

Annual Report 2015

# Challenger Life Company Limited

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Challenger Life Company Limited ACN 072 486 938 and its controlled entities.

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 2015.

## 1. Directors

The names and details of the Directors of the Company holding office during the financial year ended 30 June 2015 and up to the date of this report are listed below. Directors were in office for the 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                            |
| Brenda M Shanahan    | Independent Non-executive Director                            |
| JoAnne M Stephenson  | Independent Non-executive Director                            |
| Leon Zwier           | Independent Non-executive Director                            |
| Russell R Hooper     | Independent Non-executive Director (retired 27 February 2015) |

## 2. Company secretary

Michael Vardanega is a qualified solicitor and was appointed to the position of General Counsel and Group Company Secretary on 1 March 2011.

Andrew Brown has over 20 years' experience in the financial services industry and was appointed to the position of Company Secretary on 25 October 2012.

## 3. Principal activities and changes 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.

## 4. Capital management initiatives

The Company is growing strongly and expects to materially increase the size of its retail annuity business. In order to support this growth the following capital management initiatives were completed during the year:

- \$130.0 million equity issuance in August 2014;
- \$20.0 million equity issuance in October 2014; and
- \$345.0 million equity hybrid note issuance in October 2014 (regarded as Additional Tier 1 capital under APRA prudential standards).

## 5. Operating and financial review

The statutory profit after tax for the year attributable to the equity holders was \$303.5 million compared to \$351.1 million in the prior year.

## 6. Dividends

On 25 November 2014 the Directors of the Company declared a dividend on ordinary shares of \$75.0 million. The dividend was subsequently paid on 30 November 2014.

On 13 February 2015 the Directors of the Company declared a dividend on ordinary shares of \$55.0 million.

The dividend was subsequently paid on 24 February 2015.

On 17 August 2015 the Directors of the Company declared a dividend on ordinary shares of \$130.0 million.

## 7. Likely developments and expected results

The Group intends to continue with its current strategy of providing Australians with financial security in retirement. To continue to achieve this vision, the Company is focused on the following core strategic objectives:

1. to be recognised as the leader in retirement income solutions in Australia; and
2. to increase the portion of the Australian retirement pool allocated to secure and lifetime income products.

## 8. Significant events after the balance date

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

## 9. 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 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 or criminal or dishonest behaviour.

In accordance with the provisions of the *Corporations Act 2001*, the Company has insured the Directors and officers against liabilities incurred in their role as Directors and officers of the Company. The terms of the insurance policy, including the premium are subject to

confidentiality clauses and as such the Company is prohibited from disclosing the nature of the liabilities covered and the premium.

Indemnification is provided by the ultimate parent entity, and the premium is paid by a related party, Challenger Group Services Pty Ltd.

#### 10. Indemnification of Auditors

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

#### 11. 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 Commonwealth, state and offshore legislation. The Directors are satisfied that adequate systems are in place for the management of the Company's environmental responsibilities and compliance with various legislative, regulatory and licence requirements. Further, the

Directors are not aware of any breaches of these requirements, and to the best of their knowledge all activities have been undertaken in compliance with environmental requirements.

#### 12. Rounding

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

#### 13. 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*.

#### 14. Auditor's independence declaration

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



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

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

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 2015, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.

Ernst & Young

D J Handley-Greaves  
Partner

Sydney  
17 August 2015

A member firm of Ernst & Young Global Limited  
Liability limited by a scheme approved under Professional Standards Legislation  
ACN 004 860 860

#### 15. Authorisation

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

P L Polson  
Chair

Sydney  
17 August 2015

B R Benari  
Director

Sydney  
17 August 2015

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

## Statements of comprehensive income

For the year ended 30 June

|                                                                                      | Note | Consolidated |              | Parent       |              |
|--------------------------------------------------------------------------------------|------|--------------|--------------|--------------|--------------|
|                                                                                      |      | 2015         | 2014         | 2015         | 2014         |
|                                                                                      |      | \$M          | \$M          | \$M          | \$M          |
| Revenue                                                                              | 1    | 1,498.0      | 1,481.7      | 1,071.3      | 1,127.5      |
| Expenses                                                                             | 2    | (845.2)      | (760.1)      | (692.2)      | (600.8)      |
| Finance costs                                                                        | 18   | (229.9)      | (257.8)      | (50.4)       | (40.6)       |
| <b>Profit before income tax</b>                                                      |      | <b>422.9</b> | <b>463.8</b> | <b>328.7</b> | <b>486.1</b> |
| Income tax expense                                                                   | 4    | (95.6)       | (90.3)       | (64.3)       | (105.7)      |
| <b>Profit for the year</b>                                                           |      | <b>327.3</b> | <b>373.5</b> | <b>264.4</b> | <b>380.4</b> |
| Profit attributable to shareholders of Challenger Life Company Limited               |      | 303.5        | 351.1        | 264.4        | 380.4        |
| Profit attributable to non-controlling interests                                     | 23   | 23.8         | 22.4         | -            | -            |
| <b>Profit for the year</b>                                                           |      | <b>327.3</b> | <b>373.5</b> | <b>264.4</b> | <b>380.4</b> |
| <b>Other comprehensive income</b>                                                    |      |              |              |              |              |
| <b>Items that may be reclassified to profit and loss, net of tax</b>                 |      |              |              |              |              |
| Translation of foreign entities                                                      |      | 20.7         | (17.2)       | -            | -            |
| Hedge of net investment in foreign operations                                        |      | (23.5)       | 15.2         | -            | -            |
| Cash flow hedges – SPV <sup>1</sup>                                                  | 17   | 1.8          | (4.0)        | -            | -            |
| <b>Other comprehensive expense for the year</b>                                      |      | <b>(1.0)</b> | <b>(6.0)</b> | <b>-</b>     | <b>-</b>     |
| <b>Total comprehensive income for the year</b>                                       |      | <b>326.3</b> | <b>367.5</b> | <b>264.4</b> | <b>380.4</b> |
| Comprehensive income attributable to shareholders of Challenger Life Company Limited |      | 302.5        | 345.1        | 264.4        | 380.4        |
| Comprehensive income attributable to non-controlling interests                       |      | 23.8         | 22.4         | -            | -            |
| <b>Total comprehensive income for the year</b>                                       |      | <b>326.3</b> | <b>367.5</b> | <b>264.4</b> | <b>380.4</b> |

<sup>1</sup> SPV = Special Purpose Vehicles.

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

## Statements of financial position

| As at 30 June                                                                                                                                   |      | Consolidated    |                 | Parent          |                 |
|-------------------------------------------------------------------------------------------------------------------------------------------------|------|-----------------|-----------------|-----------------|-----------------|
|                                                                                                                                                 |      | 2015            | 2014            | 2015            | 2014            |
|                                                                                                                                                 | Note | \$M             | \$M             | \$M             | \$M             |
| <b>Assets</b>                                                                                                                                   |      |                 |                 |                 |                 |
| Cash and cash equivalents                                                                                                                       | 13   | 317.9           | 300.2           | (12.8)          | 8.3             |
| Cash and cash equivalents – SPV                                                                                                                 | 7    | 183.9           | 216.6           | -               | -               |
| Receivables                                                                                                                                     | 8    | 434.1           | 304.1           | 676.5           | 671.3           |
| Mortgage assets – SPV                                                                                                                           | 7    | 2,331.1         | 3,106.1         | -               | -               |
| Derivative assets                                                                                                                               | 12   | 612.2           | 313.3           | 747.4           | 341.3           |
| Financial assets – fair value through profit and loss                                                                                           | 5    | 10,919.4        | 9,977.3         | 12,646.4        | 10,835.2        |
| Investment property held for sale                                                                                                               | 6    | 286.7           | 222.7           | -               | -               |
| Investment and development property                                                                                                             | 6    | 2,826.4         | 2,222.1         | -               | -               |
| Finance leases                                                                                                                                  |      | 40.4            | 39.4            | 33.0            | 39.4            |
| Property, plant and equipment                                                                                                                   |      | 130.9           | 125.7           | -               | -               |
| Current tax asset                                                                                                                               | 4    | 0.5             | -               | -               | -               |
| Deferred tax asset                                                                                                                              | 4    | 3.5             | 2.6             | -               | -               |
| Other assets                                                                                                                                    |      | 56.3            | 25.5            | -               | -               |
| Goodwill                                                                                                                                        | 25   | 61.1            | 61.1            | 46.8            | 46.8            |
| Other intangible assets                                                                                                                         | 25   | 13.3            | 12.5            | -               | -               |
| <b>Total assets of shareholders of Challenger Life Company Limited, policyholders, external unit holders and non-controlling interests</b>      |      | <b>18,217.7</b> | <b>16,929.2</b> | <b>14,137.3</b> | <b>11,942.3</b> |
| <b>Liabilities</b>                                                                                                                              |      |                 |                 |                 |                 |
| Payables                                                                                                                                        | 11   | 323.7           | 436.0           | 97.2            | 299.1           |
| Derivative liabilities                                                                                                                          | 12   | 713.2           | 201.5           | 762.7           | 178.0           |
| Interest bearing financial liabilities                                                                                                          | 16   | 2,589.5         | 2,370.7         | 1,834.4         | 1,504.2         |
| Interest bearing financial liabilities – SPV                                                                                                    | 7    | 2,136.9         | 2,856.3         | -               | -               |
| External unit holders' liabilities                                                                                                              | 10   | 944.7           | 1,072.4         | -               | -               |
| Current tax liability                                                                                                                           | 4    | -               | 1.8             | -               | -               |
| Deferred tax liabilities                                                                                                                        | 4    | 142.6           | 150.9           | 161.3           | 196.6           |
| Life contract liabilities                                                                                                                       | 9    | 8,693.0         | 7,824.3         | 8,693.0         | 7,824.3         |
| <b>Total liabilities of shareholders of Challenger Life Company Limited, policyholders, external unit holders and non-controlling interests</b> |      | <b>15,543.6</b> | <b>14,913.9</b> | <b>11,548.6</b> | <b>10,002.2</b> |
| <b>Net assets of shareholders of Challenger Life Company Limited and non-controlling interests</b>                                              |      | <b>2,674.1</b>  | <b>2,015.3</b>  | <b>2,588.7</b>  | <b>1,940.1</b>  |
| <b>Equity</b>                                                                                                                                   |      |                 |                 |                 |                 |
| Contributed equity                                                                                                                              | 15   | 1,541.5         | 1,046.5         | 1,541.5         | 1,046.5         |
| Reserves                                                                                                                                        | 17   | 139.0           | 107.9           | 137.8           | 105.7           |
| Retained earnings                                                                                                                               | 17   | 898.6           | 738.0           | 909.4           | 787.9           |
| <b>Total equity of shareholders of Challenger Life Company Limited</b>                                                                          |      | <b>2,579.1</b>  | <b>1,892.4</b>  | <b>2,588.7</b>  | <b>1,940.1</b>  |
| Non-controlling interests                                                                                                                       | 23   | 95.0            | 122.9           | -               | -               |
| <b>Total equity of shareholders of Challenger Life Company Limited and non-controlling interests</b>                                            |      | <b>2,674.1</b>  | <b>2,015.3</b>  | <b>2,588.7</b>  | <b>1,940.1</b>  |

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

## Statement of changes in equity

### Statements of changes in equity

Attributable to shareholders of Challenger Life Company Limited

#### Consolidated

#### Balance at 1 July 2013

|                                                | Note | Contributed equity<br>\$M | Cash flow<br>hedge reserve<br>– SPV<br>\$M | Foreign<br>currency<br>translation<br>reserve<br>\$M | Adjusted<br>controlling<br>interest reserve<br>\$M | Other reserve<br>\$M | Retained<br>earnings<br>\$M | Total share-<br>holder equity<br>\$M | Non-control-<br>ling interests<br>\$M | Total<br>equity<br>\$M |
|------------------------------------------------|------|---------------------------|--------------------------------------------|------------------------------------------------------|----------------------------------------------------|----------------------|-----------------------------|--------------------------------------|---------------------------------------|------------------------|
| Balance at 1 July 2013                         |      | 1,046.5                   | 3.6                                        | (1.3)                                                | 18.2                                               | -                    | 581.9                       | 1,648.9                              | 346.9                                 | 1,995.8                |
| Profit for the year                            | 17   | -                         | -                                          | -                                                    | -                                                  | -                    | 351.1                       | 351.1                                | 22.4                                  | 373.5                  |
| Other comprehensive income for the year        |      | -                         | (4.0)                                      | (2.0)                                                | -                                                  | -                    | -                           | (6.0)                                | -                                     | (6.0)                  |
| <b>Total comprehensive income for the year</b> |      | <b>-</b>                  | <b>(4.0)</b>                               | <b>(2.0)</b>                                         | <b>-</b>                                           | <b>-</b>             | <b>351.1</b>                | <b>345.1</b>                         | <b>22.4</b>                           | <b>367.5</b>           |

#### Other equity movements

|                                         |    |   |   |   |     |      |         |         |         |         |
|-----------------------------------------|----|---|---|---|-----|------|---------|---------|---------|---------|
| Changes in controlling interest reserve | 17 | - | - | - | 1.1 | -    | -       | 1.1     | (257.7) | (256.6) |
| Dividends paid                          | 19 | - | - | - | -   | -    | (195.0) | (195.0) | -       | (195.0) |
| Deconsolidation of entities             |    | - | - | - | -   | -    | -       | -       | 1.2     | 1.2     |
| Distributable reserves                  | 17 | - | - | - | -   | 92.3 | -       | 92.3    | -       | 92.3    |
| Non-controlling interests movements     | 23 | - | - | - | -   | -    | -       | -       | 10.1    | 10.1    |

#### Balance at 30 June 2014 and 1 July 2014

|  |  |                |              |              |             |             |              |                |              |                |
|--|--|----------------|--------------|--------------|-------------|-------------|--------------|----------------|--------------|----------------|
|  |  | <b>1,046.5</b> | <b>(0.4)</b> | <b>(3.3)</b> | <b>19.3</b> | <b>92.3</b> | <b>738.0</b> | <b>1,892.4</b> | <b>122.9</b> | <b>2,015.3</b> |
|--|--|----------------|--------------|--------------|-------------|-------------|--------------|----------------|--------------|----------------|

|                                                |    |          |            |              |          |          |              |              |             |              |
|------------------------------------------------|----|----------|------------|--------------|----------|----------|--------------|--------------|-------------|--------------|
| Profit for the year                            | 17 | -        | -          | -            | -        | -        | 303.5        | 303.5        | 23.8        | 327.3        |
| Other comprehensive income for the year        |    | -        | 1.8        | (2.8)        | -        | -        | -            | (1.0)        | -           | (1.0)        |
| <b>Total comprehensive income for the year</b> |    | <b>-</b> | <b>1.8</b> | <b>(2.8)</b> | <b>-</b> | <b>-</b> | <b>303.5</b> | <b>302.5</b> | <b>23.8</b> | <b>326.3</b> |

#### Other equity movements

|                                         |    |       |   |   |       |      |         |         |        |         |
|-----------------------------------------|----|-------|---|---|-------|------|---------|---------|--------|---------|
| Issued capital                          | 15 | 495.0 | - | - | -     | -    | -       | 495.0   | -      | 495.0   |
| Changes in controlling interest reserve | 17 | -     | - | - | (0.4) | -    | -       | (0.4)   | -      | (0.4)   |
| Dividends paid                          | 19 | -     | - | - | -     | -    | (142.9) | (142.9) | -      | (142.9) |
| Deconsolidation of entities             |    | -     | - | - | -     | -    | -       | -       | (49.7) | (49.7)  |
| Distributable reserves                  | 17 | -     | - | - | -     | 32.5 | -       | 32.5    | -      | 32.5    |
| Non-controlling interests movements     | 23 | -     | - | - | -     | -    | -       | -       | (2.0)  | (2.0)   |

#### Balance at 30 June 2015

|  |  |                |            |              |             |              |              |                |             |                |
|--|--|----------------|------------|--------------|-------------|--------------|--------------|----------------|-------------|----------------|
|  |  | <b>1,541.5</b> | <b>1.4</b> | <b>(6.1)</b> | <b>18.9</b> | <b>124.8</b> | <b>898.6</b> | <b>2,579.1</b> | <b>95.0</b> | <b>2,674.1</b> |
|--|--|----------------|------------|--------------|-------------|--------------|--------------|----------------|-------------|----------------|

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

## Statement of changes in equity

### Statements of changes in equity (continued)

|                                                |      | Attributable to shareholders of Challenger Life Company Limited |                                            |                                                      |                                                       |                      |                             |                                      |                                         |                        |
|------------------------------------------------|------|-----------------------------------------------------------------|--------------------------------------------|------------------------------------------------------|-------------------------------------------------------|----------------------|-----------------------------|--------------------------------------|-----------------------------------------|------------------------|
| Parent                                         | Note | Contributed equity<br>\$M                                       | Cash flow<br>hedge reserve<br>– SPV<br>\$M | Foreign<br>currency<br>translation<br>reserve<br>\$M | Adjusted<br>controlling<br>interest<br>reserve<br>\$M | Other reserve<br>\$M | Retained<br>earnings<br>\$M | Total share-<br>holder equity<br>\$M | Non-<br>controlling<br>interests<br>\$M | Total<br>equity<br>\$M |
| <b>Balance at 1 July 2013</b>                  |      | 1,046.5                                                         | -                                          | -                                                    | -                                                     | -                    | 602.5                       | 1,649.0                              | -                                       | 1,649.0                |
| Profit for the year                            | 17   | -                                                               | -                                          | -                                                    | -                                                     | -                    | 380.4                       | 380.4                                | -                                       | 380.4                  |
| Other comprehensive income for the year        |      | -                                                               | -                                          | -                                                    | -                                                     | -                    | -                           | -                                    | -                                       | -                      |
| <b>Total comprehensive income for the year</b> |      | -                                                               | -                                          | -                                                    | -                                                     | -                    | <b>380.4</b>                | <b>380.4</b>                         | -                                       | <b>380.4</b>           |
| <b>Other equity movements</b>                  |      |                                                                 |                                            |                                                      |                                                       |                      |                             |                                      |                                         |                        |
| Dividends paid                                 | 19   | -                                                               | -                                          | -                                                    | -                                                     | -                    | (195.0)                     | (195.0)                              | -                                       | (195.0)                |
| Distributable reserves                         | 17   | -                                                               | -                                          | -                                                    | -                                                     | 105.7                | -                           | 105.7                                | -                                       | 105.7                  |
| <b>Balance at 30 June 2014 and 1 July 2014</b> |      | <b>1,046.5</b>                                                  | -                                          | -                                                    | -                                                     | <b>105.7</b>         | <b>787.9</b>                | <b>1,940.1</b>                       | -                                       | <b>1,940.1</b>         |
| Profit for the year                            | 17   | -                                                               | -                                          | -                                                    | -                                                     | -                    | 264.4                       | 264.4                                | -                                       | 264.4                  |
| Other comprehensive income for the year        |      | -                                                               | -                                          | -                                                    | -                                                     | -                    | -                           | -                                    | -                                       | -                      |
| <b>Total comprehensive income for the year</b> |      | -                                                               | -                                          | -                                                    | -                                                     | -                    | <b>264.4</b>                | <b>264.4</b>                         | -                                       | <b>264.4</b>           |
| <b>Other equity movements</b>                  |      |                                                                 |                                            |                                                      |                                                       |                      |                             |                                      |                                         |                        |
| Issued capital                                 | 15   | 495.0                                                           | -                                          | -                                                    | -                                                     | -                    | -                           | 495.0                                | -                                       | 495.0                  |
| Dividends paid                                 | 19   | -                                                               | -                                          | -                                                    | -                                                     | -                    | (142.9)                     | (142.9)                              | -                                       | (142.9)                |
| Distributable reserves                         | 17   | -                                                               | -                                          | -                                                    | -                                                     | 32.1                 | -                           | 32.1                                 | -                                       | 32.1                   |
| <b>Balance at 30 June 2015</b>                 |      | <b>1,541.5</b>                                                  | -                                          | -                                                    | -                                                     | <b>137.8</b>         | <b>909.4</b>                | <b>2,588.7</b>                       | -                                       | <b>2,588.7</b>         |

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

## Statement of cash flows

### Statements of cash flows

For the year ended 30 June

| For the year ended 30 June                                  |      | Consolidated |           | Parent    |           |
|-------------------------------------------------------------|------|--------------|-----------|-----------|-----------|
|                                                             |      | 2015         | 2014      | 2015      | 2014      |
|                                                             | Note | \$M          | \$M       | \$M       | \$M       |
| Operating activities                                        |      |              |           |           |           |
| Other income received                                       |      | 395.6        | 430.5     | 29.0      | 7.6       |
| Annuity and premium receipts                                | 9    | 2,764.2      | 2,806.2   | 2,764.2   | 2,806.2   |
| Annuity and claim payments                                  | 9    | (2,361.3)    | (2,526.0) | (2,361.5) | (2,526.0) |
| Payments to reinsurer                                       | 9    | (4.6)        | (4.0)     | (4.6)     | (4.0)     |
| Receipts from external unit holders                         |      | 944.0        | 581.6     | -         | -         |
| Payments to external unit holders                           |      | (1,130.7)    | (1,326.7) | -         | -         |
| Payments to vendors                                         |      | (322.0)      | (348.9)   | (124.0)   | (110.6)   |
| Dividends received                                          |      | 61.5         | 45.1      | 618.5     | 140.7     |
| Interest received                                           |      | 589.4        | 552.9     | 566.6     | 540.5     |
| Interest paid                                               |      | (71.2)       | (67.6)    | (50.1)    | (40.2)    |
| Income tax paid                                             |      | (16.4)       | (5.1)     | (15.6)    | -         |
| Net cash inflows from operating activities                  | 14   | 848.5        | 138.0     | 1,422.5   | 814.2     |
| Investing activities                                        |      |              |           |           |           |
| Payments on net purchases of investments                    |      | (825.7)      | (1,041.2) | (2,096.6) | (1,358.2) |
| Payments for purchases of controlled entities               |      | -            | (270.7)   | -         | -         |
| Net mortgage loan repayments                                |      | 769.5        | 1,055.7   | -         | -         |
| Payments on net purchases of investment properties          |      | (609.1)      | 126.4     | -         | -         |
| Payments for net purchases of property, plant and equipment |      | (0.7)        | (3.7)     | -         | -         |
| Net cash outflows from investing activities                 |      | (666.0)      | (133.5)   | (2,096.6) | (1,358.2) |
| Financing activities                                        |      |              |           |           |           |
| Proceeds from borrowings – interest bearing liabilities     |      | 306.0        | 571.1     | 289.0     | 529.4     |
| Repayment of borrowings – interest bearing liabilities      |      | (855.7)      | (1,033.4) | -         | -         |
| Proceeds from issue of equity hybrid notes                  |      | 345.0        | -         | 345.0     | -         |
| Proceeds from issue of ordinary shares                      |      | 150.0        | -         | 150.0     | -         |
| Dividends paid                                              |      | (142.9)      | (195.0)   | (142.9)   | (195.0)   |
| Distributions paid to non-controlling interests             |      | (1.2)        | (17.7)    | -         | -         |
| Proceeds from loans                                         |      | 1.3          | 3.2       | 11.9      | (8.0)     |
| Net cash (outflows)/inflows from financing activities       |      | (197.5)      | (671.8)   | 653.0     | 326.4     |
| Net decrease in cash and cash equivalents                   |      | (15.0)       | (667.3)   | (21.1)    | (217.6)   |
| Cash and cash equivalents at the beginning of the year      |      | 516.8        | 1,184.1   | 8.3       | 225.9     |
| Cash and cash equivalents at the end of the year            |      | 501.8        | 516.8     | (12.8)    | 8.3       |
| Cash and cash equivalents                                   | 13   | 317.9        | 300.2     | (12.8)    | 8.3       |
| Cash and cash equivalents – SPV                             | 7    | 183.9        | 216.6     | -         | -         |
| Cash and cash equivalents at the end of the year            |      | 501.8        | 516.8     | (12.8)    | 8.3       |

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

## Section 1: Basis of preparation and overarching significant accounting policies

Challenger Life Company Limited (the Company, the parent entity 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) for the year ended 30 June 2015 were authorised for issue in accordance with a resolution of the Directors of the Company on 17 August 2015.

### (i) Basis of preparation and statement of compliance

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

Unless otherwise stated, amounts in this financial report are presented in Australian dollars and have been prepared on a fair value basis as assets backing life insurance contracts liabilities. Financial assets, 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. The assets and liabilities disclosed in the statement of financial position are grouped by nature and listed in an order that reflects their relative liquidity.

### (ii) New and revised accounting standards and interpretations

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

#### Changes in accounting policy or disclosure

##### **AASB 2012-3 Amendments to Australian Accounting Standards – Offsetting Financial Assets and Financial Liabilities**

The amendments and application guidance to AASB 132 *Financial Instruments: Presentation* to address inconsistencies identified in applying some of the offsetting criteria for AASB 132, including clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. The amendments were effective for annual periods beginning on or after 1 January 2014 and did not result in any material changes.

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

The amendments include additional information about the fair value measurement of non-financial assets when the

recoverable amount of impaired assets is based on fair value less costs of disposal. The amendments were effective for annual periods beginning on or after 1 January 2014 and did not result in any material changes.

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

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

The adoption of other amendments and changes which were effective during the period did not result in any material changes to the financial report.

##### **Accounting standards and interpretations issued but not yet effective**

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.

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

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

##### **AASB 9 Financial Instruments**

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

The Group is currently assessing the impact of this new standard but does not expect any material impact as a result of complying with the new requirements. Early adoptions is not currently anticipated. The classification of a financial instrument will be assessed on the facts at the date of initial application and it is possible that the classification of some financial assets may change upon adoption of the new standard.

## (ii) New and revised accounting standards and interpretations (continued)

### AASB 15 Revenue from Contracts with Customers

The new revenue standard establishes a single, comprehensive framework for revenue recognition effective for annual periods beginning on or after 1 January 2017 and replaces the previous revenue standards IAS 18 *Revenue* and IAS 11 *Construction contracts*.

The standard does not apply to leases, financial instruments and insurance contracts. An exposure Draft has been issued by the AASB to defer the effective date of this standard to 1 January 2018. The Group is currently assessing the impact of this new standard but does not expect any material impact as a result of complying with the new requirements.

In addition to those described above, 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.

## (iii) Principles of consolidation

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

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

The life insurance contract operations of the Company are conducted within the separate statutory funds as required by the Life Insurance Act 1995. Both the shareholder and policyholder interests in these statutory funds are reported in aggregate in the financial report of the Group.

### 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 that back life insurance contracts are designated as financial assets at fair value through profit and loss.

## (iv) Comparatives

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

## (v) Rounding of amounts

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

## (vi) Foreign currency

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

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

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

Derivatives are used to hedge the foreign exchange risk relating to certain transactions. Refer to Note 12 Derivative financial instruments.

### Foreign controlled entities

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

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

## (vii) Goods and services tax (GST)

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

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

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

**(viii) Significant accounting judgements, estimates and assumptions**

The carrying values of amounts recognised on the statement of financial position are often based on estimates and assumptions of future events. The key estimates and assumptions that have a significant risk of causing a material adjustment to the recognised amounts within the next annual reporting period are disclosed individually within each of the relevant notes to the financial statements.

**(ix) Impairment of assets**

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

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

When the carrying amount of an asset or cash-generating unit (CGU) exceeds its recoverable amount, the asset or cash-generating unit is considered impaired and is written down to its recoverable amount. Impairment losses are recognised in the statement of comprehensive income, unless an asset has previously been revalued, in which case

the impairment loss is recognised as a reversal of that previous revaluation with any excess recognised through the statement of comprehensive income as impairment losses.

Impairment losses recognised in respect of a CGU are allocated first to reduce the carrying amount of any goodwill allocated to that 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 decreased. If such indication exists, the recoverable amount is estimated. A reversal of the impairment loss may only increase the asset's value up to its carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the statement of comprehensive income unless the asset is carried at the revalued amount, in which case it is treated as a revaluation increase. Impairment losses recognised for goodwill are not subsequently reversed.

**(x) Restrictions on assets**

Financial assets held in the company can only be used within the restrictions imposed under the *Life Insurance Act 1995* (the Life Act). The main restrictions are that the assets in a statutory fund can only be used to meet the liabilities and expenses of that statutory fund, to acquire investments to further the business of the statutory fund or as distributions when capital adequacy requirements are met. Refer to Note 9 Life contract liabilities.

## Section 2: Key numbers

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

### Note 1 Revenue

|                                                                                  | Consolidated           |                        | Parent                 |                        |
|----------------------------------------------------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                                                                  | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
| <b>Investment revenue</b>                                                        |                        |                        |                        |                        |
| <b>Fixed income securities and cash</b>                                          |                        |                        |                        |                        |
| Interest revenue                                                                 | 759.0                  | 738.5                  | 595.1                  | 520.1                  |
| Net realised and unrealised gains on fixed income securities <sup>1</sup>        | 138.7                  | 255.2                  | (52.3)                 | 156.8                  |
| <b>Investment property and property securities</b>                               |                        |                        |                        |                        |
| Property rental revenue                                                          | 266.2                  | 239.9                  | -                      | -                      |
| Dividend revenue                                                                 | 22.2                   | 25.3                   | 12.3                   | 13.7                   |
| Net realised and unrealised gains on investment property and property securities | 98.2                   | 9.9                    | (31.6)                 | (3.4)                  |
| Revenue from sale of development properties                                      | 25.6                   | 17.3                   | -                      | -                      |
| <b>Equity and infrastructure investments</b>                                     |                        |                        |                        |                        |
| Dividend revenue                                                                 | 39.9                   | 24.1                   | 601.8                  | 263.1                  |
| Net realised and unrealised gains on equity investments                          | 25.9                   | 38.4                   | (83.4)                 | 43.1                   |
| Net realised and unrealised gains on infrastructure investments                  | 39.5                   | 47.0                   | 11.5                   | 38.3                   |
| <b>Other</b>                                                                     |                        |                        |                        |                        |
| Net realised and unrealised gains on foreign exchange translation and hedges     | 27.4                   | 54.4                   | (50.3)                 | 58.8                   |
| Net realised and unrealised losses on interest rate derivatives                  | (97.3)                 | (46.6)                 | (47.7)                 | (38.2)                 |
| Net realised and unrealised gains on equity swap derivatives                     | 28.8                   | 0.8                    | -                      | -                      |
| <b>Management fee revenue</b>                                                    | 20.0                   | 12.1                   | 12.0                   | 9.8                    |
| <b>Other revenue</b>                                                             |                        |                        |                        |                        |
| Life insurance contract premiums and related revenue                             | 490.8                  | 620.5                  | 490.8                  | 620.5                  |
| Change in life insurance contract liabilities                                    | (332.6)                | (549.7)                | (332.6)                | (549.7)                |
| Change in life investment contract liabilities                                   | (56.1)                 | (5.9)                  | (56.1)                 | (5.9)                  |
| Change in reinsurance contract liabilities                                       | 1.8                    | 0.5                    | 1.8                    | 0.5                    |
| <b>Total revenue</b>                                                             | <b>1,498.0</b>         | <b>1,481.7</b>         | <b>1,071.3</b>         | <b>1,127.5</b>         |

<sup>1</sup> Includes fair value movements in subordinated debt (Note 21 Fair values of financial assets and liabilities).

### Recognition and measurement

Revenue is recognised and measured as the fair value of the consideration received or receivable to the extent that it is probable that economic benefits will flow to the Group and the revenue can be reliably measured. Revenues and expenses are 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. Interest revenue on finance leases is recognised on a basis that reflects a constant periodic return on the net investment in the finance lease. Proceeds from the sale of rental assets are recognised upon disposal of the relevant assets.

## Note 1 Revenue (continued)

### Recognition and measurement (continued)

- Gains or losses arising from changes in the fair value of financial instruments classified as fair value through profit and loss are recognised as revenue in the statement of comprehensive income when the change in value is recognised in the statement of financial position.
- Property rental revenue is accounted for on a straight line basis over the lease term. Contingent rental income is recognised as income in the period in which it is earned. Lease incentives granted are recognised as an integral part of the total rental income.
- Operating lease rental income is earned on a straight-line basis over the life of the contract.
- Dividend revenue from listed equity shares is recognised as income on the date the share is quoted ex-dividend. Dividend revenue from unlisted equity shares is recognised when the dividend is declared.
- Management fee revenue is recognised when the services are deemed to have been earned.
- Life insurance contract premiums are recognised as revenue when received.
- Changes in life insurance and investment contract liabilities arising from discount rates, inflation rates and other assumptions are recognised as revenue, with other movements being included in Note 2 Expenses. Refer to Note 9 Life contract liabilities for more detail on the recognition and measurement of life contract liabilities.

## Note 2 Expenses

|                                                   | Consolidated           |                        | Parent                 |                        |
|---------------------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                                   | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
| Life insurance contract claims and expenses       | 210.5                  | 109.0                  | 210.5                  | 109.0                  |
| Cost of life insurance contract liabilities       | 124.1                  | 93.4                   | 124.1                  | 93.4                   |
| Cost of life investment contract liabilities      | 238.1                  | 285.5                  | 238.1                  | 285.5                  |
| Reinsurance contracts                             | 1.6                    | 2.3                    | 1.6                    | 2.3                    |
| Investment property related expenses <sup>1</sup> | 68.3                   | 74.7                   | 1.3                    | 0.3                    |
| Development properties cost of sales              | 23.9                   | 15.6                   | -                      | -                      |
| Management fee expense                            | 49.5                   | 42.4                   | 20.5                   | 11.8                   |
| Distribution expenses                             | 25.8                   | 29.7                   | 25.5                   | 29.7                   |
| Expenses SPV                                      | 13.4                   | 16.1                   | -                      | -                      |
| Depreciation and amortisation expense             | 11.0                   | 12.3                   | -                      | -                      |
| Infrastructure overheads                          | 9.0                    | 8.2                    | -                      | -                      |
| Other expenses                                    | 70.0                   | 70.9                   | 70.6                   | 68.8                   |
| <b>Total expenses</b>                             | <b>845.2</b>           | <b>760.1</b>           | <b>692.2</b>           | <b>600.8</b>           |

<sup>1</sup> Investment property related expenses relate to rental income generating investment properties.

### Recognition and measurement

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

- Rental expenses incurred under an investment property operating lease are recognised on a straight line basis over the term of the lease.
- Investment property expenditure, including rates, taxes, insurance and other costs associated with the upkeep of a building, are brought to account on an accrual basis. Repair costs are expensed when incurred. Other amounts that improve the condition of the investment are capitalised into the carrying value of the asset.
- Life insurance contract claims and expenses are recognised in expenses when the liability to the policyholder under the contract has been established.

## Note 2 Expenses (continued)

### Recognition and measurement (continued)

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

Refer to Note 9 Life contract liabilities for more detail on the recognition and measurement of life contract liabilities.

## Note 3 Segment information

The reporting segments<sup>1</sup> of the Group have been identified as follows:

|                                                                                   | CLC Segment    |                |
|-----------------------------------------------------------------------------------|----------------|----------------|
|                                                                                   | 2015<br>\$M    | 2014<br>\$M    |
| <b>For the year ended 30 June</b>                                                 |                |                |
| Net income                                                                        | 541.2          | 466.0          |
| Operating expenses                                                                | (70.0)         | (66.9)         |
| <b>Normalised EBIT</b>                                                            | <b>471.2</b>   | <b>399.1</b>   |
| Interest and borrowing costs                                                      | -              | -              |
| <b>Normalised net profit before tax</b>                                           | <b>471.2</b>   | <b>399.1</b>   |
| Tax on normalised profit                                                          | (117.2)        | (77.6)         |
| <b>Normalised net profit after tax</b>                                            | <b>354.0</b>   | <b>321.5</b>   |
| Investment experience                                                             | (72.2)         | 42.3           |
| Tax on investment experience                                                      | 21.7           | (12.7)         |
| <b>Profit attributable to shareholders of Challenger Life Company Limited</b>     | <b>303.5</b>   | <b>351.1</b>   |
| <b>Other statutory segment information</b>                                        |                |                |
| Revenue from external customers                                                   | 739.1          | 743.2          |
| Interest revenue                                                                  | 758.9          | 738.5          |
| Interest expense                                                                  | (229.9)        | (257.8)        |
| Depreciation and amortisation                                                     | (11.0)         | (12.3)         |
| <b>Management view of statement of financial position</b>                         |                |                |
| <b>As at 30 June</b>                                                              |                |                |
| Segment assets                                                                    | 13,104.6       | 11,560.7       |
| Segment liabilities                                                               | (10,525.5)     | (9,668.3)      |
| <b>Net assets attributable to shareholders of Challenger Life Company Limited</b> | <b>2,579.1</b> | <b>1,892.4</b> |
| Non-controlling interests                                                         | 95.0           | 122.9          |
| <b>Total Equity</b>                                                               | <b>2,674.1</b> | <b>2,015.3</b> |

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

## Note 3 Segment information (continued)

### Definitions

#### Operating segments

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

#### CLC segment

The Group as a regulated life company operates solely in the CLC segment as a consolidated view of all the income and expenses attached to the life company.

#### Normalised vs. statutory results

Net income and operating expenses differ from revenue and expenses as disclosed in the statement of comprehensive income as certain direct costs (including distribution expenses, property expenses and management fees) included in expenses are netted off against revenues in deriving the management view of net income above. Net income consists of the normalised cash operating earnings (Life segment).

In addition, the revenues, expenses and finance costs from Special Purpose Vehicles (SPV) are separately disclosed in the statutory view but are netted off in net income.

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

#### Normalised cash operating earnings

This is calculated as cash earnings plus normalised capital growth (refer below). Cash earnings represents the sum of investment yield (being the management view of revenue from investment assets, such as net rental income, dividends and interest), interest expense, distribution expense and fees.

#### Normalised EBIT

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

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

#### Tax on normalised profit

Represents the consolidated statutory tax expense or benefit for the period, less tax attributable to non-controlling interests, less the tax applied to investment experience.

#### Investment experience after tax

The Group is required by accounting standards to value applicable assets and liabilities supporting the life insurance business at fair value. This can give rise to fluctuating valuation movements being recognised in the statement of comprehensive income, particularly during periods of market volatility. As the Group is generally a long-term holder of assets, due to assets being held to match the term of life contract liabilities, the Group takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term volatility. Investment experience is a mechanism employed to remove the volatility arising from asset and liability valuation from the results so as to more accurately reflect the underlying performance of the Group.

Investment experience is calculated as the difference between the actual investment gains/losses (both realised and unrealised) and the normalised capital growth (refer below) plus annuity valuation experience. Investment experience after tax is investment experience net of tax at the prevailing income tax rate.

#### Normalised capital growth

This is determined by multiplying the normalised capital growth rate for each asset class by the average investment assets for the period. The normalised growth rates represent the Group's medium to long-term capital growth expectations for each asset class over the investment cycle. The normalised growth rates for the year are +6.0% for equity and other 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.

Annuity valuation experience changes represent the impact of changes in macroeconomic variables, including bond yields and inflation factors, expense assumptions, losses on new business and other factors applied in the valuation of life contract liabilities. It also includes the attribution of the corresponding interest rate, foreign exchange and inflation derivatives used to hedge interest rate volatility.

#### Major customers

The Group does not rely on any large individual customers and consequently there is no significant concentration risk.

#### Geographical areas

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

**Note 3 Segment information (continued)**

|                                                                                              | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
|----------------------------------------------------------------------------------------------|------------------------|------------------------|
| <b>Reconciliation of management to statutory view of after-tax profit</b>                    |                        |                        |
| <b>Normalised net profit before tax (management view of pre-tax profit)</b>                  | <b>471.2</b>           | <b>399.1</b>           |
| Tax on normalised profit                                                                     | (117.2)                | (77.6)                 |
| <b>Normalised net profit after tax</b>                                                       | <b>354.0</b>           | <b>321.5</b>           |
| Investment experience after tax                                                              | (50.5)                 | 29.6                   |
| Profit attributable to non-controlling interests excluded from management view               | 23.8                   | 22.4                   |
| <b>Statutory view of profit after tax</b>                                                    | <b>327.3</b>           | <b>373.5</b>           |
| <b>Reconciliation of management view of revenue to statutory revenue</b>                     |                        |                        |
| <b>Net income (management view of revenue)</b>                                               | <b>541.2</b>           | <b>466.0</b>           |
| <b>Expenses and finance costs offset against revenue</b>                                     |                        |                        |
| SPV expenses and finance costs offset against SPV income                                     | 95.1                   | 128.9                  |
| Distribution expenses offset against related income                                          | 25.8                   | 29.7                   |
| Change in life contract liabilities and reinsurance contracts recognised in expenses         | 574.4                  | 490.2                  |
| Property related expenses offset against property income                                     | 92.2                   | 90.3                   |
| Interest and loan amortisation costs                                                         | 125.1                  | 117.8                  |
| Management fees                                                                              | 49.5                   | 42.4                   |
| Adjustment for non-controlling interests and other items                                     | 66.9                   | 74.1                   |
| <b>Difference between management view of investment experience and statutory recognition</b> |                        |                        |
| Actual capital growth                                                                        | 18.8                   | 122.1                  |
| Normalised capital growth                                                                    | (80.4)                 | (55.6)                 |
| Annuity valuation experience                                                                 | (10.6)                 | (24.2)                 |
| <b>Statutory revenue (refer Note 1 Revenue)</b>                                              | <b>1,498.0</b>         | <b>1,481.7</b>         |

## Note 4 Income tax

|                                                                                       | Consolidated           |                        | Parent                 |                        |
|---------------------------------------------------------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                                                                       | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
| <b>Analysis of income tax expense</b>                                                 |                        |                        |                        |                        |
| Current income tax expense for the year                                               | (101.6)                | (121.1)                | (96.8)                 | (105.4)                |
| Current income tax (expense)/benefit prior year adjustment                            | (3.6)                  | 1.9                    | (2.3)                  | 2.0                    |
| Deferred income tax benefit/(expense)                                                 | 9.6                    | 28.9                   | 34.8                   | (2.3)                  |
| <b>Income tax expense</b>                                                             | <b>(95.6)</b>          | <b>(90.3)</b>          | <b>(64.3)</b>          | <b>(105.7)</b>         |
| Income tax (expense)/benefit on translation of foreign entities                       | (9.2)                  | 4.9                    | -                      | -                      |
| Income tax benefit/(expense) on hedge of net investment in foreign entities           | 10.0                   | (2.4)                  | -                      | -                      |
| <b>Income tax benefit from other comprehensive income</b>                             | <b>0.8</b>             | <b>2.5</b>             | <b>-</b>               | <b>-</b>               |
| <b>Reconciliation of income tax expense</b>                                           |                        |                        |                        |                        |
| Profit before income tax                                                              | 422.9                  | 463.8                  | 328.7                  | 486.1                  |
| Prima facie income tax based on the Australian company tax rate of 30%                | (126.9)                | (139.1)                | (98.6)                 | (145.8)                |
| <b>Tax effect of amounts not assessable/deductible in calculating taxable income:</b> |                        |                        |                        |                        |
| - non-assessable and non-deductible items <sup>1</sup>                                | 14.9                   | 49.1                   | 25.1                   | 37.3                   |
| - rate differential on offshore income                                                | 7.8                    | (1.0)                  | 2.8                    | (1.5)                  |
| - other items                                                                         | 8.6                    | 0.7                    | 6.4                    | 4.3                    |
| <b>Income tax expense</b>                                                             | <b>(95.6)</b>          | <b>(90.3)</b>          | <b>(64.3)</b>          | <b>(105.7)</b>         |
| <b>Underlying effective tax rate<sup>2</sup></b>                                      | <b>23.9%</b>           | <b>27.3%</b>           | <b>19.6%</b>           | <b>27.9%</b>           |

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

<sup>2</sup> The calculation of the underlying effective tax rate excludes the non-controlling interests' profits of \$23.8 million (30 June 2014: \$22.4 million). It also excludes the reduction in income tax expense in respect of the TOFA transition application of \$nil (30 June 2014: \$30.0 million).

|                                                                        | Statement of financial position |                        | Statement of comprehensive income |                        |
|------------------------------------------------------------------------|---------------------------------|------------------------|-----------------------------------|------------------------|
|                                                                        | 30 June<br>2015<br>\$M          | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M            | 30 June<br>2014<br>\$M |
| <b>Analysis of deferred tax</b>                                        |                                 |                        |                                   |                        |
| <b>Deferred tax assets</b>                                             |                                 |                        |                                   |                        |
| Accruals and provisions                                                | 1.3                             | 3.2                    | (1.9)                             | 0.9                    |
| Unrealised losses on investments                                       | 0.7                             | (20.2)                 | 20.9                              | 7.7                    |
| Other                                                                  | 1.5                             | 19.6                   | (18.1)                            | (6.6)                  |
| <b>Total deferred tax assets</b>                                       | <b>3.5</b>                      | <b>2.6</b>             | <b>0.9</b>                        | <b>2.0</b>             |
| <b>Deferred tax liabilities</b>                                        |                                 |                        |                                   |                        |
| Unrealised foreign exchange movements                                  | (16.1)                          | (8.8)                  | (7.3)                             | (2.3)                  |
| Unrealised gains on investments                                        | (116.1)                         | (141.0)                | 24.9                              | 29.2                   |
| Other                                                                  | (10.4)                          | (1.1)                  | (8.9)                             | -                      |
| <b>Total deferred tax liabilities</b>                                  | <b>(142.6)</b>                  | <b>(150.9)</b>         | <b>8.7</b>                        | <b>26.9</b>            |
| <b>Net deferred tax liability (statement of financial position)</b>    | <b>(139.1)</b>                  | <b>(148.3)</b>         |                                   |                        |
| <b>Deferred income tax benefit (statement of comprehensive income)</b> |                                 |                        | <b>9.6</b>                        | <b>28.9</b>            |

**Note 4 Income tax (continued)****Parent**

|                                                                        | Statement of financial position |                | Statement of comprehensive income |               |
|------------------------------------------------------------------------|---------------------------------|----------------|-----------------------------------|---------------|
|                                                                        | 30 June 2015                    | 30 June 2014   | 30 June 2015                      | 30 June 2014  |
|                                                                        | \$M                             | \$M            | \$M                               | \$M           |
| <b>Analysis of deferred tax</b>                                        |                                 |                |                                   |               |
| <b>Deferred tax assets</b>                                             |                                 |                |                                   |               |
| Accruals and provisions                                                | 2.6                             | 3.2            | (0.6)                             | (1.6)         |
| Unrealised losses on investments                                       | 79.9                            | 67.6           | 12.3                              | 11.4          |
| Other                                                                  | 3.1                             | -              | 3.1                               | -             |
| <b>Total deferred tax assets</b>                                       | <b>85.6</b>                     | <b>70.8</b>    | <b>14.8</b>                       | <b>9.8</b>    |
| <b>Deferred tax liabilities</b>                                        |                                 |                |                                   |               |
| Unrealised foreign exchange movements                                  | (3.7)                           | (1.4)          | (2.3)                             | 1.4           |
| Unrealised gains on investments                                        | (241.6)                         | (266.0)        | 23.9                              | (14.7)        |
| Other                                                                  | (1.6)                           | -              | (1.6)                             | 1.2           |
| <b>Total deferred tax liabilities</b>                                  | <b>(246.9)</b>                  | <b>(267.4)</b> | <b>20.0</b>                       | <b>(12.1)</b> |
| <b>Net deferred tax liability (statement of financial position)</b>    | <b>(161.3)</b>                  | <b>(196.6)</b> |                                   |               |
| <b>Deferred income tax benefit (statement of comprehensive income)</b> |                                 |                | <b>34.8</b>                       | <b>(2.3)</b>  |

**Recognition and measurement**

**Income tax expense** for the year comprises current and deferred tax. Income tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity.

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

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

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

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

## Note 4 Income tax (continued)

### Recognition and measurement (continued)

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

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

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted as at the statement of financial position date.

Income taxes relating to items recognised directly in equity are recognised in equity and not in profit or loss in the statement of comprehensive income. Deferred income tax assets and liabilities are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to the same taxable entity or tax consolidated group and the same taxation authority.

### Tax consolidation

Challenger Limited and its 100% owned Australian resident subsidiaries have formed a tax consolidated

group with effect from 1 July 2002 and are therefore taxed as a single entity from that date. Challenger Limited is the head entity of the tax consolidated group.

### Tax effect accounting by members of the tax group

Members of the tax consolidated group have applied tax funding principles under which Challenger Limited and each of the members of the tax consolidated group agree to pay or receive tax equivalent amounts to or from the head entity, based on the current tax liability or current tax asset of the member. Such amounts are reflected in the amounts receivable from or payable to each member and the head entity. The group allocation approach is applied in determining the appropriate amount of current tax liability or current tax asset to allocate to members of the tax consolidated group.

### Tax arrangements with other related parties

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

Additionally, CLH was responsible for, and indemnified the Group for, actual, contingent and tax-related liabilities of SF2 and SHF. Amounts receivable by the Company from CLH under the tax indemnity agreement total \$214.5 million (30 June 2014: \$188.3 million). Transactions under this agreement are treated as contributions from or distributions to CLH. In December 2014 the Agreement was agreed to be amended such that tax obligations and benefits of CLC arising after 31 December 2014 are no longer indemnified or transferred under the Agreement.

### Section 3: Operating assets and liabilities

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

#### Note 5 Financial assets – fair value through profit and loss

|                                                                    | Consolidated           |                        | Parent                 |                        |
|--------------------------------------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                                                    | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
| <b>Fixed income securities</b>                                     |                        |                        |                        |                        |
| Domestic sovereign bonds and semi-government bonds                 | 1,340.8                | 1,584.6                | 788.5                  | 1,327.2                |
| Floating rate notes and corporate bonds                            | 5,779.7                | 4,536.8                | 4,789.8                | 3,898.1                |
| Residential mortgage and asset-backed securities                   | 2,243.8                | 2,199.4                | 1,723.0                | 1,740.1                |
| Non-SPV mortgage assets                                            | 318.3                  | 153.2                  | -                      | -                      |
| Controlled entities                                                | -                      | -                      | 2,067.3                | 1,030.9                |
|                                                                    | <b>9,682.6</b>         | <b>8,474.0</b>         | <b>9,368.6</b>         | <b>7,996.3</b>         |
| <b>Equity securities</b>                                           |                        |                        |                        |                        |
| Controlled entities                                                | -                      | -                      | 628.0                  | 351.0                  |
| Shares in listed and unlisted corporations                         | 43.9                   | 73.9                   | 41.0                   | 40.7                   |
| Unit trusts, managed funds and other                               | 299.4                  | 307.9                  | 53.2                   | 160.8                  |
|                                                                    | <b>343.3</b>           | <b>381.8</b>           | <b>722.2</b>           | <b>552.5</b>           |
| <b>Infrastructure investments</b>                                  |                        |                        |                        |                        |
| Units in listed and unlisted infrastructure trusts                 | 290.1                  | 360.7                  | 141.1                  | 121.0                  |
| Other infrastructure investments                                   | 306.0                  | 291.5                  | -                      | -                      |
|                                                                    | <b>596.1</b>           | <b>652.2</b>           | <b>141.1</b>           | <b>121.0</b>           |
| <b>Property securities</b>                                         |                        |                        |                        |                        |
| Indirect property investments in listed and unlisted trusts        | <b>297.4</b>           | <b>469.3</b>           | <b>177.5</b>           | <b>158.3</b>           |
| <b>Controlled trusts</b>                                           |                        |                        |                        |                        |
| Infrastructure                                                     | -                      | -                      | 251.9                  | 298.9                  |
| Property                                                           | -                      | -                      | 1,012.1                | 1,151.1                |
| Other                                                              | -                      | -                      | 973.0                  | 557.1                  |
|                                                                    | <b>-</b>               | <b>-</b>               | <b>2,237.0</b>         | <b>2,007.1</b>         |
| <b>Total financial assets – fair value through profit and loss</b> | <b>10,919.4</b>        | <b>9,977.3</b>         | <b>12,646.4</b>        | <b>10,835.2</b>        |
| Current                                                            | 5,476.9                | 5,001.1                | 8,509.3                | 7,204.7                |
| Non-current                                                        | 5,442.5                | 4,976.2                | 4,137.1                | 3,630.5                |
|                                                                    | <b>10,919.4</b>        | <b>9,977.3</b>         | <b>12,646.4</b>        | <b>10,835.2</b>        |

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

### Recognition and measurement

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

Purchases and sales of financial assets are recognised on the date on which the Group commits to purchase or sell the asset. Financial assets are derecognised when the right to receive cash flows from the asset has expired or when the risks and rewards of ownership have been substantially transferred.

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

Assets backing life contract liabilities of the statutory fund are required to be designated as fair value through profit and loss in accordance with AASB 1038 Life Insurance Contracts when permitted by other Australian Accounting Standards.

### Unlisted investment valuations

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

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

Refer to Note 20 Financial risk management for further disclosure.

## Note 6 Investment and development property

### Consolidated

|                                                              | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
|--------------------------------------------------------------|------------------------|------------------------|
| Investment property held for sale <sup>1</sup>               | 286.7                  | 222.7                  |
| Investment property in use                                   | 2,736.6                | 2,125.5                |
| Investment property under development                        | 19.2                   | 18.8                   |
| <b>Total investment property</b>                             | <b>3,042.5</b>         | <b>2,367.0</b>         |
| Development property held for resale                         | 70.6                   | 77.8                   |
| <b>Total investment and development property<sup>2</sup></b> | <b>3,113.1</b>         | <b>2,444.8</b>         |

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

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

**Note 6 Investment and development property (continued)**

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

<sup>1</sup> Investment property acquisitions: Golden Grove \$138.9 million (July 2014), The Barracks \$153.0 million (October 2014), 53 Albert St \$222.3 million (December 2014), Next Hotel \$142.0 million, Clarence Street \$144.9 million and Bourke Street \$85.9 million (January 2015).

**Recognition and measurement**

Investment and development property is initially recognised at cost, including transaction costs.

Subsequent to initial recognition, investment and development property is recognised at fair value.

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

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

The valuer must have no pecuniary interest that could conflict with the valuation of the property, must be suitably indemnified, and must comply with the Australian Property Institute (API) Code of Ethics and Rules of Conduct (or foreign equivalent).

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

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

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

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

Where properties are debt financed, that finance is provided either by secured mortgages or by funding that contains a number of negative undertakings (including undertakings not to create or allow encumbrances, and undertakings not to incur financial indebtedness which ranks in priority to existing debt).

**Investment property under development**

When redevelopment of an existing investment property commences, it continues to be classified and measured as investment property when the asset is being redeveloped for continued future use as an investment property.

Investment property under construction is held at cost until an estimate of the fair value can be reliably determined.

**Note 6 Investment and development property (continued)****Recognition and measurement (continued)****Development property held for resale**

Development properties held for the purpose of resale are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price (fair value) in the ordinary course of business on completion, less estimated costs of completion and selling costs.

Cost includes cost of acquisition, development costs, holding costs and directly attributable interest on borrowed funds where the development is a qualifying asset. Capitalisation of borrowing costs ceases during extended periods in which active development is interrupted. When a development is completed and ceases to be a qualifying asset, borrowing costs and other costs are expensed as incurred.

**Property valuations****Analysis of investment property as at 30 June**

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

**Note 6 Investment and development property (continued)**

| <b>Analysis of investment property as at 30 June (continued)</b> | Acquisition date <sup>1</sup> | Total cost \$M <sup>2</sup> | Carrying value 2015 \$M | Cap rate 2015 <sup>3</sup> % | Last external valuation date | Carrying value 2014 \$M | Cap rate 2014 <sup>3</sup> % |
|------------------------------------------------------------------|-------------------------------|-----------------------------|-------------------------|------------------------------|------------------------------|-------------------------|------------------------------|
| <b>Europe</b>                                                    |                               |                             |                         |                              |                              |                         |                              |
| Rozalia park                                                     | 12-Apr-07                     | 80.6                        | 17.3                    | 10.19                        | 30-Jun-15                    | 13.9                    | 10.71                        |
| Rue Charles Nicolle, Villeneuve les Beziers                      | 31-Dec-08                     | 18.3                        | 10.7                    | 8.75                         | 30-Jun-15                    | 11.9                    | 8.50                         |
| Avenue de Savigny, Aulnay sous Bois                              | 31-Dec-08                     | 20.3                        | 14.4                    | 6.75                         | 30-Jun-15                    | 15.4                    | 6.95                         |
| 105 Route d'Orleans, Sully sur Loire                             | 31-Dec-08                     | 27.1                        | 10.2                    | 9.75                         | 30-Jun-15                    | 11.6                    | 9.75                         |
| 140 Rue Marcel Paul, Gennevilliers                               | 31-Dec-08                     | 14.0                        | 10.1                    | 9.50                         | 30-Jun-15                    | 10.7                    | 7.25                         |
| ZAC Papillon, Parçay-Meslay                                      | 31-Dec-08                     | 10.1                        | 6.9                     | 9.25                         | 30-Jun-15                    | 7.1                     | 8.65                         |
| <b>Japan</b>                                                     |                               |                             |                         |                              |                              |                         |                              |
| Carino Chitosedai                                                | 31-Jan-10                     | 118.3                       | 102.0                   | 5.00                         | 31-Dec-14                    | 97.7                    | 5.10                         |
| Carino Tokiwadai                                                 | 31-Jan-10                     | 77.0                        | 67.5                    | 4.90                         | 30-Jun-15                    | 64.5                    | 5.20                         |
| Izumiya Hakubaicho                                               | 31-Jan-10                     | 68.7                        | 59.2                    | 5.30                         | 31-Dec-14                    | 56.2                    | 5.50                         |
| Valor Toda                                                       | 31-Jan-10                     | 42.5                        | 36.3                    | 5.80                         | 30-Jun-15                    | 34.3                    | 6.00                         |
| Life Higashinakano                                               | 31-Jan-10                     | 32.8                        | 29.7                    | 4.90                         | 31-Dec-14                    | 28.4                    | 5.00                         |
| Life Asakusa                                                     | 31-Jan-10                     | 27.8                        | 26.2                    | 4.90                         | 30-Jun-15                    | 24.3                    | 5.20                         |
| Yaoko Sakato Chiyoda                                             | 31-Jan-10                     | 18.2                        | 14.8                    | 5.40                         | 31-Dec-14                    | 13.8                    | 5.50                         |
| Kansai Super Saigo                                               | 31-Jan-10                     | 13.1                        | 11.3                    | 5.60                         | 30-Jun-15                    | 10.9                    | 6.10                         |
| Kojima Nishiarai                                                 | 31-Jan-10                     | 10.8                        | 9.2                     | 5.00                         | 30-Jun-15                    | 8.1                     | 6.00                         |
| DeoDeo Kure                                                      | 31-Jan-10                     | 31.4                        | 25.9                    | 5.90                         | 30-Jun-15                    | 24.8                    | 6.10                         |
| Seiyu Miyagino                                                   | 31-Jan-10                     | 9.7                         | 8.7                     | 5.80                         | 30-Jun-15                    | 8.2                     | 6.10                         |
| Aeon Kushiro                                                     | 31-Jan-10                     | 27.8                        | 26.6                    | 5.60                         | 30-Jun-15                    | 25.1                    | 5.90                         |
| Life Nagata                                                      | 31-Jan-10                     | 25.2                        | 22.8                    | 5.10                         | 30-Jun-15                    | 21.5                    | 5.50                         |
| Valor Takinomizu                                                 | 31-Jan-10                     | 26.8                        | 21.3                    | 6.10                         | 31-Dec-14                    | 21.5                    | 5.80                         |
| Osada Nagasaki                                                   | 31-Jan-10                     | -                           | -                       | -                            | -                            | 10.1                    | -                            |
| <b>Total overseas</b>                                            |                               | <b>700.5</b>                | <b>531.1</b>            |                              |                              | <b>520.0</b>            |                              |
| <b>Total investment property in use<sup>4</sup></b>              |                               | <b>3,070.7</b>              | <b>3,023.3</b>          |                              |                              | <b>2,348.2</b>          |                              |
| <b>Investment property under development</b>                     |                               |                             |                         |                              |                              |                         |                              |
| TRE Data Centre                                                  | 14-Apr-10                     | 12.4                        | 12.4                    | -                            | n/a                          | 12.0                    | -                            |
| Enfield                                                          | 31-Dec-08                     | 20.5                        | 6.8                     | -                            | 30-Jun-15                    | 6.8                     | -                            |
| <b>Total investment property under development</b>               |                               | <b>32.9</b>                 | <b>19.2</b>             |                              |                              | <b>18.8</b>             |                              |
| <b>Development property</b>                                      |                               |                             |                         |                              |                              |                         |                              |
| Maitland                                                         | 6-Dec-06                      | 70.6                        | 70.6                    | -                            | -                            | 77.8                    | -                            |
| <b>Total development property</b>                                |                               | <b>70.6</b>                 | <b>70.6</b>             | -                            | -                            | <b>77.8</b>             | -                            |

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

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

<sup>3</sup> The capitalisation rate is derived by dividing the net property income over the carrying value of an investment property.

<sup>4</sup> At 30 June 2015, the investment property portfolio occupancy rate for Australia was 98.0% (30 June 2014: 97.0%) with a weighted average lease expiry of 4.4 years (30 June 2014: 5.1 years), Europe 87.9% (30 June 2014: 82.1%) with a weighted average lease expiry of 1.7 years (30 June 2014: 2.0 years) and Japan 100% (30 June 2014: 95.3%) with a weighted average lease expiry of 9.1 years (30 June 2014: 8.7 years).

## Note 7 Special Purpose Vehicles

### Consolidated

|                                                                  | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
|------------------------------------------------------------------|------------------------|------------------------|
| Cash and cash equivalents                                        | 183.9                  | 216.6                  |
| Mortgage assets <sup>1</sup>                                     | 2,331.1                | 3,106.1                |
| Derivative assets                                                | 2.2                    | 1.3                    |
| <b>Total assets</b>                                              | <b>2,517.2</b>         | <b>3,324.0</b>         |
| Payables <sup>2</sup>                                            | 72.6                   | 79.7                   |
| Derivative liabilities                                           | 0.8                    | 1.7                    |
| Interest bearing financial liabilities <sup>1</sup>              | 2,306.7                | 3,061.1                |
| <b>Total liabilities</b>                                         | <b>2,380.1</b>         | <b>3,142.5</b>         |
| <b>Net assets</b>                                                | <b>137.1</b>           | <b>181.5</b>           |
| Cash flow hedge reserve                                          | (1.4)                  | 0.4                    |
| <b>Total equity attributable to residual income unit holders</b> | <b>135.7</b>           | <b>181.9</b>           |

<sup>1</sup> \$541.4 million (30 June 2014: \$691.1 million) of the Mortgage assets balance is considered current, and \$535.7 million (30 June 2014: \$685.8 million) of the Interest bearing financial liabilities balance is considered current.

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

### Recognition and measurement

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

The Group is managing the run-off of this portfolio.

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

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

SPV cash and cash equivalents are financial assets and comprise cash at bank 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.

SPV mortgage assets are non-derivative financial loan assets with fixed or determinable payments that are not quoted in an active market. They are recognised at their fair value.

The Group uses derivative financial instruments to hedge the risks associated with SPV interest rate and foreign currency fluctuations. All these derivative financial instruments are stated at fair value. Gains or losses arising from fair value changes on derivatives that do not qualify for hedge accounting are recognised in the statement of comprehensive income.

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

SPV interest bearing financial liabilities are initially recognised at fair value calculated net of directly attributable transaction costs, and subsequently measured at fair value. Any difference is recognised in the statement of comprehensive income.

## Note 8 Receivables

|                                                                       | Consolidated           |                        | Parent                 |                        |
|-----------------------------------------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                                                       | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
| Accrued investment income                                             | 111.6                  | 80.9                   | 432.8                  | 426.4                  |
| Trade debtors                                                         | 2.7                    | 7.7                    | -                      | -                      |
| Tax indemnity agreement with Challenger Life Company Holdings Pty Ltd | 214.5                  | 188.3                  | 222.0                  | 196.4                  |
| Amounts recoverable from related entities                             | 13.6                   | 2.8                    | 1.5                    | 14.7                   |
| Other receivables                                                     | 52.3                   | 24.4                   | 0.6                    | 33.8                   |
| Derivative credit support                                             | 39.4                   | -                      | 19.6                   | -                      |
| <b>Total receivables</b>                                              | <b>434.1</b>           | <b>304.1</b>           | <b>676.5</b>           | <b>671.3</b>           |
| Current                                                               | 215.8                  | 113.3                  | 454.5                  | 474.9                  |
| Non-current                                                           | 218.3                  | 190.8                  | 222.0                  | 196.4                  |
|                                                                       | 434.1                  | 304.1                  | 676.5                  | 671.3                  |

### Recognition and measurement

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

### Carrying values

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

## Note 9 Life contract liabilities

### Consolidated and parent

|                                                                   | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
|-------------------------------------------------------------------|------------------------|------------------------|
| Life investment contract liabilities – at fair value              | 6,626.9                | 6,210.1                |
| Life insurance contract liabilities – at margin on services value | 2,013.3                | 1,556.6                |
| Reinsurance contract liabilities – at margin on services value    | 52.8                   | 57.6                   |
| <b>Total life contract liabilities</b>                            | <b>8,693.0</b>         | <b>7,824.3</b>         |

|                                              | Life investment contract liabilities |                        | Life insurance contract liabilities |                        | Reinsurance contract liabilities |                        | Total life contract liabilities |                        |
|----------------------------------------------|--------------------------------------|------------------------|-------------------------------------|------------------------|----------------------------------|------------------------|---------------------------------|------------------------|
|                                              | 30 June<br>2015<br>\$M               | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M              | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M           | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M          | 30 June<br>2014<br>\$M |
| <b>Movement in life contract liabilities</b> |                                      |                        |                                     |                        |                                  |                        |                                 |                        |
| Balance at the beginning of the year         | 6,210.1                              | 6,150.0                | 1,556.6                             | 913.5                  | 57.6                             | 59.8                   | 7,824.3                         | 7,123.3                |
| Deposits and premium receipts                | 2,273.4                              | 2,185.7                | 490.8                               | 620.5                  | -                                | -                      | 2,764.2                         | 2,806.2                |
| Payments and withdrawals                     | (2,150.8)                            | (2,417.0)              | (210.5)                             | (109.0)                | (4.6)                            | (4.0)                  | (2,365.9)                       | (2,530.0)              |
| Revenue per Note 1                           | 56.1                                 | 5.9                    | (158.2)                             | (70.8)                 | (1.8)                            | (0.5)                  | (103.9)                         | (65.4)                 |
| Expense per Note 2                           | 238.1                                | 285.5                  | 334.6                               | 202.4                  | 1.6                              | 2.3                    | 574.3                           | 490.2                  |
| <b>Balance at the end of the year</b>        | <b>6,626.9</b>                       | <b>6,210.1</b>         | <b>2,013.3</b>                      | <b>1,556.6</b>         | <b>52.8</b>                      | <b>57.6</b>            | <b>8,693.0</b>                  | <b>7,824.3</b>         |

**Note 9 Life contract liabilities (continued)**

|                                                                                     | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
|-------------------------------------------------------------------------------------|------------------------|------------------------|
| <b>Analysis of life insurance and reinsurance contract liability and expenses</b>   |                        |                        |
| <b>Best estimate liability</b>                                                      |                        |                        |
| Value of future life insurance contract benefits                                    | 2,009.7                | 1,554.1                |
| Value of future expenses                                                            | 79.0                   | 67.1                   |
| Value of future premiums                                                            | (203.7)                | (112.2)                |
| <b>Total best estimate liability</b>                                                | <b>1,885.0</b>         | <b>1,509.0</b>         |
| Value of future profit margins                                                      | 181.1                  | 105.2                  |
| <b>Net life insurance and reinsurance contract liability</b>                        | <b>2,066.1</b>         | <b>1,614.2</b>         |
| <b>Life insurance and reinsurance contract operating expenses</b>                   |                        |                        |
| Maintenance expenses                                                                | 7.8                    | 6.3                    |
| <b>Total life insurance and reinsurance contract operating expenses</b>             | <b>7.8</b>             | <b>6.3</b>             |
| <b>Analysis of life contract profit</b>                                             |                        |                        |
| Profit margin release on life insurance contracts                                   | 9.4                    | 6.5                    |
| Loss recognition in respect of life insurance contracts <sup>1</sup>                | (86.0)                 | (72.9)                 |
| Loss recognition in respect of life investment contracts                            | (94.4)                 | (111.6)                |
| Difference in actual and assumed experience in respect of life insurance contracts  | 78.4                   | 77.4                   |
| Difference in actual and assumed experience in respect of life investment contracts | 251.0                  | 297.6                  |
| <b>Profit arising from difference between actual and assumed experience</b>         | <b>158.4</b>           | <b>197.0</b>           |
| Investment earnings on assets in excess of life contract liabilities                | 145.1                  | 154.1                  |
| <b>Life contract profit after tax</b>                                               | <b>303.5</b>           | <b>351.1</b>           |

<sup>1</sup> Under Margin of Service (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.

**Recognition and measurement**

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

**Life investment contract liabilities**

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

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

**Life insurance contract liabilities**

Life insurance contracts are contracts regulated under the Life Act that involve the acceptance of significant insurance

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

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

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

## Note 9 Life contract liabilities (continued)

### Life insurance contract liabilities (continued)

The key areas of judgement in the determination of the actuarial assumptions are the duration of claims/policy payments, acquisition and maintenance expense levels, and economic assumptions for discount and inflation rates.

### Life insurance premium revenue

Life insurance premiums are recognised as revenue when received.

### Life insurance claims expense

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

### Reinsurance

The Group has maintained reinsurance arrangements during the period that meet the definition of a life insurance contract. The MoS methodology requires the present value of future cash flows arising from reinsurance contracts to be included in the calculation of life insurance contract liabilities.

### Valuation

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

### Key assumptions applied in the valuation of life contract liabilities

#### Discount rates

Under APRA Prudential Standards and AASB 1038 *Life Insurance Contracts*, life insurance contract liabilities are calculated by discounting expected future cash flows at a risk-free rate, set at the Commonwealth Government Bond curve plus an illiquidity premium where applicable or for foreign-denominated liabilities, a curve derived from the yields of highly liquid AAA-rated sovereign risk securities in the currency of the policy liabilities plus an illiquidity premium where applicable. The illiquidity premium is determined by reference to observable market rates including Australian sovereign debt, corporate, securitised and collateralised debt publicly placed in the domestic market, and market swap rates.

Life investment contract liabilities are calculated under the fair value through profit and loss provisions of AASB 139 *Financial Instruments: Recognition and Measurement*. The discount rates are determined based on the current

observable, objective rates that relate to the nature, structure and term of the future liability cash flows.

For both insurance and investment contracts the approach is the same as adopted at 2014. Discount rates applied for Australian liabilities were between 2.5-4.0% (30 June 2014: 3.0-4.7%) per annum.

#### Expenses

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

#### Inflation

Inflation estimates are based on long-term expectations and reviewed annually for changes in the market environment based on a comparison of real and nominal yields of instruments of equivalent term and credit risk. The current assumption for Australia is 1.4% for short-term inflation and 2.6% for long-term (30 June 2014: 1.7% short-term, 2.7% long-term) per annum.

#### Surrenders

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

#### Mortality

Base mortality rates for individual lifetime annuities are determined as a multiple of annuitant experience based on IML00 and IFL00 tables, adjusted for Challenger's own recent experience. IML00 and IFL00 are mortality tables developed by the Institute and Faculty of Actuaries (UK) based on United Kingdom annuitant lives experience from 1999–2002. The tables refer to male and female lives respectively. Rates are adjusted for expected future mortality improvements based on observed and expected improvements. Rates of future mortality improvement for individual lifetime annuities applied are between 1.0-4.0% (30 June 2014: 1.0-4.0%) per annum.

Base mortality rates for wholesale mortality and longevity reinsurance are determined as a multiple of pensioner mortality rates (based on the self-administered pension schemes or SAPS2 tables mortality investigation developed by the Institute and Faculty of Actuaries (UK) using United Kingdom data collected between 2004–2012) or population rates as appropriate. Rates are adjusted for expected future mortality improvements based on observed and expected improvements. Rates of future mortality improvement applied are between 0.0-4.0% (30 June 2014: 1.0-4.0%) per annum.

## Note 9 Life contract liabilities (continued)

### Valuation (continued)

#### Impact of changes in assumptions on life insurance contracts

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

#### Restrictions on assets

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

#### Statutory fund information

The life contract operations of CLC are conducted within three separate statutory funds as required by the Life Act. Both the shareholders' and policyholders' interests in these statutory funds are reported in aggregate in the financial report of the Group. Fund 1 is a non-investment-linked fund and Fund 3 is investment-linked. Both of these are closed to new business. Fund 2 is the principal operating fund of the Group and contains non-investment-linked contracts, including the Group's term annuity business, lifetime annuity policies and the related reinsurance, plus the wholesale mortality, wholesale morbidity and longevity reinsurance. Life contract liabilities for Funds 1, 2 and 3 are \$3.9 million, \$8,685.6 million and \$3.5 million respectively (2014: \$4.8 million, \$7,815.6 million, \$3.9 million).

### Current / non-current split for total life contracts

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

### Life insurance risk

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

### Insurance risk sensitivity analysis

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

|                                                   | Increase in life insurance contract liabilities |              |              |              | Profit/(loss) after tax and equity impact |              |              |              |
|---------------------------------------------------|-------------------------------------------------|--------------|--------------|--------------|-------------------------------------------|--------------|--------------|--------------|
|                                                   | Gross                                           |              | Net          |              | Gross                                     |              | Net          |              |
|                                                   | 30 June 2015                                    | 30 June 2014 | 30 June 2015 | 30 June 2014 | 30 June 2015                              | 30 June 2014 | 30 June 2015 | 30 June 2014 |
| <b>Insurance risk sensitivity analysis</b>        | \$M                                             | \$M          | \$M          | \$M          | \$M                                       | \$M          | \$M          | \$M          |
| 50% increase in the rate of mortality improvement | 104.7                                           | 71.3         | 53.9         | 36.6         | (73.3)                                    | (49.9)       | (37.7)       | (25.6)       |
| 10% increase in maintenance expenses              | 6.6                                             | 4.2          | 6.6          | 4.2          | (4.6)                                     | (2.9)        | (4.6)        | (2.9)        |

**Note 9 Life contract liabilities (continued)****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 20 Financial risk management:

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

**Actuarial information**

Mr A Bofinger FIAA, as the Appointed Actuary of CLC, is satisfied as to the accuracy of the data used in the valuations of life contract liabilities in the financial report

and the tables in this note. The life contract liabilities have been determined at the reporting date in accordance with the Life Act.

**Note 10 External unit holders' liabilities****Consolidated**

|                                                   | <b>30 June<br/>2015<br/>\$M</b> | <b>30 June<br/>2014<br/>\$M</b> |
|---------------------------------------------------|---------------------------------|---------------------------------|
| Current                                           | 590.0                           | 1,072.4                         |
| Non-current                                       | 354.7                           | -                               |
| <b>Total liabilities to external unit holders</b> | <b>944.7</b>                    | <b>1,072.4</b>                  |

**Recognition and measurement**

The Group controls a number of guaranteed index return trusts that contain contributed funds in respect of fixed term wholesale mandates. The fixed term and guaranteed nature of the mandates effectively places the balance of the risks related to the performance of the trusts with the Group. As a result, the Group is deemed to control these trusts.

The contributed funds for these trusts are classed as a liability and external unit holders' liabilities on the statement of financial position represents the funds owing to third parties on these mandates. The liability is recognised at fair value.

**Note 11 Payables**

|                                     | Consolidated           |                        | Parent                 |                        |
|-------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                     | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
| Trade creditors and accruals        | 63.2                   | 80.2                   | 4.6                    | 11.6                   |
| Security deposits                   | 18.5                   | 18.3                   | -                      | -                      |
| Amounts payable to related entities | 95.1                   | -                      | 76.0                   | -                      |
| Unsettled trades payable            | 72.8                   | 230.8                  | 12.8                   | 259.5                  |
| Other creditors                     | 4.5                    | 5.5                    | 3.8                    | 3.5                    |
| Payables - SPV                      | 69.6                   | 76.7                   | -                      | -                      |
| Derivative credit support           | -                      | 24.5                   | -                      | 24.5                   |
| <b>Total payables</b>               | <b>323.7</b>           | <b>436.0</b>           | <b>97.2</b>            | <b>299.1</b>           |
| Current                             | 261.7                  | 368.8                  | 97.2                   | 299.1                  |
| Non-current                         | 62.0                   | 67.2                   | -                      | -                      |
|                                     | 323.7                  | 436.0                  | 97.2                   | 299.1                  |

**Recognition and measurement**

Payables represent unsecured, non-interest bearing financial liabilities in respect of goods and services provided to the Group prior to the end of the financial

year. They include accruals, trade and other creditors and are recognised at amortised cost.

## Note 12 Derivative financial instruments

| Consolidated<br>Analysis of derivative financial<br>instruments | 30 June 2015             |                                    |                                         | 30 June 2014             |                                    |                                         |
|-----------------------------------------------------------------|--------------------------|------------------------------------|-----------------------------------------|--------------------------|------------------------------------|-----------------------------------------|
|                                                                 | Notional<br>value<br>\$M | Net fair<br>value<br>assets<br>\$M | Net fair<br>value<br>liabilities<br>\$M | Notional<br>value<br>\$M | Net fair<br>value<br>assets<br>\$M | Net fair<br>value<br>liabilities<br>\$M |
| <b>Non-SPV</b>                                                  |                          |                                    |                                         |                          |                                    |                                         |
| Interest rate swaps                                             |                          |                                    |                                         |                          |                                    |                                         |
| Less than one year                                              | 6,958.7                  | 16.0                               | (3.5)                                   | 2,194.7                  | 9.7                                | (0.5)                                   |
| One to three years                                              | 6,736.0                  | 88.3                               | (31.1)                                  | 2,930.7                  | 61.2                               | (8.7)                                   |
| Three to five years                                             | 2,713.7                  | 65.4                               | (31.3)                                  | 1,610.9                  | 51.6                               | (9.0)                                   |
| Greater than five years                                         | 11,661.1                 | 365.9                              | (252.2)                                 | 4,724.4                  | 152.5                              | (86.3)                                  |
| <b>Total interest rate swaps</b>                                | <b>28,069.5</b>          | <b>535.6</b>                       | <b>(318.1)</b>                          | <b>11,460.7</b>          | <b>275.0</b>                       | <b>(104.5)</b>                          |
| Inflation-linked swaps                                          |                          |                                    |                                         |                          |                                    |                                         |
| Less than one year                                              | 315.0                    | -                                  | (6.8)                                   | 253.0                    | -                                  | -                                       |
| Greater than five years                                         | 9.7                      | 0.3                                | (7.4)                                   | 7.7                      | -                                  | (4.6)                                   |
| <b>Total inflation-linked swaps</b>                             | <b>324.7</b>             | <b>0.3</b>                         | <b>(14.2)</b>                           | <b>260.7</b>             | <b>-</b>                           | <b>(4.6)</b>                            |
| Futures contracts                                               |                          |                                    |                                         |                          |                                    |                                         |
| Less than one year                                              | 3,345.3                  | -                                  | (0.1)                                   | 4,757.2                  | -                                  | (0.2)                                   |
| One to three years                                              | -                        | -                                  | -                                       | 150.0                    | -                                  | -                                       |
| <b>Total futures contracts</b>                                  | <b>3,345.3</b>           | <b>-</b>                           | <b>(0.1)</b>                            | <b>4,907.2</b>           | <b>-</b>                           | <b>(0.2)</b>                            |
| Forward currency contracts                                      |                          |                                    |                                         |                          |                                    |                                         |
| Less than one year                                              | 2,115.4                  | 20.8                               | (25.2)                                  | 2,168.7                  | 15.9                               | (3.3)                                   |
| One to three years                                              | 12.5                     | 0.1                                | -                                       | -                        | -                                  | -                                       |
| <b>Total forward currency contracts</b>                         | <b>2,127.9</b>           | <b>20.9</b>                        | <b>(25.2)</b>                           | <b>2,168.7</b>           | <b>15.9</b>                        | <b>(3.3)</b>                            |
| Cross-currency swaps                                            |                          |                                    |                                         |                          |                                    |                                         |
| Less than one year                                              | 669.7                    | 2.7                                | (81.4)                                  | 368.1                    | 17.2                               | (22.3)                                  |
| One to three years                                              | 693.0                    | 15.5                               | (105.1)                                 | 245.6                    | 1.7                                | (25.6)                                  |
| Three to five years                                             | 649.0                    | 23.8                               | (86.5)                                  | 96.4                     | -                                  | (16.2)                                  |
| Greater than five years                                         | 193.4                    | -                                  | (55.2)                                  | 211.1                    | 0.1                                | (22.1)                                  |
| <b>Total cross-currency swaps</b>                               | <b>2,205.1</b>           | <b>42.0</b>                        | <b>(328.2)</b>                          | <b>921.2</b>             | <b>19.0</b>                        | <b>(86.2)</b>                           |
| Equity swaps                                                    |                          |                                    |                                         |                          |                                    |                                         |
| Less than one year                                              | 771.5                    | 5.3                                | (18.7)                                  | -                        | -                                  | -                                       |
| Three to five years                                             | 415.7                    | 4.0                                | (4.9)                                   | -                        | -                                  | -                                       |
| <b>Total equity swaps</b>                                       | <b>1,187.2</b>           | <b>9.3</b>                         | <b>(23.6)</b>                           | <b>-</b>                 | <b>-</b>                           | <b>-</b>                                |
| Credit default swaps                                            |                          |                                    |                                         |                          |                                    |                                         |
| Less than one year                                              | 32.5                     | -                                  | (0.1)                                   | 37.1                     | 0.1                                | -                                       |
| One to three years                                              | 222.5                    | 1.9                                | (1.8)                                   | 116.5                    | 1.9                                | (0.1)                                   |
| Three to five years                                             | 49.0                     | -                                  | (0.8)                                   | 107.0                    | 0.1                                | (0.9)                                   |
| Greater than five years                                         | 9.1                      | -                                  | (0.3)                                   | -                        | -                                  | -                                       |
| <b>Total credit default swaps</b>                               | <b>313.1</b>             | <b>1.9</b>                         | <b>(3.0)</b>                            | <b>260.6</b>             | <b>2.1</b>                         | <b>(1.0)</b>                            |

**Note 12 Derivative financial instruments (continued)**

| Consolidated<br>Analysis of derivative financial<br>instruments | 30 June 2015             |                                    |                                         | 30 June 2014             |                                    |                                         |
|-----------------------------------------------------------------|--------------------------|------------------------------------|-----------------------------------------|--------------------------|------------------------------------|-----------------------------------------|
|                                                                 | Notional<br>value<br>\$M | Net fair<br>value<br>assets<br>\$M | Net fair<br>value<br>liabilities<br>\$M | Notional<br>value<br>\$M | Net fair<br>value<br>assets<br>\$M | Net fair<br>value<br>liabilities<br>\$M |
| Options                                                         |                          |                                    |                                         |                          |                                    |                                         |
| Less than one year                                              | 0.4                      | -                                  | -                                       | -                        | -                                  | -                                       |
| One to three years                                              | 0.5                      | -                                  | -                                       | 0.4                      | -                                  | -                                       |
| Three to five years                                             | -                        | -                                  | -                                       | 0.5                      | -                                  | -                                       |
| <b>Total options</b>                                            | <b>0.9</b>               | <b>-</b>                           | <b>-</b>                                | <b>0.9</b>               | <b>-</b>                           | <b>-</b>                                |
| <b>Total non-SPV</b>                                            | <b>37,573.7</b>          | <b>610.0</b>                       | <b>(712.4)</b>                          | <b>19,980.0</b>          | <b>312.0</b>                       | <b>(199.8)</b>                          |
| <b>SPV</b>                                                      |                          |                                    |                                         |                          |                                    |                                         |
| Interest rate swaps – SPV                                       |                          |                                    |                                         |                          |                                    |                                         |
| Less than one year                                              | 17.8                     | -                                  | (0.1)                                   | 17.6                     | -                                  | (0.1)                                   |
| One to three years                                              | 17.0                     | -                                  | (0.3)                                   | 24.6                     | -                                  | (0.2)                                   |
| Three to five years                                             | 2.9                      | -                                  | (0.1)                                   | 1.7                      | -                                  | (0.1)                                   |
| <b>Total interest rate swaps – SPV</b>                          | <b>37.7</b>              | <b>-</b>                           | <b>(0.5)</b>                            | <b>43.9</b>              | <b>-</b>                           | <b>(0.4)</b>                            |
| Cross-currency swaps – SPV                                      |                          |                                    |                                         |                          |                                    |                                         |
| Greater than five years                                         | 999.8                    | 2.2                                | (0.3)                                   | 1,350.6                  | 1.3                                | (1.3)                                   |
| <b>Total cross-currency swaps – SPV</b>                         | <b>999.8</b>             | <b>2.2</b>                         | <b>(0.3)</b>                            | <b>1,350.6</b>           | <b>1.3</b>                         | <b>(1.3)</b>                            |
| <b>Total – SPV</b>                                              | <b>1,037.5</b>           | <b>2.2</b>                         | <b>(0.8)</b>                            | <b>1,394.5</b>           | <b>1.3</b>                         | <b>(1.7)</b>                            |
| <b>Total derivative financial instruments<sup>1</sup></b>       |                          | <b>612.2</b>                       | <b>(713.2)</b>                          |                          | <b>313.3</b>                       | <b>(201.5)</b>                          |

<sup>1</sup> The Group's derivative financial instruments are subject to enforceable netting arrangements under International Swaps and Derivatives Association (ISDA) Master Agreements with derivative counterparties, allowing for net settlement as a single arrangement of multiple instruments with a counterparty in the event of default or other specified circumstances. If applied to the derivative portfolio, the derivative assets would reduce by \$341.8 million (30 June 2014: \$81.0 million) and the derivative liabilities would reduce by \$341.8 million (30 June 2014: \$81.0 million).

**Recognition and measurement**

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

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

- fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability;
- cash flow hedges when they hedge the exposure to variability in cash flows that is attributable either to a particular risk associated with a recognised asset or liability or to a forecast transaction; or
- hedges of net investments in foreign operations when they hedge the exposure to changes in the value of the assets and liabilities of foreign controlled 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.

## Note 12 Derivative financial instruments (continued)

### 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 both the carrying amount of the hedged item and the derivative are remeasured to fair value through the statement of comprehensive income. The same applies where the hedged item is an unrecognised firm commitment. Any subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognised as an asset or liability with a corresponding gain or loss recognised in the statement of comprehensive income.

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

### Cash flow hedges

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

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

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

equity remain in equity until the forecast transaction occurs.

### Hedges of net investments in foreign operations

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

### Derivatives designated as hedges of net investment in foreign currency operations

The Group hedges its exposure to accounting gains and losses arising from translation of foreign controlled entities from their functional currency into the Group's presentation currency on consolidation. At 30 June 2015, a post-tax loss of \$23.5 million (30 June 2014: post-tax gain \$15.2 million) was recognised in equity for the hedging of exposure to the net investment in foreign currency operations.

### Derivatives designated as cash flow hedges

The Group applies hedge accounting when it can demonstrate that all, or a portion of, the value movements of a derivative financial instrument effectively hedges the variability in cash flows attributable to a specific risk associated with a recognised asset or liability or probable future transaction. As described in Note 20 Financial risk management, SPVs enter into interest rate swap agreements to hedge the interest rate risk between variable rate loans, which generally reprice with changes in official interest rates, and issued RMBS that reprice with changes in the 30-day and 90-day bank bill swap rate. Cross-currency swaps are also entered into to hedge currency movements on foreign denominated RMBS. The SPVs apply hedge accounting to both types of transaction, with the fair value change on the effective portion of the derivative being recognised in equity.

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

**Note 13 Cash and cash equivalents**

|                                                    | Consolidated           |                        | Parent                 |                        |
|----------------------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                                    | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
| Cash at bank                                       | 279.7                  | 274.9                  | (12.8)                 | -                      |
| Deposits at call                                   | 8.5                    | 8.4                    | -                      | -                      |
| Other cash equivalents                             | 29.7                   | 16.9                   | -                      | 8.3                    |
| <b>Total cash and cash equivalents<sup>1</sup></b> | <b>317.9</b>           | <b>300.2</b>           | <b>(12.8)</b>          | <b>8.3</b>             |

<sup>1</sup> All cash and cash equivalents are considered current.

**Recognition and measurement**

Cash and cash equivalents are financial assets and comprise cash at bank 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. For the purposes of the statement of cash flows, cash and cash equivalents are stated net of bank overdrafts

**Note 14 Reconciliation of profit to operating cash flow**

|                                                                                                       | Consolidated           |                        | Parent                 |                        |
|-------------------------------------------------------------------------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                                                                                       | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
| <b>Profit for the year</b>                                                                            | <b>327.3</b>           | <b>373.5</b>           | <b>264.4</b>           | <b>380.4</b>           |
| <b>Adjusted for</b>                                                                                   |                        |                        |                        |                        |
| Net realised (gain)/loss on disposal of investment assets                                             | (606.4)                | (141.5)                | 122.0                  | (69.4)                 |
| Net unrealised loss/(gain) on revaluation of investment assets                                        | 319.6                  | (219.3)                | 132.0                  | (186.1)                |
| Change in life contract liabilities                                                                   | 470.1                  | 424.8                  | 470.1                  | 424.8                  |
| Depreciation and amortisation expense                                                                 | 11.0                   | 12.3                   | -                      | -                      |
| <b>Change in operating assets and liabilities, net of acquisition/disposal of controlled entities</b> |                        |                        |                        |                        |
| Decrease/(increase) in receivables                                                                    | 58.6                   | (11.1)                 | 7.9                    | (120.6)                |
| (Increase)/decrease in other assets                                                                   | (0.8)                  | 7.9                    | -                      | -                      |
| Increase in payables                                                                                  | 12.0                   | 125.1                  | 29.6                   | 106.6                  |
| Increase in life contract liabilities                                                                 | 398.3                  | 276.2                  | 398.3                  | 276.2                  |
| Decrease in external unit holders' liabilities                                                        | (127.6)                | (679.0)                | -                      | -                      |
| (Decrease)/increase in net tax liabilities                                                            | (13.6)                 | (30.9)                 | (1.8)                  | 2.3                    |
| <b>Net cash flows from operating activities</b>                                                       | <b>848.5</b>           | <b>138.0</b>           | <b>1,422.5</b>         | <b>814.2</b>           |

## Section 4: Capital structure and financing costs

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

### Note 15 Contributed equity

|                                  | 30 June 2015       |                | 30 June 2014       |                |
|----------------------------------|--------------------|----------------|--------------------|----------------|
|                                  | No. of shares<br>M | \$M            | No. of shares<br>M | \$M            |
| <b>Ordinary shares</b>           |                    |                |                    |                |
| Opening ordinary shares issued   | 1,046.5            | 1,046.5        | 1,046.5            | 1,046.5        |
| New ordinary shares issued       | 150.0              | 150.0          | -                  | -              |
| <b>Total ordinary shares</b>     | <b>1,196.5</b>     | <b>1,196.5</b> | <b>1,046.5</b>     | <b>1,046.5</b> |
| <b>Equity hybrid notes</b>       |                    |                |                    |                |
| Opening equity hybrid notes      | -                  | -              | -                  | -              |
| New equity hybrid notes          | 345.0              | 345.0          | -                  | -              |
| <b>Total equity hybrid notes</b> | <b>345.0</b>       | <b>345.0</b>   | <b>-</b>           | <b>-</b>       |
| <b>Total contributed equity</b>  | <b>1,541.5</b>     | <b>1,541.5</b> | <b>1,046.5</b>     | <b>1,046.5</b> |

#### Recognition and measurement

Ordinary shares are classified as equity. Issued capital in respect of ordinary shares is recognised as the fair value of the consideration received by the parent entity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

CLC issued notes of \$345.0 million in October 2014. These notes were approved by APRA as qualifying as Additional Tier 1 capital of CLC. The notes are classified as equity.

#### 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.

##### Equity hybrid notes

The holder of a note is entitled to receive distributions on the notes at the discretion of the Board of CLC and to the extent that the Board has determined that a distribution can be paid. Distributions are non-cumulative. Holders are not permitted to vote at any meeting of shareholders of CLC or to otherwise participate in the profits of CLC. Holders of notes rank ahead of ordinary shares, equally among other instruments approved as Additional Tier 1 capital of CLC and behind any claims of creditors of CLC.

On the occurrence of a non-viability trigger event as determined by APRA, the notes can be written-off or converted to shares in CLC in part or in whole in an amount that is sufficient to ensure that CLC does not become non-viable. CLC is also entitled to optionally redeem the notes (subject to APRA approval) on a specified date or as a result of certain tax or regulatory

events occurring (as defined in the note terms and conditions).

#### 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.

#### Credit ratings

Standard & Poor's long-term credit ratings for Challenger Life Company Limited (CLC) at the date of the statement of financial position is 'A' (stable). The rating remained unchanged during the year.

#### Equity issue and additional tier 1 instrument

The Company is growing strongly and expects to materially increase the size of its retail annuity business. In order to support this growth the following capital management initiatives were completed during the year:

- \$150.0 million equity issuance; and
- \$345.0 million equity hybrid note issuance (regarded as Additional Tier 1 capital under APRA prudential standards).

#### Internal Capital Adequacy Assessment Process (ICAAP) Summary Statement – CLC

CLC is a life insurance company regulated under the Life Act. The Life Act, via Prudential Standards issued by APRA, imposes minimum statutory capital requirements on all life insurance companies. Under these new standards a life company must have in place an ICAAP, documented in an ICAAP Summary Statement. CLC complied with these requirements at all times during the period.

## Note 15 Contributed equity (continued)

### Capital management (continued)

#### Prescribed capital amount (PCA)

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

CLC's regulatory capital base and PCA have been calculated based on the Life and General Insurance Capital (LAGIC) regulatory standards issued by APRA.

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

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

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

#### Subordinated debt

CLC's total regulatory capital base includes \$474.0 million (30 June 2014: \$476.8 million) of admissible subordinated debt. Subordinated debt tranches issued prior to 1 January 2013 will continue to be fully eligible as

Tier 2 regulatory capital under LAGIC until each tranche's first call date after 1 January 2013, and will then amortise over the ensuing four years. For tranches already past their call date, under LAGIC the first coupon date following the call date is considered the first call date.

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

#### Tier 1 and Tier 2 regulatory capital

Under APRA's transition arrangements, CLC's statutory funds have three years to transition to the minimum requirement of Tier 1 capital representing 80% of the PCA. At a CLC consolidated level, APRA provided a two year transition period from 1 January 2013 to meet the 80% Tier 1 requirement. CLC is currently meeting these requirements at both the statutory and consolidated level. The Tier 1 ratio was 1.31 times for the PCA at 30 June 2015 (30 June 2014: 1.31 times).

#### CLC's target surplus – 1 January 2016

CLC maintains a target level of capital representing APRA's PCA plus a target surplus. The target surplus is a management guide to the level of excess capital that CLC seeks to hold over and above APRA's minimum requirements. CLC's target surplus is set to ensure that it provides a buffer against adverse market conditions and having regard to CLC's credit rating. CLC uses internal capital models to determine its target surplus, which are risk-based and are responsive to changes in CLC's asset allocation and market conditions.

Details of the CLC capital adequacy multiple are provided on the following page.

**Note 15 Contributed equity (continued)****Capital management (continued)****CLC's target surplus (continued)**

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

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

<sup>2</sup> Asset risk charge includes the Combined stress scenario adjustment and default stress.

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

**Note 16 Interest bearing financial liabilities**

|                                           | 30 June 2015    |                    | 30 June 2014    |                    |
|-------------------------------------------|-----------------|--------------------|-----------------|--------------------|
| <b>Consolidated<sup>1</sup></b>           | Facility<br>\$M | Outstanding<br>\$M | Facility<br>\$M | Outstanding<br>\$M |
| <b>Bank loans</b>                         |                 |                    |                 |                    |
| Controlled property trusts <sup>2</sup>   | 769.8           | 535.8              | 809.0           | 646.0              |
| Controlled infrastructure trusts          | 206.0           | 206.0              | 206.1           | 206.1              |
| Repurchase agreements                     | 1,267.3         | 1,267.3            | 978.3           | 978.3              |
| <b>Total bank loans</b>                   | <b>2,243.1</b>  | <b>2,009.1</b>     | <b>1,993.4</b>  | <b>1,830.4</b>     |
| <b>Non-bank loans</b>                     |                 |                    |                 |                    |
| Subordinated debt issuance                | 567.0           | 567.0              | 525.9           | 525.9              |
| Controlled property trusts                | 11.3            | 11.3               | 10.5            | 10.5               |
| Other finance                             | 2.1             | 2.1                | 3.9             | 3.9                |
| <b>Total non-bank loans</b>               | <b>580.4</b>    | <b>580.4</b>       | <b>540.3</b>    | <b>540.3</b>       |
| <b>Total interest bearing liabilities</b> | <b>2,823.5</b>  | <b>2,589.5</b>     | <b>2,533.7</b>  | <b>2,370.7</b>     |
| Current                                   |                 | 1,379.1            |                 | 1,043.1            |
| Non-current                               |                 | 1,210.4            |                 | 1,327.6            |
|                                           |                 | <b>2,589.5</b>     |                 | <b>2,370.7</b>     |

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

<sup>2</sup> Total facility limit consists of redraw loan facilities limits totalling \$300.0 million and non-redraw loan facilities limits totalling \$469.8 million.

## Note 16 Interest bearing financial liabilities (continued)

### Recognition and measurement

All borrowings and subordinated debt are financial liabilities and are initially recognised at fair value. In the case of borrowings which are subsequently measured at amortised cost, the initial measurement 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 of certain controlled investment trusts of CLC's statutory funds are subsequently measured at amortised cost for the purpose of determining the unit price of those trusts. These borrowings are measured at amortised cost in this financial report with a difference between the proceeds (net of transaction costs) and the redemption amount recognised in the statement of comprehensive income over the period of the contract using the effective interest rate method.

All other borrowings of the controlled entities of the statutory funds, or their controlled entities, are subsequently measured at fair value with movements recognised in the statement of comprehensive income. 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.

### Details of liabilities

#### Controlled property trusts

The loans have variable terms and are generally secured by way of first-ranking mortgages over the investment properties. The 30 June 2015 balance includes \$236.3 million (30 June 2014: \$246.0 million) of Yen denominated loans in the Japanese property trusts. Other controlled property trusts loans total \$299.5 million (30 June 2014: \$400.0 million). None (30 June 2014: \$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 2022 and is secured by way of first-ranking mortgages over the corresponding infrastructure assets.

#### Repurchase agreements

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

### Non-bank loans

#### Subordinated debt issuance

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

The December 2006 notes are unsecured and were issued in two maturities (\$US125.0 million at 10 years with a non-call period of 5 years and \$US25.0 million at 20 years with a non-call period of 10 years). A portion of this subordinated debt has a fixed interest rate with the remaining portion being at a floating rate of interest. The November 2007 issuance was unsecured and matures at 30 years with a non-call period of 10 years and carries a floating rate of interest. The proceeds of both issuances were made available to Statutory Fund No.2 of CLC (SF2) and rank in right of payment either *pari passu* with, or senior to, all other unsecured and subordinated indebtedness of SF2, except for such indebtedness preferred by operation of bankruptcy laws or similar laws of general application. Subordinated debt is measured at fair value through the profit and loss and adjusted for movements in interest rates, credit spreads and foreign exchange rates.

The notes were issued under 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 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 2015, there was \$474.0 million (30 June 2014: \$476.8 million) of subordinated debt admissible as Tier 2 regulatory capital.

#### Controlled property trusts

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

## Note 17 Reserves and retained earnings

| Consolidated                                                            | Consolidated           |                        | Parent                 |                        |
|-------------------------------------------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                                                         | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
| <b>Foreign currency translation reserve<sup>1</sup></b>                 |                        |                        |                        |                        |
| Balance at the beginning of the year                                    | (3.3)                  | (1.3)                  | -                      | -                      |
| Gain/(loss) on translation of foreign entities <sup>2</sup>             | 20.5                   | (11.8)                 | -                      | -                      |
| (Loss)/gain on hedge of net investment in foreign entities <sup>2</sup> | (23.5)                 | 15.2                   | -                      | -                      |
| Recycled to the profit and loss                                         | 0.2                    | (5.4)                  | -                      | -                      |
| <b>Balance at the end of the year</b>                                   | <b>(6.1)</b>           | <b>(3.3)</b>           | <b>-</b>               | <b>-</b>               |
| <b>Adjusted controlling interests reserve<sup>1</sup></b>               |                        |                        |                        |                        |
| Balance at the beginning of the year                                    | 19.3                   | 18.2                   | -                      | -                      |
| Change in holdings in controlled entities                               | (0.4)                  | 1.1                    | -                      | -                      |
| <b>Balance at the end of the year</b>                                   | <b>18.9</b>            | <b>19.3</b>            | <b>-</b>               | <b>-</b>               |
| <b>Cash flow hedge reserve – SPV<sup>1</sup></b>                        |                        |                        |                        |                        |
| Balance at the beginning of the year                                    | (0.4)                  | 3.6                    | -                      | -                      |
| Net gain/(loss) on cash flow hedges                                     | 1.8                    | (4.0)                  | -                      | -                      |
| <b>Balance at the end of the year</b>                                   | <b>1.4</b>             | <b>(0.4)</b>           | <b>-</b>               | <b>-</b>               |
| <b>Other reserve</b>                                                    |                        |                        |                        |                        |
| Balance at the beginning of the year                                    | 92.3                   | -                      | 105.7                  | -                      |
| Movement in distributable reserves                                      | 32.5                   | 92.3                   | 32.1                   | 105.7                  |
| <b>Balance at the end of the year</b>                                   | <b>124.8</b>           | <b>92.3</b>            | <b>137.8</b>           | <b>105.7</b>           |
| <b>Total reserves</b>                                                   | <b>139.0</b>           | <b>107.9</b>           | <b>137.8</b>           | <b>105.7</b>           |
| <b>Retained earnings</b>                                                |                        |                        |                        |                        |
| Balance at the beginning of the year                                    | 738.0                  | 581.9                  | 787.9                  | 602.5                  |
| Profit attributable to equity holders                                   | 303.5                  | 351.1                  | 264.4                  | 380.4                  |
| Dividends paid                                                          | (142.9)                | (195.0)                | (142.9)                | (195.0)                |
| <b>Total retained earnings</b>                                          | <b>898.6</b>           | <b>738.0</b>           | <b>909.4</b>           | <b>787.9</b>           |

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

<sup>2</sup> Net of tax.

### Recognition and measurement

#### Foreign currency translation reserve

This reserve is used to record foreign exchange differences arising from the translation of the foreign subsidiaries. It also includes the effective portion of fair value changes on foreign exchange derivative contracts designated as hedges of a net investment in a foreign entity.

#### Adjusted controlling interests reserve

This reserve relates to changes arising from movements in the ownership interests in entities already controlled by the Group. The difference between the fair value of the

consideration paid/received for the change in holding and the change in the Group's share of the net assets of the entity is recorded in this reserve.

#### Cash flow hedge reserve – SPV

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

#### Other reserve

This distributable reserve relates to amounts indemnified to CLC by its parent.

**Note 18 Finance costs**

|                                    | Consolidated           |                        | Parent                 |                        |
|------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                    | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
| Interest expense                   | 125.1                  | 117.8                  | 50.4                   | 40.6                   |
| Interest expense – SPV             | 81.7                   | 112.8                  | -                      | -                      |
| Interest expense – property trusts | 23.1                   | 27.2                   | -                      | -                      |
| <b>Total finance costs</b>         | <b>229.9</b>           | <b>257.8</b>           | <b>50.4</b>            | <b>40.6</b>            |

**Recognition and measurement**

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

Finance costs that are directly attributable to the acquisition, construction or production of qualifying property assets (being assets that take a substantial period of time to develop for their intended use or sale) are capitalised as part of the cost of that asset. Revenue

earned on the investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

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

**Note 19 Dividends paid and proposed**

|                                                                                     | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
|-------------------------------------------------------------------------------------|------------------------|------------------------|
| <b>Parent</b>                                                                       |                        |                        |
| <b>Unfranked dividends declared and paid during the year</b>                        |                        |                        |
| Ordinary shares                                                                     | 130.0                  | 195.0                  |
| Equity hybrid notes                                                                 | 12.9                   | -                      |
| <b>Total unfranked dividends declared and paid during the year</b>                  | <b>142.9</b>           | <b>195.0</b>           |
| <b>Unfranked dividends proposed (not recognised as a liability as 30 June)</b>      |                        |                        |
| Ordinary shares                                                                     | 130.0                  | -                      |
| <b>Total unfranked dividend proposed (not recognised as a liability at 30 June)</b> | <b>130.0</b>           | <b>-</b>               |

## Section 5: Risk management

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

### Note 20 Financial risk management

#### Governance and risk management framework

The Group's activities expose it to a variety of financial risks, such as market risk (including currency risk, interest rate risk, equity price risk and credit spread risk), credit default risk and liquidity risk. The management of these risks is fundamental to the Group's business and to building shareholder value. The Board is responsible, in conjunction with senior management, for understanding the risks associated with the activities of the Group and implementing structures and policies to adequately monitor and manage those risks.

The Board has established the Life Risk Committee (LRC) and Life Audit Committee (LAC) to assist in the discharge of certain responsibilities. In particular, the committees assist the Board in setting the risk appetite and ensuring the Group has an effective risk management framework incorporating management, operational and financial controls.

The Board has 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.

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

The Challenger Limited 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 LRC and the Board.

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 Section 1: Basis of preparation and overarching significant accounting policies or the relevant note.

#### Market risk

Market risk is the risk that the fair value and/or future cash flows from a financial instrument will fluctuate as a result of changes in market factors. Market risk comprises (amongst others) interest rate risk (due to fluctuations in market interest rates), price risk (due to fluctuations in the fair value of equities or credit spreads) and currency risk (due to fluctuations in foreign currency exchange rates).

#### Interest rate risk

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

The Company's market risk policy is approved by the Board and sets out the relevant risk limits for interest rate exposure. 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 SPV, the impact of a rising/falling bank bill swap rate (BBSW) benchmark over the Reserve Bank of Australia's target cash rate results in an

## Note 20 Financial risk management (continued)

### Interest rate risk (continued)

increase/decrease in the cost of funding and therefore on the profit of the trusts. This interest rate risk is mitigated by actively adjusting the interest rates charged to borrowers if a sustained adverse differential to the benchmark is evidenced. SPV are also exposed to the risks arising from borrowers fixing the rates on their mortgage. This interest rate risk is managed by using cash flow hedges to swap the fixed rate to a floating rate exposure at an amount equal to the notional value of the mortgages being fixed.

### Interest rate sensitivity

The Group's sensitivity to movements in interest rates in relation to the value of financial assets and liabilities is shown in the table below. It is assumed that the change

happens at the statement of financial position date and that there are concurrent movements in interest rates and parallel moves in the yield curve. All material underlying exposures and related hedges are included in the analysis which includes investment properties with leases, where the future income stream is duration-hedged for interest rate movements. The impact on profit and equity is post-tax at a rate of 30%. The risks faced and methods used in the sensitivity analysis are the same as those applied in the comparative period.

As shown below, 100 basis points (1%) movements in interest rates would have only a small net impact on the Group's financial position as upside risks in the Company and the property trusts largely offset downside risk in the SPV, and vice versa:

|              | Change in variable | 30 June 2015<br>Profit/(loss)<br>\$M | 30 June 2015<br>Change in equity<br>\$M | 30 June 2014<br>Profit/(loss)<br>\$M | 30 June 2014<br>Change in equity<br>\$M |
|--------------|--------------------|--------------------------------------|-----------------------------------------|--------------------------------------|-----------------------------------------|
| Non-SPV      | +100bps            | 7.0                                  | 7.0                                     | 4.7                                  | 4.7                                     |
|              | -100bps            | (7.0)                                | (7.0)                                   | (4.7)                                | (4.7)                                   |
| SPV          | +100bps            | (2.0)                                | (2.0)                                   | (2.6)                                | (2.6)                                   |
|              | -100bps            | 2.0                                  | 2.0                                     | 2.6                                  | 2.6                                     |
| <b>Total</b> | <b>+100bps</b>     | <b>5.0</b>                           | <b>5.0</b>                              | <b>2.1</b>                           | <b>2.1</b>                              |
|              | <b>-100bps</b>     | <b>(5.0)</b>                         | <b>(5.0)</b>                            | <b>(2.1)</b>                         | <b>(2.1)</b>                            |

### Price risk

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

Equity risks will arise as a natural result of the Company's Asset Allocation Plan. The Group'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 statement of comprehensive income and statement of financial position is shown in the below sensitivity analysis.

The impact on profit and equity is post-tax at a rate of 30%. The risks faced and methods used in the sensitivity analysis are the same as those applied in the comparative period. As shown below, a 10% movement in equity prices would have a material impact on the consolidated Group's financial position. It is assumed that the relevant change occurs as at the reporting date:

| Equity securities by asset class classification | Change in variable | 30 June 2015<br>Profit/(loss)<br>\$M | 30 June 2015<br>Change in equity<br>\$M | 30 June 2014<br>Profit/(loss)<br>\$M | 30 June 2014<br>Change in equity<br>\$M |
|-------------------------------------------------|--------------------|--------------------------------------|-----------------------------------------|--------------------------------------|-----------------------------------------|
| Property securities                             | +10%               | 20.8                                 | 20.8                                    | 32.8                                 | 32.8                                    |
|                                                 | -10%               | (20.8)                               | (20.8)                                  | (32.8)                               | (32.8)                                  |
| Infrastructure investments                      | +10%               | 20.3                                 | 20.3                                    | 25.2                                 | 25.2                                    |
|                                                 | -10%               | (20.3)                               | (20.3)                                  | (25.2)                               | (25.2)                                  |
| Other assets                                    | +10%               | 13.1                                 | 13.1                                    | 20.6                                 | 20.6                                    |
|                                                 | -10%               | (13.1)                               | (13.1)                                  | (20.6)                               | (20.6)                                  |
| <b>Total assets</b>                             | <b>+10%</b>        | <b>54.2</b>                          | <b>54.2</b>                             | <b>78.6</b>                          | <b>78.6</b>                             |
|                                                 | <b>-10%</b>        | <b>(54.2)</b>                        | <b>(54.2)</b>                           | <b>(78.6)</b>                        | <b>(78.6)</b>                           |

**Note 20 Financial risk management (continued)****Price risk (continued)****Credit spread risk sensitivity**

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

**Currency risk**

It is the 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, Japanese Yen, British Pound, US Dollar against the Australian Dollar. In order to protect

against foreign currency exchange rate movements, the Group has entered into foreign currency derivatives.

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

The SPV entities hedge exposure to foreign currency risk arising from issuing mortgage-backed securities in foreign currencies. The currencies impacted are primarily the British Pound, Euro and US Dollar. All derivatives in the SPV are designated as cash flow hedges. These hedges are effective and there is no material impact on the profit and loss. The following table details the Group's net exposure to foreign currency as at the reporting date in Australian dollar equivalent amounts:

|                                                     | GBP<br>\$M  | USD<br>\$M     | Euro<br>\$M  | JPY<br>\$M   | Other<br>\$M |
|-----------------------------------------------------|-------------|----------------|--------------|--------------|--------------|
| <b>30 June 2015</b>                                 |             |                |              |              |              |
| Financial assets                                    | 366.6       | 2,061.7        | 446.2        | 250.0        | 368.5        |
| Financial liabilities                               | (44.9)      | (197.8)        | (31.4)       | -            | -            |
| Foreign currency contracts and cross currency swaps | (318.5)     | (1,935.7)      | (420.6)      | (246.1)      | (371.0)      |
| <b>Net exposure in Australian dollars</b>           | <b>3.2</b>  | <b>(71.8)</b>  | <b>(5.8)</b> | <b>3.9</b>   | <b>(2.5)</b> |
| <b>30 June 2014</b>                                 |             |                |              |              |              |
| 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)      |
| <b>Net exposure in Australian dollars</b>           | <b>10.1</b> | <b>(106.1)</b> | <b>(6.1)</b> | <b>(2.3)</b> | <b>24.8</b>  |

The analysis in the currency risk table shows the impact on the statement of comprehensive income and equity of a movement in the Group's major foreign currency exposure exchange rates against the Australian dollar using the net exposure at the balance date. All underlying exposures and related hedges are included in the analysis.

A sensitivity of 10% has been applied as this reflects a reasonable measurement given the current level of exchange rates and the volatility observed on an historic basis. The impact on profit and equity is post-tax at a rate of 30%.

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

**Note 20 Financial risk management (continued)****Currency risk (continued)**

|                     | Movement in<br>variable against \$ | 30 June 2015<br>Profit/(loss)<br>\$M | 30 June 2015<br>Change in equity<br>\$M | 30 June 2014<br>Profit/(loss)<br>\$M | 30 June 2014<br>Change in equity<br>\$M |
|---------------------|------------------------------------|--------------------------------------|-----------------------------------------|--------------------------------------|-----------------------------------------|
| British Pound (GBP) | +10%                               | 0.2                                  | 0.2                                     | 0.7                                  | 0.7                                     |
|                     | -10%                               | (0.2)                                | (0.2)                                   | (0.7)                                | (0.7)                                   |
| US Dollar (USD)     | +10%                               | (5.0)                                | (5.0)                                   | (7.4)                                | (7.4)                                   |
|                     | -10%                               | 5.0                                  | 5.0                                     | 7.4                                  | 7.4                                     |
| Euro (EUR)          | +10%                               | (0.4)                                | (0.4)                                   | (0.4)                                | (0.4)                                   |
|                     | -10%                               | 0.4                                  | 0.4                                     | 0.4                                  | 0.4                                     |
| Japanese Yen (JPY)  | +10%                               | -                                    | 0.3                                     | -                                    | (0.2)                                   |
|                     | -10%                               | -                                    | (0.3)                                   | -                                    | 0.2                                     |
| Other               | +10%                               | (0.2)                                | (0.2)                                   | 1.7                                  | 1.7                                     |
|                     | -10%                               | 0.2                                  | 0.2                                     | (1.7)                                | (1.7)                                   |

**Credit default risk**

The Group makes use of external ratings agencies (Standard & Poor's, Fitch, Moody's or other reputable credit rating agency) to determine credit ratings. Where a counterparty or debt obligation is rated by multiple external rating agencies, the Group will use Standard & Poor's ratings where available or otherwise in accordance with the current APRA Prudential Standards. All credit exposures with an external rating are also rated internally and cross-referenced to the external rating, if applicable. Where external credit ratings are not available, internal credit ratings are assigned by appropriately qualified and experienced credit personnel who operate separately from the risk originators.

Each business unit is responsible for managing credit risks that arise with oversight from a centralised credit risk management team.

**Credit exposure by credit rating**

The table below provides information regarding the maximum credit risk exposure of the Group in respect of the major classes of financial assets by equivalent credit rating. The maximum credit exposure is deemed to be the carrying value of the asset not including any collateral or other credit protection in place. The analysis classifies the assets according to internal or external credit ratings. Assets rated investment grade are those rated S&P BBB- or above, with non-investment grade therefore being below BBB-:

|                                           | Investment grade |                |                |                | Non-inv.<br>grade | Other        | Total           |
|-------------------------------------------|------------------|----------------|----------------|----------------|-------------------|--------------|-----------------|
|                                           | AAA<br>\$M       | AA<br>\$M      | A<br>\$M       | BBB<br>\$M     | \$M               | \$M          | \$M             |
| <b>30 June 2015</b>                       |                  |                |                |                |                   |              |                 |
| Cash and cash equivalents                 | 317.9            | -              | -              | -              | -                 | -            | 317.9           |
| Cash and cash equivalents – SPV           | 183.9            | -              | -              | -              | -                 | -            | 183.9           |
| Receivables                               | 14.0             | 47.5           | 3.1            | 4.7            | 21.3              | 343.5        | 434.1           |
| Mortgage assets – SPV                     | 1,305.8          | 670.2          | 353.0          | -              | 2.1               | -            | 2,331.1         |
| Fixed income securities                   | 3,345.1          | 754.4          | 1,653.6        | 1,768.9        | 2,021.5           | 139.1        | 9,682.6         |
| Derivative assets                         | -                | 609.7          | 0.5            | 1.4            | -                 | 0.6          | 612.2           |
| <b>Total assets with credit exposures</b> | <b>5,166.7</b>   | <b>2,081.8</b> | <b>2,010.2</b> | <b>1,775.0</b> | <b>2,044.9</b>    | <b>483.2</b> | <b>13,561.8</b> |
| <b>30 June 2014</b>                       |                  |                |                |                |                   |              |                 |
| 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           |
| Mortgage assets – 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         | 8,474.0         |
| Derivative assets                         | -                | 312.2          | 0.9            | 0.2            | -                 | 0.1          | 313.3           |
| <b>Total assets with credit exposures</b> | <b>5,510.4</b>   | <b>2,110.4</b> | <b>1,701.5</b> | <b>1,582.2</b> | <b>1,487.9</b>    | <b>322.1</b> | <b>12,714.3</b> |

## Note 20 Financial risk management (continued)

### Credit default risk (continued)

#### Mortgage assets - SPV

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

#### 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 mortgage 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.

#### Ageing and impairment of amortised cost financial assets

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

|                     | Not past due/not impaired<br>\$M | Past due but not impaired |                   |                   |                   | Past due and impaired<br>\$M | Total<br>\$M |
|---------------------|----------------------------------|---------------------------|-------------------|-------------------|-------------------|------------------------------|--------------|
|                     |                                  | 0-1 months<br>\$M         | 1-3 months<br>\$M | 3-6 months<br>\$M | > 6 months<br>\$M |                              |              |
| <b>30 June 2015</b> |                                  |                           |                   |                   |                   |                              |              |
| Receivables         | 434.1                            | -                         | -                 | -                 | -                 | -                            | 434.1        |
| <b>30 June 2014</b> |                                  |                           |                   |                   |                   |                              |              |
| Receivables         | 303.3                            | 0.7                       | -                 | 0.1               | -                 | -                            | 304.1        |

#### Concentration risk

The credit risk framework includes an assessment of the counterparty credit risk in each business unit and at a total Group level. The Group has no significant concentrations of credit risk at the statement of financial position date.

#### Subordinated debt

The Company has subordinated debt liabilities with a nominal value of \$400.0 million and \$US150.0 million that are required to be held at fair value through profit and loss. The change recognised in the statement of comprehensive income in respect of valuation changes (excluding foreign exchange) for the year ended 30 June 2015 was a loss of \$5.9 million (30 June 2014: \$19.1 million). The subordinated debt has been valued by reference to the trading margin on the Challenger Capital Notes, adjusted to allow for its higher ranking in the capital structure (using market comparable instruments) and illiquidity.

#### Liquidity risk

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

CLC aims to ensure that it has sufficient liquidity to meet its obligations on a short, medium and long-term basis. The Life liquidity management policy is approved by the CLC Board and sets out liquidity targets and management actions depending on actual liquidity levels relative to those targets. Detailed forecast cash positions are reported regularly to the CLC Asset Liability Committee. At the reporting date, all requirements of the CLC Board approved liquidity management policy were satisfied.

**Note 20 Financial risk management (continued)****Maturity profile of undiscounted financial liabilities**

The table below summarises the maturity profile of the Group's undiscounted financial liabilities. This is based on contractual undiscounted repayment obligations. Totals

differ to the amounts on the statement of financial position by the amount of time value of money discounting reflected in the statement of financial position values:

|                                                 | 1 year<br>or less<br>\$M | 1-3<br>years<br>\$M | 3-5<br>years<br>\$M | >5<br>years<br>\$M | Total<br>\$M    |
|-------------------------------------------------|--------------------------|---------------------|---------------------|--------------------|-----------------|
| <b>30 June 2015</b>                             |                          |                     |                     |                    |                 |
| Payables                                        | 261.7                    | 5.2                 | 56.8                | -                  | 323.7           |
| Interest bearing financial liabilities          | 1,559.4                  | 655.5               | 110.8               | 758.3              | 3,084.0         |
| Interest bearing financial liabilities – SPV    | 607.5                    | 828.5               | 496.6               | 683.2              | 2,615.8         |
| External unit holders' liabilities              | 590.0                    | 354.7               | -                   | -                  | 944.7           |
| Life contract liabilities                       | 2,510.8                  | 2,739.3             | 1,027.2             | 891.5              | 7,168.8         |
| Derivative liabilities                          | 136.1                    | 138.2               | 123.4               | 315.2              | 712.9           |
| <b>Total undiscounted financial liabilities</b> | <b>5,665.5</b>           | <b>4,721.4</b>      | <b>1,814.8</b>      | <b>2,648.2</b>     | <b>14,849.9</b> |
| <b>30 June 2014</b>                             |                          |                     |                     |                    |                 |
| Payables                                        | 368.8                    | 7.0                 | 60.2                | -                  | 436.0           |
| Interest bearing financial liabilities          | 1,066.6                  | 1,029.4             | 171.7               | 1,064.3            | 3,332.0         |
| Interest bearing financial liabilities – SPV    | 785.9                    | 1,055.7             | 649.7               | 1,016.4            | 3,507.7         |
| External unit holders' liabilities              | 1,072.4                  | -                   | -                   | -                  | 1,072.4         |
| Life contract liabilities                       | 2,024.0                  | 2,638.5             | 1,233.2             | 907.1              | 6,802.8         |
| Derivative liabilities                          | 47.7                     | 85.6                | 64.8                | 156.9              | 355.0           |
| <b>Total undiscounted financial liabilities</b> | <b>5,365.4</b>           | <b>4,816.2</b>      | <b>2,179.6</b>      | <b>3,144.7</b>     | <b>15,505.9</b> |

**Note 21 Fair values of financial assets and liabilities****Fair value determination and classification**

Fair value reflects the price that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The majority of the Group's financial instruments are held in the life insurance statutory funds of 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*.

Financial instruments measured at fair value are categorised under a three level hierarchy, reflecting the availability of observable market inputs when estimating the fair value. If different levels of inputs are used to measure a financial instrument's fair value, the classification within the hierarchy is based on the lowest level that is significant to the fair value measurement. The three levels are:

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

## Note 21 Fair values of financial assets and liabilities (continued)

### Fair value determination and classification (continued)

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

### Valuation techniques

The Group's listed and unlisted fixed income securities, government/semi-government securities and over-the-counter derivative financial instruments are all classified as Level 2. This recognises the availability of a quoted price but not from an active market as defined by the standard. Fixed income securities where market observable inputs are not available are classified Level 3. The Group derivative financial instruments are traded over-the-counter so, whilst they are not exchange traded, there is a market observable price. All of the listed fixed income and government/semi-government securities have prices determined by a market. Externally rated unlisted fixed income securities are valued by applying market observable credit spreads on similar assets with an equivalent credit rating. Internally-rated fixed income securities are Level 3 as the determination of an equivalent credit rating is a significant non-observable input.

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

classified as Level 3 include the subordinated debt that has been valued by reference to the trading margin on the Challenger Capital Notes, adjusted to allow for its higher ranking in the capital structure (using market comparable instruments) and illiquidity. External unit holders' liabilities are valued at the face value of the amounts payable and classified as Level 2. The portion of life investment contract liabilities classified as Level 2 represent products or product options for which the liability is determined based on an account balance, rather than a discounted cash flow as applied to the rest of the portfolio.

Cash and cash equivalents are carried at amortised cost. To determine a fair value where the asset is liquid or maturing within three months, the fair value is approximate to the carrying amounts. This assumption is applied to liquid assets and the short-term elements of all other financial assets and financial liabilities.

### Valuation process

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

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

## Note 21 Fair values of financial assets and liabilities (continued)

|                                              | Level 1<br>\$M | Level 2<br>\$M  | Level 3<br>\$M | Total<br>\$M    |
|----------------------------------------------|----------------|-----------------|----------------|-----------------|
| <b>30 June 2015</b>                          |                |                 |                |                 |
| Derivative assets                            | -              | 612.2           | -              | 612.2           |
| Fixed income securities <sup>1</sup>         | -              | 7,800.2         | 1,882.4        | 9,682.6         |
| Equity securities                            | 10.0           | 100.7           | 232.6          | 343.3           |
| Infrastructure investments <sup>1</sup>      | 128.0          | -               | 468.1          | 596.1           |
| Property securities <sup>2</sup>             | 177.4          | -               | 120.0          | 297.4           |
| Investment property                          | -              | 111.7           | 3,001.4        | 3,113.1         |
| Receivables - SPV                            | -              | 2,331.1         | -              | 2,331.1         |
| <b>Total assets</b>                          | <b>315.4</b>   | <b>10,955.9</b> | <b>5,704.5</b> | <b>16,975.8</b> |
| Derivative liabilities                       | 0.1            | 712.9           | 0.2            | 713.2           |
| Interest bearing financial liabilities       | -              | 81.3            | 568.4          | 649.7           |
| Interest bearing liabilities - SPV           | -              | 2,136.9         | -              | 2,136.9         |
| External unit holders' liabilities           | -              | 944.7           | -              | 944.7           |
| Life investment contract liabilities         | -              | 88.4            | 6,538.6        | 6,627.0         |
| <b>Total liabilities</b>                     | <b>0.1</b>     | <b>3,964.2</b>  | <b>7,107.2</b> | <b>11,071.5</b> |
| <b>30 June 2014</b>                          |                |                 |                |                 |
| Derivative assets                            | -              | 313.3           | -              | 313.3           |
| Fixed income securities                      | -              | 7,132.4         | 1,341.6        | 8,474.0         |
| Equity securities                            | 171.4          | 46.0            | 164.4          | 381.8           |
| Infrastructure investments                   | 109.2          | -               | 543.0          | 652.2           |
| Property securities                          | 364.9          | -               | 104.4          | 469.3           |
| Investment property                          | -              | 222.7           | 2,144.3        | 2,367.0         |
| Receivables - SPV                            | -              | 3,106.1         | -              | 3,106.1         |
| <b>Total assets</b>                          | <b>645.5</b>   | <b>10,820.5</b> | <b>4,297.7</b> | <b>15,763.7</b> |
| Derivative liabilities                       | 0.2            | 201.1           | 0.2            | 201.5           |
| Interest bearing financial liabilities       | -              | 141.6           | 529.1          | 670.7           |
| Interest bearing financial 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         |
| <b>Total liabilities</b>                     | <b>0.2</b>     | <b>4,372.3</b>  | <b>6,638.5</b> | <b>11,011.0</b> |

<sup>1</sup> 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 2015 the carrying value of asset-backed financing assets was \$7.7 million (30 June 2014: \$70.8 million) with no undrawn commitments (30 June 2014: \$47.4 million) and securitisations was \$3,367.2 million (30 June 2014: \$3,007.6 million) plus \$184.4 million undrawn commitments (30 June 2014: \$34.4 million).

<sup>2</sup> Refer to Note 6 Investment and development property for valuation techniques and key unobservable inputs.

**Note 21 Fair values of financial assets and liabilities (continued)****Level 3 reconciliation**

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

|                                                                                                                                                 | 30 June 2015   |                    | 30 June 2014   |                    |
|-------------------------------------------------------------------------------------------------------------------------------------------------|----------------|--------------------|----------------|--------------------|
|                                                                                                                                                 | Assets<br>\$M  | Liabilities<br>\$M | Assets<br>\$M  | Liabilities<br>\$M |
| Balance at the beginning of the year                                                                                                            | 2,153.4        | 6,638.5            | 2,649.8        | 6,642.2            |
| Fair value gains/(losses)                                                                                                                       | 153.3          | 336.8              | (29.9)         | 223.9              |
| Acquisitions                                                                                                                                    | 1,621.0        | 2,176.7            | 784.9          | 2,043.6            |
| Maturities and disposals                                                                                                                        | (1,172.2)      | (2,044.8)          | (1,106.1)      | (2,271.2)          |
| Transfers (to)/from other categories <sup>1,2</sup>                                                                                             | (52.4)         | -                  | (145.3)        | -                  |
| <b>Balance at the end of the year<sup>3</sup></b>                                                                                               | <b>2,703.1</b> | <b>7,107.2</b>     | <b>2,153.4</b> | <b>6,638.5</b>     |
| Unrealised losses included in the statement of comprehensive income for assets and liabilities held at the statement of financial position date | (144.5)        | (331.1)            | (48.3)         | (223.9)            |

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

<sup>2</sup> 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.

<sup>3</sup> Does not include investment property.

## Note 21 Fair values of financial assets and liabilities (continued)

### Level 3 sensitivities

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

|                                         | Level 3<br>value <sup>1</sup><br>\$M | Positive<br>impact<br>\$M | Negative<br>impact<br>\$M | Valuation technique                                | Reasonable change in<br>non-observable input <sup>2,3</sup> |
|-----------------------------------------|--------------------------------------|---------------------------|---------------------------|----------------------------------------------------|-------------------------------------------------------------|
| <b>30 June 2015</b>                     |                                      |                           |                           |                                                    |                                                             |
| Fixed income securities                 | 1,882.4                              | 63.4                      | (21.7)                    | Discounted cash flow                               | Primarily credit spreads                                    |
| Interest bearing financial liabilities  | (568.4)                              | (10.4)                    | 11.5                      | Discounted cash flow                               | Primarily credit spreads                                    |
| <b>Net fixed income</b>                 | <b>1,314.0</b>                       | <b>53.0</b>               | <b>(10.2)</b>             |                                                    |                                                             |
| Equity, infrastructure, property assets | 820.7                                | 46.9                      | (47.1)                    | Discounted cash flow,<br>External financial report | Primarily discount rate<br>on cash flow models              |
| Investment contract liabilities         | (6,538.6)                            | 3.8                       | (3.8)                     | Discounted cash flow                               | Primarily expense<br>assumptions                            |
| Derivative liabilities                  | (0.2)                                | 0.3                       | (0.3)                     | Discounted cash flow                               | Primarily credit spreads                                    |
| <b>Total Level 3</b>                    | <b>(4,404.1)</b>                     | <b>104.0</b>              | <b>(61.4)</b>             |                                                    |                                                             |
| <b>30 June 2014</b>                     |                                      |                           |                           |                                                    |                                                             |
| Fixed income securities                 | 1,341.6                              | 66.2                      | (13.2)                    | Discounted cash flow                               | Primarily credit spreads                                    |
| Interest bearing financial liabilities  | (529.1)                              | (22.9)                    | 24.2                      | Discounted cash flow                               | Primarily credit spreads                                    |
| <b>Net fixed income</b>                 | <b>812.5</b>                         | <b>43.3</b>               | <b>11.0</b>               |                                                    |                                                             |
| Equity, infrastructure, property assets | 811.8                                | 42.3                      | (41.9)                    | Discounted cash flow,<br>External financial report | Primarily discount rate<br>on cash flow models              |
| Investment contract liabilities         | (6,109.2)                            | 4.4                       | (4.4)                     | Discounted cash flow                               | Primarily expense<br>assumptions                            |
| Derivative liabilities                  | (0.2)                                | 0.1                       | (0.1)                     | Discounted cash flow                               | Primarily credit spreads                                    |
| <b>Total Level 3</b>                    | <b>(4,485.1)</b>                     | <b>90.1</b>               | <b>(35.4)</b>             |                                                    |                                                             |

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

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

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

## Section 6: Group structure

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

### Note 22 Controlled entities

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

|                                                        |                                                                |
|--------------------------------------------------------|----------------------------------------------------------------|
| CDPG Luxembourg Holdings SARL (Luxembourg)             | Challenger UK Terminals Ltd (Jersey)                           |
| CDPG Luxembourg II SARL (Luxembourg)                   | Challenger Welcome Break Ltd (Jersey)                          |
| CDPG Luxembourg SARL (Luxembourg)                      | Challenger Wind Holdings Pty Ltd                               |
| Challenger DPG France II SAS                           | Clashfern Investments (UK) Ltd (UK)                            |
| Challenger DPG France SAS                              | CLS US Holdings, LLC (USA)                                     |
| Challenger High Yield Fund                             | Godo Kaisha Kenedix Master Tokumei Kumiai <sup>1</sup> (Japan) |
| Challenger Life Debt Investments (Europe) Ltd (UK)     | Godo Kaisha Sub Tokumei Kumiai One <sup>1</sup> (Japan)        |
| Challenger Life Fund Property Investments Pty Ltd      | Godo Kaisha Sub Tokumei Kumiai Two <sup>1</sup> (Japan)        |
| Challenger Life Offshore Investments Ltd (Jersey)      | Kudu Investment Partners I, LP <sup>2</sup>                    |
| 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)   | RRETRO Fund Ltd <sup>1</sup> (Cayman Islands)                  |
| Challenger SkyBridge Fund (LP) Jersey Ltd (Jersey)     | US LLC Holdings Pty Ltd                                        |
| Challenger Strategic Property Partners 1               | Waterford County Pty Ltd                                       |
| Challenger UK Tank Storage Ltd (UK)                    |                                                                |
| Challenger Millennium NPL Trust                        | Interstar Millennium Series 2004-4E Trust                      |
| Challenger Millennium Series 2007-1E Trust             | Interstar Millennium Series 2004-5 Trust                       |
| Challenger Millennium Series 2007-2L Trust             | Interstar Millennium Series 2005-1G Trust                      |
| Challenger Millennium Series 2013-1 Trust              | Interstar Millennium Series 2005-2L Trust                      |
| Challenger Millennium Warehouse C Trust                | Interstar Millennium Series 2005-3E Trust                      |
| Challenger Millennium Warehouse F Trust                | Interstar Millennium Series 2006-1 Trust                       |
| Interstar Millennium Series 2002-1G Trust              | Interstar Millennium Series 2006-2G Trust                      |
| Interstar Millennium Series 2003-3G Trust              | Interstar Millennium Series 2006-3L Trust                      |
| Interstar Millennium Series 2004-1E Trust              | Interstar Millennium Series 2006-4H Trust                      |
| Interstar Millennium Series 2004-2G Trust              | Interstar NZ Millennium Series 2004-A Trust                    |
| 417 St Kilda Road Trust                                | Challenger Property Trust No.30                                |
| 417 St. Kilda Holding Trust A                          | Challenger Property Trust No.31                                |
| 417 St. Kilda Holding Trust B                          | Challenger Property Trust No.32                                |
| Balloon Inflation Linked Bond Trust <sup>1</sup>       | Challenger Property Trust No.35                                |
| Belconnen Property Trust                               | Challenger Property Trust No.36                                |
| Challenger Australia Listed Property Holding Trust     | Challenger Seattle Trust                                       |
| Challenger Bunbury Trust                               | Challenger Towers Holding Trust                                |
| Challenger CKT Holding Trust                           | Challenger UK Tank Storage Holding Trust                       |
| Challenger Diversified Property Trust 1                | Challenger USPF II Trust                                       |
| Challenger European Property Holding Trust             | Challenger Wind Trust                                          |
| Challenger European Property Trust                     | CLC Commercial Mortgages Trust                                 |
| Challenger German Property Trust                       | CLC Leveraged Loan Trust                                       |
| Challenger Howard Property Trust for 417 St Kilda Road | County Court Property Trust                                    |
| Challenger Intermediate Unit Trust                     | Crown Domestic Sovereign Bond Trust <sup>1</sup>               |
| Challenger Karratha Trust                              | Discovery House Trust                                          |
| Challenger Kenedix Japan Trust                         | Harris Global Sovereign Bond Trust <sup>1</sup>                |
| Challenger Life IRP Trust                              | Hayes Park Property Trust                                      |
| Challenger Life MN 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                        | TLG Holding Unit Trust                                         |
| Challenger Property Trust No.19                        | TLG Unit Trust                                                 |
| Challenger Property Trust No.27                        | Village Property Trust                                         |

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

<sup>1</sup> Percentage holding is less than 100%.

<sup>2</sup> Consolidated in 2015.

## Note 22 Controlled entities (continued)

### Recognition and measurement

Controlled entities are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. The acquisition method of accounting is applied on acquisition or initial consolidation. This method ascribes fair values to the identifiable assets and liabilities

acquired. The difference between the net fair value acquired and the fair value of the consideration paid (including the fair value of any pre-existing investment in the entity) is recognised as either goodwill on the statement of financial position or a discount on acquisition through the statement of comprehensive income.

## Note 23 Non-controlling interests

|                                                                        | 30 June<br>2015 | 30 June<br>2014 |
|------------------------------------------------------------------------|-----------------|-----------------|
| Representing the following shares of equity in the applicable entities | \$M             | \$M             |
| Contributed equity                                                     | 29.6            | 73.4            |
| Reserves                                                               | 19.0            | 19.0            |
| Opening retained profits <sup>1</sup>                                  | 22.6            | 8.1             |
| Profit for the year                                                    | 23.8            | 22.4            |
| <b>Total non-controlling interests</b>                                 | <b>95.0</b>     | <b>122.9</b>    |

<sup>1</sup> Includes pre-acquisition retained profit.

### Recognition and measurement

Non-controlling interests reflects the share of the results and equity attributable to non-controlling interests for controlled entities where the Group owns less than 100% of the issued capital or units. Each of the components is

accounted for in accordance with the Group's accounting policies as stated elsewhere in the notes to the financial statements.

## Note 24 Related parties

### Controlled entities

The immediate parent entity of the Company is Challenger Life Company Holdings Pty Limited and the ultimate parent entity is Challenger Limited.

Unless an exception applies under relevant legislation, transactions between commonly-controlled entities within the Group (except where otherwise disclosed) are conducted on an arm's length basis under normal commercial terms and

conditions. The Group's interests in controlled entities are disclosed in Note 22 Controlled entities

### Directors

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

### Directors

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

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.

**Note 24 Related Party (continued)****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. A summary of this compensation is shown in the table below:

|                                | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
|--------------------------------|------------------------|------------------------|
| <b>Consolidated and parent</b> |                        |                        |
| <b>KMP compensation</b>        |                        |                        |
| Short-term benefits            | 5.3                    | 5.2                    |
| Post-employment benefits       | 0.1                    | 0.1                    |
| Share-based payments           | 4.9                    | 5.0                    |
| <b>Total</b>                   | <b>10.3</b>            | <b>10.3</b>            |

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.

**Other related parties**

During the year, there were transactions between the Group and other companies that form part of the

Challenger Limited consolidated group. This included the provision of investment management, transaction advisory, accounting and administration and other professional services. Transactions are conducted on an arm's length basis under normal commercial terms and conditions.

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

|                                                 | Consolidated           |                        | Parent                 |                        |
|-------------------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                                 | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
| Accounting and administrative services          | 77.5                   | 69.6                   | 77.5                   | 69.6                   |
| Investment management and advisory fees         | 33.0                   | 24.0                   | 20.1                   | 11.2                   |
| Realised hedge payments/(receipts) <sup>1</sup> | 10.8                   | (13.1)                 | 10.8                   | (13.1)                 |

<sup>1</sup> The company hedges certain foreign exchange and interest rate exposures with transactions with Challenger Treasury Limited. The outstanding balance at 30 June 2015 was \$15.9 million (2014: \$16.4 million)

Amounts receivable and payable in respect of related entity transactions are disclosed in Note 8 Receivables and Note 11 Payables respectively.

## Section 7: Other items

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

### Note 25 Goodwill and other intangible assets

|                                                    | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
|----------------------------------------------------|------------------------|------------------------|
| <b>Consolidated</b>                                |                        |                        |
| <b>Goodwill<sup>1</sup></b>                        | <b>61.1</b>            | <b>61.1</b>            |
| <b>Other intangible assets</b>                     |                        |                        |
| Balance at the beginning of the year               | 12.5                   | 12.1                   |
| Movements for the year                             |                        |                        |
| - amortisation expense                             | (0.8)                  | (0.7)                  |
| - foreign exchange gain                            | 1.6                    | 1.1                    |
| <b>Balance at the end of the year</b>              |                        |                        |
| - cost                                             | 22.8                   | 22.8                   |
| - accumulated amortisation                         | (6.2)                  | (5.4)                  |
| - foreign exchange losses                          | (3.3)                  | (4.9)                  |
| <b>Balance at the end of the year <sup>1</sup></b> | <b>13.3</b>            | <b>12.5</b>            |

1 All goodwill is considered non-current. The parent has \$46.8 million of goodwill (2014: \$46.8 million).

2 \$0.8 million (30 June 2014: \$0.7 million) of the Other intangibles assets balance is expected to be realised within the next 12 months.

#### Recognition and measurement

##### Goodwill

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

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

The cash-generating unit 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 and allocated first to reduce the carrying amount of any goodwill allocated to that cash-generating unit, then to reduce the carrying amount of the other assets in the unit on a pro rata basis. Impairment losses recognised for goodwill are not subsequently reversed.

When goodwill forms part of a cash-generating unit and an operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining

the gain or loss on disposal of the operation. Goodwill disposed of in this manner is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

##### Other intangible assets

Other intangible assets acquired are recorded at cost less accumulated amortisation and impairment losses. The cost of an intangible asset acquired in a business combination is its fair value as at the date of acquisition. Amortisation is calculated based on the timing of projected cash flows over the estimated useful lives.

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

Where the Group acquires, as part of a business combination, an operating lease over land, the fair value of this lease is recognised separately from goodwill. This intangible asset is recorded at fair value less accumulated amortisation. Amortisation is calculated using the straight line method over the effective life of the lease (in this case, 25 years).

**Note 25 Goodwill and other intangible assets (continued)****Recognition and measurement (continued)****Goodwill recoverable amounts**

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

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

- Bond rate, taken as the yield on a government bond at the beginning of the forecasted horizon;

**Impairment testing of goodwill**

The following represent the carrying amounts of goodwill:

| CGU  | 30 June 2015<br>\$M | 30 June 2014<br>\$M | 30 June 2015<br>Discount rate<br>% | 30 June 2014<br>Discount rate<br>% | Cash flow<br>horizon<br>(years) |
|------|---------------------|---------------------|------------------------------------|------------------------------------|---------------------------------|
| Life | 61.1                | 61.1                | 11.0                               | 11.0                               | 5                               |

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

**Sensitivity to change 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

- forecast gross margins, being the average gross margins achieved in the year ended immediately preceding the forecasted horizon, adjusted for the expected impact of competitive pressure on margins and expected efficiency improvements;
- Growth rates, which are consistent with long-term trends in the industry segments in which the businesses operate.

The derived values for the cash-generating unit are in excess of the carrying values of goodwill.

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

recoverable amounts for the Group to fall below the carrying amounts as at 30 June 2015.

**Note 26 Contingent liabilities, contingent assets and credit commitments****Warranties**

Over the course of its corporate activity the Group has given, as a vendor of assets including real estate properties, warranties to purchasers on several agreements that are outstanding at 30 June 2015. Other than noted below, at the date of this report no material claims against these warranties have been received by the Group.

**Contingent future commitments**

The Group has made capital commitments to external counterparties for future investment opportunities such as development or investment purchases. As at 30 June 2015 there are potential future commitments totalling \$303.0 million (30 June 2014: \$217.1 million) in relation to these opportunities. Currently there are no requests from any of these parties to make payments.

**Other information**

In the normal course of business, the Group enters into various contracts that could give rise to contingent liabilities in relation to performance obligations under those contracts. The information usually required by Australian Accounting Standards is not disclosed for a number of such contracts on the grounds that it may

seriously prejudice the outcome of the claims. At the date of this report, significant uncertainty exists regarding any potential liability under these claims.

**Operating leases****Group as lessee**

The Group has entered into a commercial operating lease for the rental of a property that would not be available for purchase. The Group then rents the site to the external parties as an active operation. The current lease has 18 years until expiry.

The Group has an operating lease (leasehold) over an industrial site with a subsidiary of the Group operating a business from the site. The current leasehold expires in 2032.

**Group as lessor**

Investment properties owned by the Group are leased to third parties under operating leases. Lease terms vary between tenants and some leases include percentage rental payments based on sales volume.

**Note 26 Contingent liabilities, contingent assets and credit commitments (continued)****Contracted capital expenditure commitments**

These represent amounts payable in relation to capital expenditure commitments contracted for at the reporting date but not recognised as liabilities. They primarily relate to the investment property portfolio.

**Other contracted commitments**

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

|                                                           | 30 June<br>2015<br>\$M | 30 June<br>2014<br>\$M |
|-----------------------------------------------------------|------------------------|------------------------|
| <b>Analysis of credit commitments</b>                     |                        |                        |
| <b>Non-cancellable operating leases – Group as lessee</b> |                        |                        |
| Amounts due in less than one year                         | 4.5                    | 4.4                    |
| Amounts due between one and two years                     | 4.6                    | 4.5                    |
| Amounts due between two and five years                    | 14.6                   | 14.2                   |
| Amounts due in greater than five years                    | 78.3                   | 83.4                   |
| <b>Total operating leases – Group as lessee</b>           | <b>102.0</b>           | <b>106.5</b>           |
| <b>Contracted capital expenditure</b>                     |                        |                        |
| Amounts due in less than one year                         | 7.9                    | 8.6                    |
| Amounts due between one and two years                     | 5.1                    | 4.0                    |
| Amounts due between two and five years                    | 7.5                    | 9.9                    |
| Amounts due in greater than five years                    | 3.2                    | 3.9                    |
| <b>Total capital expenditure commitments</b>              | <b>23.7</b>            | <b>26.4</b>            |
| <b>Non-cancellable operating leases – Group as lessor</b> |                        |                        |
| Amounts due in less than one year                         | (227.3)                | (160.5)                |
| Amounts due between one and two years                     | (197.2)                | (151.2)                |
| Amounts due between two and five years                    | (439.1)                | (391.8)                |
| Amounts due in greater than five years                    | (306.0)                | (463.6)                |
| <b>Total operating leases – Group as lessor</b>           | <b>(1,169.6)</b>       | <b>(1,167.1)</b>       |
| <b>Other contracted commitments</b>                       |                        |                        |
| Amounts due in less than one year                         | 306.7                  | 129.1                  |
| <b>Total other contracted commitments</b>                 | <b>306.7</b>           | <b>129.1</b>           |
| <b>Total commitments to/(by) the Group</b>                | <b>(737.2)</b>         | <b>(905.1)</b>         |

**Note 27 Statutory fund information****Life insurance funds**

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

| Statutory Fund | Type of business                    | Major products                                                                                                                            | Type of contract                                                                                                                    |
|----------------|-------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------|
| 1              | Unit-linked superannuation business | Capital guaranteed bonds <sup>1</sup><br>Performance annuity bonds <sup>1</sup>                                                           | Investment contract<br>Insurance/investment contract <sup>2</sup>                                                                   |
| 2              | Non-linked superannuation business  | Fixed-rate annuity<br>Lifetime annuity<br>Allocated pension<br>Personal super<br>Wholesale longevity<br>Wholesale mortality and morbidity | Investment contract<br>Insurance contract<br>Investment contract<br>Investment contract<br>Insurance contract<br>Insurance contract |
| 3              | Unit-linked superannuation business | Investment-linked bonds<br>Investment-linked allocated pensions                                                                           | Investment contract<br>Investment contract                                                                                          |
|                | Unit-linked ordinary business       | Investment-linked bonds                                                                                                                   | Investment contract                                                                                                                 |

<sup>1</sup> These products are non-investment linked per the Life Act definitions

<sup>2</sup> Performance annuity bonds have a portion of life insurance risk being a life time option component

**Note 27 Statutory fund information (continued)****Disaggregated information by statutory fund****Statement of comprehensive income****2015**

|                                                 | Statutory Fund No.1<br>\$M | Statutory Fund No.2<br>\$M | Statutory Fund No.3<br>\$M | Statutory Fund Total<br>\$M | Shareholder Fund<br>\$M | Total<br>\$M |
|-------------------------------------------------|----------------------------|----------------------------|----------------------------|-----------------------------|-------------------------|--------------|
| Revenue                                         | -                          | 1,435.6                    | 0.2                        | 1,435.8                     | 62.2                    | 1,498.0      |
| Expenses                                        | 0.3                        | (842.0)                    | -                          | (841.7)                     | (3.5)                   | (845.2)      |
| Finance costs                                   | -                          | (213.7)                    | -                          | (213.7)                     | (16.2)                  | (229.9)      |
| <b>Profit before tax</b>                        | <b>0.3</b>                 | <b>379.9</b>               | <b>0.2</b>                 | <b>380.4</b>                | <b>42.5</b>             | <b>422.9</b> |
| Income tax expense                              | (0.1)                      | (83.6)                     | (0.1)                      | (83.8)                      | (11.8)                  | (95.6)       |
| <b>Profit for the year</b>                      | <b>0.2</b>                 | <b>296.3</b>               | <b>0.1</b>                 | <b>296.6</b>                | <b>30.7</b>             | <b>327.3</b> |
| Profit attributable to non-controlling interest | -                          | 23.8                       | -                          | 23.8                        | -                       | 23.8         |
| <b>Profit attributable to equity holders</b>    | <b>0.2</b>                 | <b>272.5</b>               | <b>0.1</b>                 | <b>272.8</b>                | <b>30.7</b>             | <b>303.5</b> |

**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)      |
| <b>Profit before tax</b>                        | <b>(0.3)</b> | <b>382.2</b> | <b>0.1</b> | <b>382.0</b> | <b>81.8</b> | <b>463.8</b> |
| Income tax expense                              | 0.1          | (63.8)       | (0.1)      | (63.8)       | (26.5)      | (90.3)       |
| <b>Profit for the year</b>                      | <b>(0.2)</b> | <b>318.4</b> | <b>-</b>   | <b>318.2</b> | <b>55.3</b> | <b>373.5</b> |
| Profit attributable to non-controlling interest | -            | 22.4         | -          | 22.4         | -           | 22.4         |
| <b>Profit attributable to equity holders</b>    | <b>(0.2)</b> | <b>296.0</b> | <b>-</b>   | <b>295.8</b> | <b>55.3</b> | <b>351.1</b> |

**Abbreviated statement of financial position****30 June 2015**

|                           | Statutory Fund No.1<br>\$M | Statutory Fund No.2<br>\$M | Statutory Fund No.3<br>\$M | Statutory Fund Total<br>\$M | Shareholder Fund<br>\$M | Total<br>\$M    |
|---------------------------|----------------------------|----------------------------|----------------------------|-----------------------------|-------------------------|-----------------|
| Cash and cash equivalents | 4.0                        | 489.0                      | 2.0                        | 495.0                       | 6.8                     | 501.8           |
| Investment assets         | 3.2                        | 12,505.8                   | 3.8                        | 12,512.8                    | 2,131.9                 | 14,644.7        |
| Other assets              | 0.1                        | 3,014.4                    | (0.2)                      | 3,014.3                     | 56.9                    | 3,071.2         |
| <b>Total assets</b>       | <b>7.3</b>                 | <b>16,009.2</b>            | <b>5.6</b>                 | <b>16,022.1</b>             | <b>2,195.6</b>          | <b>18,217.7</b> |
| Life contract liabilities | 3.9                        | 8,685.6                    | 3.5                        | 8,693.0                     | -                       | 8,693.0         |
| Other liabilities         | -                          | 4,997.8                    | 0.2                        | 4,998.0                     | 1,852.6                 | 6,850.6         |
| <b>Total liabilities</b>  | <b>3.9</b>                 | <b>13,683.4</b>            | <b>3.7</b>                 | <b>13,691.0</b>             | <b>1,852.6</b>          | <b>15,543.6</b> |
| <b>Net assets</b>         | <b>3.4</b>                 | <b>2,325.8</b>             | <b>1.9</b>                 | <b>2,331.1</b>              | <b>343.0</b>            | <b>2,674.1</b>  |
| Contributed equity        | -                          | -                          | -                          | -                           | 1,541.5                 | 1,541.5         |
| Reserves                  | 1.6                        | 890.8                      | 0.8                        | 893.2                       | (754.2)                 | 139.0           |
| Retained earnings         | 1.8                        | 1,340.0                    | 1.1                        | 1,342.9                     | (444.3)                 | 898.6           |
| Non-controlling interests | -                          | 95.0                       | -                          | 95.0                        | -                       | 95.0            |
| <b>Total equity</b>       | <b>3.4</b>                 | <b>2,325.8</b>             | <b>1.9</b>                 | <b>2,331.1</b>              | <b>343.0</b>            | <b>2,674.1</b>  |

**Note 27 Statutory fund information (continued)****Abbreviated statement of financial position****30 June 2014**

|                           | Statutory<br>Fund No.1<br>\$M | Statutory<br>Fund No.2<br>\$M | Statutory<br>Fund No.3<br>\$M | Statutory<br>Fund Total<br>\$M | Shareholder<br>Fund<br>\$M | Total<br>\$M    |
|---------------------------|-------------------------------|-------------------------------|-------------------------------|--------------------------------|----------------------------|-----------------|
| 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         |
| <b>Total assets</b>       | <b>8.2</b>                    | <b>15,108.8</b>               | <b>6.0</b>                    | <b>15,123.0</b>                | <b>1,806.2</b>             | <b>16,929.2</b> |
| 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         |
| <b>Total liabilities</b>  | <b>4.9</b>                    | <b>13,397.1</b>               | <b>4.1</b>                    | <b>13,406.1</b>                | <b>1,507.8</b>             | <b>14,913.9</b> |
| <b>Net assets</b>         | <b>3.3</b>                    | <b>1,711.7</b>                | <b>1.9</b>                    | <b>1,716.9</b>                 | <b>298.4</b>               | <b>2,015.3</b>  |
| 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           |
| <b>Total equity</b>       | <b>3.3</b>                    | <b>1,711.7</b>                | <b>1.9</b>                    | <b>1,716.9</b>                 | <b>298.4</b>               | <b>2,015.3</b>  |

**Capital adequacy****30 June 2015**

|                                              | Statutory<br>Fund No.1<br>\$M | Statutory<br>Fund No.2<br>\$M | Statutory<br>Fund No.3<br>\$M | Statutory<br>Fund Total<br>\$M | Shareholder<br>Fund<br>\$M | Total<br>\$M   |
|----------------------------------------------|-------------------------------|-------------------------------|-------------------------------|--------------------------------|----------------------------|----------------|
| Net assets <sup>1</sup>                      | 3.5                           | 2,230.9                       | 1.9                           | 2,236.3                        | 342.9                      | 2,579.2        |
| Regulatory adjustments                       | -                             | (281.4)                       | -                             | (281.4)                        | (45.2)                     | (326.6)        |
| <b>Tier 1 regulatory capital</b>             | <b>3.5</b>                    | <b>1,949.5</b>                | <b>1.9</b>                    | <b>1,954.9</b>                 | <b>297.7</b>               | <b>2,252.6</b> |
| Tier 2 capital <sup>2</sup>                  | -                             | 474.0                         | -                             | 474.0                          | -                          | 474.0          |
| <b>Capital base</b>                          | <b>3.5</b>                    | <b>2,423.5</b>                | <b>1.9</b>                    | <b>2,428.9</b>                 | <b>297.7</b>               | <b>2,726.6</b> |
| <b>Prescribed capital amounts components</b> |                               |                               |                               |                                |                            |                |
| Insurance risk charge                        | 0.4                           | 120.0                         | -                             | 120.4                          | 0.1                        | 120.5          |
| Asset risk charge                            | 0.4                           | 1,525.3                       | 0.1                           | 1,525.8                        | 55.3                       | 1,581.1        |
| Asset concentration risk charge              | -                             | -                             | -                             | -                              | -                          | -              |
| Operational risk charge                      | -                             | 22.6                          | -                             | 22.6                           | -                          | 22.6           |
| Default stress                               | -                             | 10.4                          | -                             | 10.4                           | 0.1                        | 10.5           |
| Aggregation benefit                          | (0.2)                         | (91.6)                        | -                             | (91.8)                         | (0.1)                      | (91.9)         |
| Combined stress scenario adjustment          | -                             | 182.0                         | -                             | 182.0                          | -                          | 182.0          |
| Transition relief <sup>3</sup>               | -                             | (103.3)                       | -                             | (103.3)                        | (4.3)                      | (107.6)        |
| <b>Prescribed capital Amount</b>             | <b>0.6</b>                    | <b>1,665.4</b>                | <b>0.1</b>                    | <b>1,666.1</b>                 | <b>51.1</b>                | <b>1,717.2</b> |
| <b>Capital adequacy multiple</b>             | <b>6.1</b>                    | <b>1.5</b>                    | <b>26.7</b>                   | <b>1.5</b>                     | <b>5.8</b>                 | <b>1.6</b>     |

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**Note 27 Statutory fund information (continued)****Capital adequacy****30 June 2014**

|                                  | Statutory<br>Fund No.1<br>\$M | Statutory<br>Fund No.2<br>\$M | Statutory<br>Fund No.3<br>\$M | Statutory<br>Fund Total<br>\$M | Shareholder<br>Fund<br>\$M | Total<br>\$M   |
|----------------------------------|-------------------------------|-------------------------------|-------------------------------|--------------------------------|----------------------------|----------------|
| Net assets <sup>1</sup>          | 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)        |
| <b>Tier 1 regulatory capital</b> | <b>3.3</b>                    | <b>1,513.7</b>                | <b>1.8</b>                    | <b>1,518.8</b>                 | <b>264.3</b>               | <b>1,783.1</b> |
| Additional Tier 1 capital        | -                             | -                             | -                             | -                              | -                          | -              |
| Tier 2 capital <sup>2</sup>      | -                             | 476.8                         | -                             | 476.8                          | -                          | 476.8          |
| <b>Capital base</b>              | <b>3.3</b>                    | <b>1,990.5</b>                | <b>1.8</b>                    | <b>1,995.6</b>                 | <b>264.3</b>               | <b>2,259.9</b> |

**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 <sup>3</sup>      | -          | (206.7)        | -           | (206.7)        | (8.5)       | (215.2)        |
| <b>Prescribed capital Amount</b>    | <b>0.5</b> | <b>1,299.9</b> | <b>0.1</b>  | <b>1,300.5</b> | <b>56.7</b> | <b>1,357.2</b> |
| <b>Capital adequacy multiple</b>    | <b>6.6</b> | <b>1.5</b>     | <b>18.0</b> | <b>1.5</b>     | <b>4.7</b>  | <b>1.7</b>     |

<sup>2</sup> Net assets includes additional tier 1 capital

<sup>2</sup> Differs from the \$567.0 million (30 June 2014: \$525.9 million) disclosed in Note 16 Interest bearing financial liabilities due to \$2.5 million (30 June 2014: \$2.7 million) accrued interest and \$95.3 million (30 June 2014: \$51.7 million) of inadmissible Tier 2 regulatory capital

<sup>2</sup> LAGIC transition relief will reduce by an additional third (\$107.6 million) 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.

**Note 28 Remuneration of auditors**

Auditor's 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.

**Note 29 Subsequent events**

At the date of this report, no matter or circumstance has arisen that has affected, or may significantly affect,

Challenger's operations, the results of those operations or the Group's state of affairs in future financial years.

# Directors' declaration

## 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 2015 and of its performance for the year ended on that date; and
  - ii. complying with Australian Accounting Standards (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 disclosed in Section 1(i) Basis of preparation and statement of compliance to the financial statements;
- c. there are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable; and
- d. this declaration has been made after receiving the declarations required to be made to the Directors in accordance with section 295A of the *Corporations Act 2001* for the financial year ended 30 June 2015.

On behalf of the Board



P L Polson  
Chair

Sydney  
17 August 2015



B R Benari  
Director

Sydney  
17 August 2015



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## Independent auditor's report

### 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 statements of financial position as at 30 June 2015, the statements of comprehensive income, statements of changes in equity and statements 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 company and the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

#### Directors' responsibility for the financial report

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

#### Auditor's responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's 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.

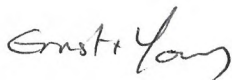
#### Independence

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 company's and consolidated entity's financial position as at 30 June 2015 and of its performance for the year ended on that date; and
  - ii. complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and
- b. the financial report also complies with International Financial Reporting Standards as disclosed in Section 1.



Ernst & Young



D J Handley-Greaves  
Partner

Sydney  
17 August 2015

## Directory

Principal place of business and registered office in Australia

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Sydney NSW 2000

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Facsimile: 02 9994 7777

Website: [www.challenger.com.au](http://www.challenger.com.au)

### Directors

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Peter Polson (Chair)

Brian Benari (Managing Director and Chief Executive Officer)

Graham Cubbin

Steven Gregg

Jonathan Grunzweig

Brenda Shanahan

JoAnne Stephenson

Leon Zwier

### Company secretaries

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Michael Vardanega

Andrew Brown

### Auditor

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Ernst & Young

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Sydney NSW 2000