
Net assets	3.3	1,711.7	1.9	1,716.9	298.4	2,015.3
Contributed equity	-	-	-	-	1,046.5	1,046.5
Reserves	1.6	521.4	0.8	523.8	(415.9)	107.9
Retained earnings	1.7	1,067.4	1.1	1,070.2	(332.2)	738.0
Non-controlling interests	-	122.9	-	122.9	-	122.9
Total equity	3.3	1,711.7	1.9	1,716.9	298.4	2,015.3

Abbreviated statement of financial position	Statutory Fund No.1 \$M	Statutory Fund No.2 \$M	Statutory Fund No.3 \$M	Statutory Fund Total \$M	Shareholder Fund \$M	Total \$M
As at 30 June 2013						
Cash and cash equivalents	5.5	905.0	2.0	912.5	271.6	1,184.1
Investment assets	2.8	8,838.6	3.9	8,845.3	2,066.3	10,911.6
Other assets	0.1	4,730.4	-	4,730.5	202.8	4,933.3
Total assets	8.4	14,474.0	5.9	14,488.3	2,540.7	17,029.0
Life contract liabilities	4.9	7,114.7	3.7	7,123.3	-	7,123.3
Other liabilities	-	5,880.5	0.4	5,880.9	2,029.0	7,990.9
Total liabilities	4.9	12,995.2	4.1	13,004.2	2,029.0	15,033.2
Net assets	3.5	1,478.8	1.8	1,484.1	511.7	1,995.8
Contributed equity	-	-	-	-	1,046.5	1,046.5
Reserves	1.6	360.4	0.8	362.8	(342.3)	20.5
Retained earnings	1.9	771.5	1.0	774.4	(192.5)	581.9
Non-controlling interests	-	346.9	-	346.9	-	346.9
Net assets	3.5	1,478.8	1.8	1,484.1	511.7	1,995.8

Capital adequacy	Statutory Fund No.1 \$M	Statutory Fund No.2 \$M	Statutory Fund No.3 \$M	Statutory Fund Total \$M	Shareholder Fund \$M	Total \$M
As at 2014						
Net assets	3.3	1,589.0	1.8	1,594.1	298.4	1,892.5
Regulatory adjustments	-	(75.3)	-	(75.3)	(34.1)	(109.4)
Common equity Tier 1 regulatory capital	3.3	1,513.7	1.8	1,518.8	264.3	1,783.1
Additional Tier 1 capital	-	-	-	-	-	-
Tier 2 capital ¹	-	476.8	-	476.8	-	476.8
Capital base	3.3	1,990.5	1.8	1,995.6	264.3	2,259.9
Prescribed Capital Amounts components						
Insurance risk charge	0.3	83.5	-	83.8	0.1	83.9
Asset risk charge	0.4	1,444.8	0.1	1,445.3	64.2	1,509.5
Asset concentration risk charge	-	-	-	-	-	-
Operational risk charge	-	22.8	-	22.8	-	22.8
Default stress	-	20.0	-	20.0	1.0	21.0
Aggregation benefit	(0.2)	(64.5)	-	(64.7)	(0.1)	(64.8)
Combined stress scenario adjustment	-	-	-	-	-	-
Transition relief ²	-	(206.7)	-	(206.7)	(8.5)	(215.2)
Prescribed Capital Amount	0.5	1,299.9	0.1	1,300.5	56.7	1,357.2
Capital adequacy multiple	6.6	1.5	18.0	1.5	4.7	1.7

	Statutory Fund No.1	Statutory Fund No.2	Statutory Fund No.3	Statutory Fund Total	Share- holder Fund	Total
	\$M	\$M	\$M	\$M	\$M	\$M
Capital adequacy						
As at 30 June 2013						
Net assets	3.6	1,131.8	1.9	1,137.3	511.6	1,648.9
Regulatory adjustments	(0.1)	(52.8)	-	(52.9)	(32.5)	(85.4)
Common equity Tier 1 regulatory capital	3.5	1,079.0	1.9	1,084.4	479.1	1,563.5
Additional Tier 1 capital	-	-	-	-	-	-
Tier 2 capital	-	488.8	-	488.8	-	488.8
Capital base	3.5	1,567.8	1.9	1,573.2	479.1	2,052.3
Prescribed Capital Amounts components						
Insurance risk charge	0.4	31.1	-	31.5	0.1	31.6
Asset risk charge	0.4	1,317.1	0.1	1,317.6	134.8	1,452.4
Asset concentration risk charge	-	-	-	-	-	-
Operational risk charge	-	18.5	-	18.5	-	18.5
Aggregation benefit	(0.2)	(24.5)	-	(24.7)	(0.1)	(24.8)
Combined stress scenario adjustment	-	-	-	-	-	-
Transition relief ²	-	(310.0)	-	(310.0)	(12.8)	(322.8)
Prescribed Capital Amount	0.6	1,032.2	0.1	1,032.9	122.0	1,154.9
Capital adequacy multiple	5.6	1.5	14.7	1.5	3.9	1.8

¹ Differs from \$525.9 million disclosed in Note 18 Interest bearing liabilities due to \$2.7 million of accrued interest and (\$51.7 million) of inadmissible Tier 2 regulatory capital.

² LAGIC transition relief will reduce by one third (\$107.6 million) on 1 January 2015 and 1 January 2016.

Disaggregated information by linked / non-linked

As stated above, the Company's non-linked business is contained in Statutory Funds No. 1 and No. 2 and the linked business in Fund No. 3.

32. Remuneration of auditors

Auditors' remuneration in respect of the entities within the Group is incurred and paid by Challenger Group Services Pty Limited, a subsidiary of the ultimate parent entity, Challenger Limited.

33. Reconciliation of profit to operating cash flow

	Consolidated		Parent	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
	\$M	\$M	\$M	\$M
Profit for the period	373.5	557.2	380.4	541.0
<i>Adjustments for</i>				
Net realised gain on disposal of investment assets	(141.5)	(174.5)	(74.2)	(129.2)
Net unrealised gain on revaluation of investment assets	(219.3)	(74.5)	(181.2)	8.1
Change in life contract liabilities	424.8	289.5	424.8	289.5
Depreciation and amortisation expense	12.3	7.6	-	-
<i>Change in operating assets and liabilities, net of disposal/acquisition of controlled entities</i>				
(Increase) / decrease in receivables	(11.1)	22.5	(215.8)	7.8
Decrease in other assets	7.9	8.3	-	-
Increase / (decrease) in payables	125.1	(42.8)	172.6	(9.3)
Increase in life contract liabilities	276.2	280.8	276.2	280.8
Decrease in external unit holders' liabilities	(679.0)	(99.8)	-	-
Decrease in net tax liabilities	(30.9)	(6.1)	2.3	21.9
Net cash flows from operating activities	138.0	768.2	785.1	1,010.6

34. Controlled entities

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

Challenger Diversified Properties Group	Challenger Welcome Break Limited (Jersey)
Challenger High Yield Fund	Challenger Wind Holdings Pty Limited
Challenger Holding (Vagyonkezelő) KFT (Hungary)	Clashfern Investments (UK) Limited (UK)
Challenger Jersey I3 Limited (Jersey)	CLS US Holdings, LLC (USA)
Challenger Life Debt Investments (Europe) Limited (UK)	Godo Kaisha Kenedix Master Tokumei Kumiai (Japan)
Challenger Life Fund Property Investments Pty Ltd	Godo Kaisha Sub Tokumei Kumiai One (Japan)
Challenger Life Offshore Investments Limited (Jersey)	Godo Kaisha Sub Tokumei Kumiai Two (Japan)
Challenger Life Subsidiary Holdings Ltd	LANV Pty Ltd
Challenger Luxembourg Holding No.1A SARL (Luxembourg)	Oaklands Hill Pty Ltd
Challenger Luxembourg Holding No.2 SARL (Luxembourg)	River and Mercantile Global Equity Fund
Challenger SkyBridge Fund (LP) Jersey Ltd (Jersey)	RRETRO Fund Ltd (Cayman Islands) ¹
Challenger Strategic Property Partner 1	Waterford County Pty Limited ¹
Challenger UK Tank Storage Limited (UK)	Wyetree European Recovery Fund
Challenger UK Terminals Ltd (Jersey)	
Challenger Millennium NPL Trust	Interstar Millennium Series 2004-1E Trust
Challenger Millennium Series 2007-1E Trust	Interstar Millennium Series 2004-2G Trust
Challenger Millennium Series 2007-2L Trust	Interstar Millennium Series 2004-4E Trust
Challenger Millennium Series 2008-1 Trust	Interstar Millennium Series 2004-5 Trust
Challenger Millennium Series 2008-2 Trust	Interstar Millennium Series 2005-1G Trust
Challenger Millennium Series 2009-1 Trust	Interstar Millennium Series 2005-2L Trust
Challenger Millennium Series 2013-1 Trust	Interstar Millennium Series 2005-3E Trust
Challenger Millennium Warehouse C Trust	Interstar Millennium Series 2006-1 Trust

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Challenger Millennium Warehouse F Trust	Interstar Millennium Series 2006-2G Trust
Challenger Millennium Warehouse JP Trust	Interstar Millennium Series 2006-3L Trust
Interstar Millennium Series 2002-1G Trust	Interstar Millennium Series 2006-4H Trust
Interstar Millennium Series 2003-3G Trust	
417 St Kilda Road Trust	Challenger Property Trust No.32
417 St. Kilda Holding Trust A	Challenger Property Trust No.35
417 St. Kilda Holding Trust B	Challenger Property Trust No.36
Balloon Inflation Linked Bond Trust ¹	Challenger Seattle Trust
Belconnen Property Trust	Challenger Towers Holding Trust
Challenger Australia Listed Property Holding Trust	Challenger UK Tank Storage Holding Trust
Challenger Bunbury Trust	Challenger Wind Trust
Challenger CKT Holding Trust	CLC Commercial Mortgages Trust
Challenger European Property Trust	CLC Leveraged Loan Trust
Challenger Guernsey Trust	County Court Property Trust
Challenger Howard Property Trust for 417 St Kilda Road	Crown Domestic Sovereign Bond Trust ¹
Challenger Infrastructure Unit Holding Trust	Discovery House Trust
Challenger Intermediate Unit Trust	Harris Global Sovereign Bond Trust ¹
Challenger Karratha Trust	Hayes Park Property Trust
Challenger Kenedix Japan Trust	Hotels Investment Trust
Challenger MEIF Holding Trust	Rendezvous Hotels Flinders Street Trust
Challenger MEIF Trust	Riverside Trust No.1
Challenger North of England Gas Holding Trust	Riverside Trust No.2
Challenger Property Income Trust	Senator House Property Trust
Challenger Property Trust No.18	Talavera Herring Unit Trust
Challenger Property Trust No.19	TLG Holding Unit Trust
Challenger Property Trust No.27	TLG Unit Trust
Challenger Property Trust No.30	Village Property Trust
Challenger Property Trust No.31	World Business Centre Heathrow Property Trust
River and Mercantile Global Equity Fund	Wyetree European Recovery Fund

¹ Deconsolidated in 2014.

² Percentage holding is less than 100%.

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

35. Subsequent events

CLC is growing strongly and expects to continue to increase the size of its retail annuity business. In order to support CLC's growth profile, the CLC Board has approved the intention to raise \$250 million¹ in perpetual, subordinated, unsecured notes (Notes) issued to Challenger Limited.

Upon issue, the Notes will count as Additional Tier 1 capital under APRA Prudential Standard LPS112 Capital Adequacy: Measurement of Capital.

Further on 19 August 2014, the Board of Challenger Limited (CLC's ultimate parent entity) approved the following capital initiatives:

- Equity placement of Challenger ordinary shares to institutional holders raising \$250 million;
- Share Purchase Plan (SPP) allowing retail investors to participate and is expected to raise \$30 million; and
- The intention to launch Challenger Capital Notes (Challenger Notes) targeting to raise \$250 million². The Challenger Notes will be issued by Challenger Limited with the proceeds used to purchase the Notes.

The majority of the proceeds from the equity placement and SPP are planned to be injected into CLC as Common Equity Tier 1 capital.

At the date of this report and other than as disclosed above, no other 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.

36. Contingent liabilities and commitments

Litigation Nil

Warranties and contingent liabilities

Contingent liabilities exist in respect of claims and potential claims against entities within the Group and provisions have been made in the financial statements where necessary. The Group does not consider that the outcome of any such claims known to exist at the date of this report is likely to have a material effect on the operations or the financial position.

Commitments

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

¹ Targeting \$250 million with ability to raise more or less, subject to market conditions.

² Subordinated, unsecured convertible notes issued by Challenger Limited (in Australia). Targeting \$250 million with ability to raise more or less, subject to market conditions.

Directors' declaration

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

- a) the financial statements and notes of Challenger Life Company Limited and its controlled entities (the Group) are in accordance with the *Corporations Act 2001*, including:
 - I. giving a true and fair view of the Group's financial position as at 30 June 2014 and of its performance for the year ended on that date; and
 - II. complying with Australian Accounting Standard (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*;
- b) the financial statements and notes of the Group also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board as disclosed in Note 1(ii) to the financial statements; and
- 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.

On behalf of the Board



G A Cubbin
Director
Sydney
19 August 2014



B R Benari
Director
Sydney
19 August 2014

Independent Auditor's Report



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Independent auditor's report to the members of Challenger Life Company Limited

Report on the financial Report

We have audited the accompanying financial report of Challenger Life Company Limited, which comprises the consolidated statement of financial position as at 30 June 2014, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' Responsibility for the financial Report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal controls as the directors determine are necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with *International Financial Reporting Standards*.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

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

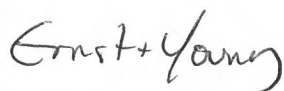
Independence

In conducting our audit we have complied with the independence requirements of the *Corporations Act 2001*. We have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included in the directors' report

Opinion

In our opinion:

- a. the financial report of Challenger Life Company Limited is in accordance with the *Corporations Act 2001*, including:
 - i giving a true and fair view of the consolidated entity's financial position as at 30 June 2014 and of its performance for the year ended on that date; and
 - ii complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and
- b. the financial report also complies with *International Financial Reporting Standards* as disclosed in Note 1.

The logo for Ernst & Young, featuring the company name in a stylized, handwritten-style script.

Ernst & Young

A handwritten signature in dark ink, appearing to be 'D J Handley-Greaves'.

D J Handley-Greaves
Partner
Sydney
19 August 2014

Directory

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Brian R Benari (Chief Executive Officer)
Graham A Cubbin
Steven Gregg
Jonathan H Grunzweig
Russell R Hooper
Brenda M Shanahan
JoAnne M Stephenson
Leon Zwier

Company Secretaries

Michael Vardanega
Andrew Brown

Auditor

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