Challenger Limited

and its controlled entities

2015 Appendix 4D and Interim Results Announcement

Appendix 4D Interim financial report

under ASX Listing Rule 4.2A.3 for the six months ended 31 December 2014

Current period	1 July 2014 to 31 December 2014
Prior corresponding period (PCP)	1 July 2013 to 31 December 2013

Results for announcement to the market

	2014 $M	2013 $M	Change %
Revenue from ordinary activities	846.6	772.3	9.6
Profit from ordinary activities after tax attributable to equity holders	130.1	166.3	(21.8)
Net profit for the period attributable to equity holders	**130.1**	**166.3**	**(21.8)**

Normalised net profit after tax, management's preferred measure of profit, for the six months ended 31 December 2014 decreased by 5.3% to $154.9 million (PCP: $163.5 million). Refer to Note 2 Segment information in the interim financial report for a definition of normalised profit after tax and a reconciliation to statutory profit for the period.

Dividend information

	2014 Cents	2013 Cents	Change %
Interim per ordinary share – **70% franked (2013: unfranked)**	**14.5**	**12.5**	**16.0**

There is no dividend reinvestment plan in operation. There is no conduit foreign income for this dividend.

2015 Interim dividend dates

Ex-dividend date	2 March 2015
Record date	4 March 2015
Payment date	31 March 2015

Basis of preparation

This interim financial report under ASX Listing Rule 4.2A.3 covers Challenger Limited and its controlled entities, and is based on the attached interim financial report.

Results announcement for the six months ended 31 December 2014

Contents

Directors' report

The Directors of Challenger Limited (the Company) submit their report, together with the financial report of the Company and its controlled entities (the Group or Challenger), for the half year ended 31 December 2014.

1. Directors

The names and details of the Directors of the Company holding office during the six months to 31 December 2014 and as at the date of this report are listed below. Directors were in office for this entire period unless otherwise stated.

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

2. Review of operations

Strong retail sales of annuities and growing funds under management during the first half of the 2015 financial year have continued to build on the leading retirement income platform that Challenger has developed over the past number of years.

Key performance indicators for the interim period ended 31 December 2014 (with the interim period to 31 December 2013 being the prior comparative period (PCP) for the income statement and 30 June 2014 being the PCP for the statement of financial position, unless otherwise stated) include:

- Challenger's statutory profit attributable to equity holders of $130.1 million was down $36.2 million (21.8%) compared to the PCP, reflecting the impact of fair value changes on life contract liabilities (principally new business losses on increased annuity sales) and a higher tax expense with the conclusion of the Taxation on Financial Arrangements (TOFA) benefits at 30 June 2014. (Refer Note 5 Income tax in the financial report for details).
- Normalised net profit after tax reduced by 5.3% to $154.9 million compared to the PCP. The PCP benefited from a $15.0 million reduction in tax expense in relation to TOFA (as mentioned above). Excluding the TOFA benefit, normalised net profit after tax would have increased by 4.3%.
- Normalised basic earnings per share (EPS) decreased 3.0 cents (9.4%) to 28.8 cents per share and statutory basic EPS decreased 8.1 cents (25.1%) to 24.2 cents compared to the PCP. There was a higher number of shares on issue following the first half 2015 capital initiatives, as well as lower net profit after tax.
- The normalised cost to income ratio was marginally lower at 34.4%, compared to 35.2% for the six months to 30 June 2014, reflecting Challenger's scalable business model.
- An interim dividend of 14.5 cents per share was declared, franked at 70%, up from 12.5 cents (unfranked) for the prior interim dividend.
- Total Life retail annuity sales of $1.6 billion represented growth of 8.1% and was a record half year retail annuity sales result. The Life retail book grew by $0.6 billion (7.2%).
- Total Funds Management net inflows were $6.7 billion, with net flows benefiting from the formation of Whitehelm Capital, up substantially from inflows of $1.1 billion in the PCP.
- Total Assets Under Management increased by $6.4 billion (12.7%) to $57.2 billion.
- Challenger's normalised and statutory return on equity after tax were 13.2% and 11.1% respectively.

Capital management initiatives

Challenger Life Company Limited (CLC) is growing strongly and expects to materially increase the size of its retail annuity business. In order to support Challenger's growth initiatives the following capital management initiatives were completed during the six months ended 31 December 2014:

- $250.0 million institutional equity placement undertaken in August 2014 with 33.2 million ordinary shares issued. The placement price of $7.53 per share represented a 1.1% discount to the 10 day volume weighted average price (adjusted for the 2014 financial year final dividend).
- $40.2 million Share Purchase Plan (SPP) providing eligible retail Australian and New Zealand investors the opportunity to participate in the capital raising. The SPP was completed in October 2014 with an issue price of $7.10 per share. More than 3,500 investors participated and 5.6 million new ordinary shares were issued.
- $345.0 million raised via the Challenger Capital Notes (Notes) in October 2014, which are subordinated unsecured convertible notes issued by Challenger Limited. The Notes are quoted and tradable on the ASX (under code CGFPA) and pay franked distributions on a quarterly basis at a margin of 3.40% per annum over the Australian 90 day Bank Bill Rate. Distributions can be paid to note holders as a combination of cash and franking credits.

The proceeds from the Notes ($345.0 million) have been injected into CLC as additional Tier 1 equity. The majority of the proceeds ($150.0 million) from the institutional equity placement and SPP have been injected into CLC as Common Equity Tier 1 (CET1) capital, with the remainder retained at Group.

These capital management initiatives will fund Life's growth initiatives whilst providing capital flexibility.

2. Review of operations (continued)

Normalised profit and investment experience

CLC and its consolidated entities are required by AASB 1038 *Life Insurance Contracts* to value all assets and liabilities supporting the life company at fair value where permitted by other accounting standards. This gives rise to fluctuating valuation movements on assets and liabilities being recognised in the profit and loss in CLC and on consolidation in Challenger Limited. CLC is generally a long-term holder of assets, due to holding assets to match the term of life contract liabilities. As a result, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements. Investment experience represents the difference between actual investment gains/losses (both realised and unrealised) and expected gains/losses based on CLC's medium to long-term expected returns. Investment experience also includes any economic and actuarial assumption changes arising from changes in market conditions.

A reconciliation between statutory revenue and the management view of revenue, net income, is included in the financial report as part of Note 2 Segment information. This note also includes a reconciliation of statutory profit after tax and normalised net profit after tax (the management view of post-tax profit). The application of the normalised profit framework has been reviewed by Challenger's independent auditor to ensure that the reported results are consistently applied in accordance with the methodology described in Note 2 Segment information in the financial report.

Challenger's normalised net profit after tax was $154.9 million for the interim period ended 31 December 2014, a decrease of $8.6 million (5.3%) compared to the PCP. Normalised net profit after tax decreased in spite of higher net income (up $22.4 million) and lower borrowing costs (down $0.5 million), which were offset by higher expenses (up $8.8 million), and higher normalised tax (up $22.7 million). The increase in tax includes the conclusion of the TOFA deduction, which ended on 30 June 2014.

The net income growth of $22.4 million (7.7%) is mainly attributable to:

- higher Life cash operating earnings (up $20.6 million) as a result of growth in Life investment assets.
- higher Funds Management net fee income (up $2.3 million) due to higher Funds Under Management (FUM).
- lower other income (down $0.5 million) due to lower average cash balances.

The management view of operating expenses is $108.2 million for the period, increasing $8.8 million on the PCP. The increase in expenses is primarily due to increased employee numbers to support Challenger's growth initiatives.

Challenger's full time equivalent employee numbers at 31 December 2014 was 563 which was 13.1% (or 65) higher compared to 31 December 2013. The increase in employee numbers includes 23 employees following the acquisition of Accurium Pty Limited (previously Bendzulla Actuarial Pty Limited) during the 2014 financial year and additional employees relating to distribution and asset origination initiatives. Challenger's business is one of Australia's most efficient financial services companies. Over the past five years, total expenses have increased by only $21.0 million, whilst net income has increased by $108.0 million, resulting in the cost to income ratio falling by seven percentage points over the period.

Challenger's normalised cost to income ratio of 34.4% remains well within the targeted range. The medium-term normalised cost to income ratio target is a range of 32% to 36%. The normalised cost to income ratio for the full 2015 financial year is expected to be at the mid-point of this range, as growth in net income is partially reinvested in the business to capture growth opportunities.

Normalised EBIT for the period was $206.4 million, up $13.6 million (7.1%) from $192.8 million for the PCP. Life normalised EBIT increased by $15.2 million, reflecting growth in investment assets following strong annuities sales and net book growth. Funds Management normalised EBIT is relatively unchanged, up $0.1 million despite strong FUM growth, due to a lower contribution from performance fees and a change in mix in AUM. Corporate normalised EBIT decreased by $1.7 million, due to higher personnel costs and lower other income.

Normalised tax for the half was $49.8 million, up $22.7 million (83.8%), giving an effective normalised tax rate of 24.3% for the period, resulting from higher normalised net profit and the end of the TOFA benefits as mentioned previously. Excluding the TOFA tax deduction in the PCP, the normalised effective tax rate was 22.1%.

Investment experience after tax was a loss of $24.8 million for the period compared to profit of $2.8 million for the PCP. Investment experience from marking Life's investment assets to market was positive $7.6 million (post tax). Strong property valuation gains for both directly held properties and other real estate investments were partly offset by fixed income losses as a result of expansion in fixed income corporate credit spreads. The impact of changes in economic and actuarial adjustments on Life's liabilities was a loss of $32.4 million (post tax) and was primarily driven by an accounting loss on writing new business net of prior period losses.

2. Review of operations (continued)

Normalised profit and investment experience (continued)

The following tables provide an overview of Challenger's normalised results and a reconciliation to statutory profit:

Management analysis	31 Dec 2014 $M	31 Dec 2013 $M	Change %
Cash earnings	223.3	211.3	5.7
Normalised capital growth	34.5	25.9	33.2
Normalised cash operating earnings (COE)	**257.8**	**237.2**	**8.7**
Net fee income	56.1	53.8	4.3
Other income	0.7	1.2	(41.7)
Net income[1]	**314.6**	**292.2**	**7.7**
Operating expenses[1]	(108.2)	(99.4)	8.9
Normalised EBIT	**206.4**	**192.8**	**7.1**
Interest and borrowing costs	(1.7)	(2.2)	(22.7)
Normalised net profit before tax	204.7	190.6	7.4
Tax on normalised net profit[2]	(49.8)	(27.1)	83.8
Normalised net profit after tax	**154.9**	**163.5**	**(5.3)**
Investment experience after tax	(24.8)	2.8	Large
Statutory net profit after tax attributable to equity holders	**130.1**	**166.3**	**(21.8)**
Normalised EBIT by division			
Life	215.8	200.6	7.6
Funds Management	20.8	20.7	0.5
Corporate	(30.2)	(28.5)	6.0
Total	**206.4**	**192.8**	**7.1**

[1] Net Income and Operating expenses are internal classifications and are defined in Note 2 Segment information in the financial report. These differ from the statutory Revenue and Expenses classifications, as certain direct costs (including commissions, property expenses and management fees) are netted off against gross revenues and Special Purpose Vehicle revenues, expenses and finance costs are netted and included in net income. These classifications have been made in the Directors' report, and in Note 2 Segment information, as they reflect metrics used by management to measure the business performance of Challenger. Whilst the allocation of amounts to the above items and Investment experience differs to the statutory view, both approaches result in the same profit for the period.

[2] In February 2012, a private binding ruling was received from the Australian Tax Office (ATO) confirming the application of the Taxation of Financial Arrangements (TOFA) on certain historical transaction elections. This resulted in a net reduction of normalised tax of circa $30.0 million for each of the three financial years 2012 to 2014. Consequently, the PCP includes a $15.0 million reduction to the underlying tax expense.

2. Review of operations (continued)

Normalised profit and investment experience (continued)

Management analysis (continued)	31 Dec 2014 $M	31 Dec 2013 $M
Investment experience		
Actual capital growth[3]		
Cash and fixed income	(45.7)	18.2
Infrastructure	16.8	1.5
Property (net of debt)	75.3	(17.0)
Equity and other investments	(1.0)	13.1
Total actual capital growth	**45.4**	**15.8**
Normalised capital growth[4]		
Cash and fixed income	(14.5)	(14.0)
Infrastructure	10.6	10.3
Property (net of debt)	23.5	18.7
Equity and other investments	14.9	10.9
Total normalised capital growth	**34.5**	**25.9**
Investment experience		
Cash and fixed income	(31.2)	32.2
Infrastructure	6.2	(8.8)
Property (net of debt)	51.8	(35.7)
Equity and other investments	(15.9)	2.2
	10.9	**(10.1)**
Actuarial assumption changes[5]	(46.3)	14.2
Investment experience before tax	(35.4)	4.1
Tax benefit/(expense)	10.6	(1.3)
Investment experience after tax	**(24.8)**	**2.8**

[3] Actual capital growth represents net realised and unrealised capital gains or losses and includes the attribution of interest rate, inflation and foreign exchange derivatives that are used to hedge exposures.
[4] Normalised capital growth is determined by multiplying the normalised capital growth rate for each asset class by the average investment assets for the period. The normalised growth rates represent Challenger's capital growth expectations for each asset class over the investment cycle. The normalised growth rate is +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 experience.
[5] Actuarial assumption changes represents the impact of changes in macroeconomic variables, including bond yields and inflation factors, expense assumptions, losses on new business and other factors applied in the valuation of life contract liabilities. It also includes the attribution of interest rate derivatives used to hedge interest rate exposures.

Earnings per share (EPS)

As shown in the following table, basic normalised EPS decreased by 3.0 cents (9.4%) to 28.8 cents per share compared to 31.8 cents per share for the PCP. The decrease in normalised EPS reflects higher normalised profit before tax offset by the conclusion of the transitional TOFA taxation deductions on 30 June 2014 and a higher share count following the institutional equity placement and retail SPP completed during the period. Basic and diluted statutory EPS decreased compared to the PCP, driven primarily by the above factors as well as a lower investment experience in the current period.

For the period ended	31 Dec 2014 cents	31 Dec 2013 cents	Change %
Basic – normalised	28.8	31.8	(9.4)
Diluted – normalised	27.0	30.3	(10.9)
Basic – statutory	24.2	32.3	(25.1)
Diluted – statutory	22.8	30.8	(26.0)

2. Review of operations (continued)

Life financial results

The Life business includes CLC, Australia's leading provider of annuities and guaranteed retirement income products. Products appeal to investors seeking the security and certainty of guaranteed income flows with protection against the uncertainties inherent in market, inflation and longevity risks. Products are distributed via financial advisers, both independent and from the major hubs. Being an independent manufacturer, CLC's products are included on all major hubs.

CLC has won the Association of Financial Advisers/Plan for Life annuity provider of the year for the past six years and has won the income stream innovation award for the past four years.

The Life business also includes Accurium Pty Limited, the leading provider in Self-Managed Superannuation Fund (SMSF) actuarial certificates, which was acquired in February 2014.

CLC is diversifying its capital and earnings base by participating in wholesale reinsurance longevity and mortality risk transactions. CLC is experienced in managing, pricing and reinsuring these risks. Undertaking wholesale longevity and mortality reinsurance transactions is a natural business extension for the life company.

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

The Life segment's normalised EBIT increased by $15.2 million (7.6%) to $215.8 million compared to the PCP, driven by higher normalised COE (up $20.6 million or 8.7%) partly offset by $5.4 million higher expenses. The increase in normalised COE is a result of higher investment assets, with average investment assets 8.7% higher than the PCP. The normalised COE margin remained at 4.4%, unchanged from the PCP.

Life normalised RoE (pre-tax) was 18.9%, down from 20.9% in the PCP, due to a higher capital base following the capital management initiatives undertaken during the half and increase in retained earnings. Challenger is committed to its 18% (pre-tax) RoE target and expects to meet this target as capital is fully deployed.

Life retail annuity sales for the period were $1.6 billion, representing an 8.1% increase on the PCP and a record half-yearly retail annuity sales result. Retail annuity sales continue to benefit from favourable macroeconomic trends, including an ageing population and retirees taking a more conservative approaches to wealth management in retirement. These favourable trends are being leveraged by Challenger's product innovation and extensive distribution footprint.

Lifetime annuity sales (the Liquid Lifetime and Care Annuity products) continued to grow strongly and were $319.2 million in the period, up from $270.2 million in the PCP. Lifetime annuity sales represented 20.3% of total retail annuity sales in the period, more than doubling from 9.5% two years ago. Growth in lifetime sales was negatively impacted by suspension of Care Annuity sales in November 2014, following the Australian Government's Department of Social Services' decision to redefine how the Care Annuity would be treated for social security purposes. Existing Care Annuity customers are not impacted and in order to address future uncertainty, Challenger discontinued new sales of the Care Annuity in its current form. The aged care market is an attractive market and Challenger is preparing a replacement product in expectation of re-entering the aged care market.

Retail annuity sales continue to benefit from consistently high reinvestment rates for term annuities with a residual capital value. Term annuity reinvestments in the period were $321.2 million, or 20% of total retail term annuity sales. Retail annuity net flows (i.e. new annuity sales less capital repayments at maturity) were $560.8 million, up from $539.9 million in the PCP. Based on the closing 30 June 2014 Life retail annuity book, the retail annuity net book growth was 7.2% for the interim period. Excluding Care Annuity net flows, net book growth for the period was 6.3%.

Institutional sales represent Challenger's Guaranteed Index Return (GIR) product (disclosed in the External unit holders' liabilities). Sales were $548.9 million for the period, mainly representing the reinvestment of GIR maturities.

Life's closing 31 December 2014 investment assets were $12.4 billion, up 13.8% ($1.5 billion) from 31 December 2013. The increase in investment assets is attributable to annuity net flows, deployment of capital into CLC following the completion of the capital management initiatives and cash earnings (net of dividends to Group).

Funds Management financial results

Challenger's Funds Management business is Australia's seventh[1] largest investment manager and one of Australia's fastest growing. Over a three year period, FUM has doubled, driven by a clear business strategy focused on investor alignment.

Fidante Partners' multi-boutique platform comprises separately branded investment management businesses. The model aligns the interests of investors, boutique investment managers and Fidante Partners.

The Fidante Partners model is delivering superior investment performance, with 97% of all funds and mandates outperforming their benchmark since inception.

Challenger Investment Partners manage fixed income and property under Challenger's brand for CLC and third party institutional investors. During the period, the Challenger Investment Partners infrastructure business merged with Access Capital Advisers to form Whitehelm Capital, and create Fidante Partners' first boutique infrastructure fund manager.

Funds Management EBIT of $20.8 million was in line with the PCP. It reflects 4.3% higher net fee income (up $2.3 million), partially offset by higher expenses (up $2.2 million or 6.6%). Net fee income reflects higher Fidante Partners net income (up $1.0 million) and higher Challenger Investment Partners fee income (up $1.3 million). Fidante Partners' net fee income includes distribution fees, administration fees and a share in the equity accounted profits of the majority of the boutique fund managers. Fidante Partners' net income also includes performance fees earned by the boutique fund managers.

Challenger Investment Partners' net income increased due to higher net performance and transaction fees (up $3.2 million), offset by lower management fees (down $1.9 million).

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[1] *Consolidated FUM for Australian fund managers – Rainmaker Roundup September 2014.*

2. Review of operations (continued)

Funds Management financial results (continued)

Management fees fell as a result of a change in the FUM mix, including the transition of the infrastructure business to Whitehelm Capital and the incorporation of Challenger's fixed income asset-backed securities (ABS) management.

RoE (pre-tax) was 32.5%, up 1.2 percentage points from the PCP.

Total FUM at 31 December 2014 was $55.2 billion, up 22.7% from 31 December 2013. Fidante Partners' FUM was $42.5 billion, up $8.8 billion or 26.1% from 31 December 2013. FUM growth was driven by strong net inflows and positive market movements.

Fidante Partners' net flows were $5.4 billion for the period, with net flows benefiting from the formation of Whitehelm Capital ($3.9 billion) and strong organic net flows across boutique managers ($1.5 billion). Net flows are benefiting from boutique investment managers' strong investment performance and Fidante Partners' extensive distribution capability.

Challenger Investment Partners' 31 December 2014 FUM was $12.7 billion, up $1.4 billion (12.4%) from 31 December 2013. The increase is as a result of the transfer on 1 July 2014 of Challenger's fixed income ABS management from CLC to Challenger Investment Partners, resulting in a net inflow of $1.8 billion, as well as organic cash inflows of $0.5 billion (including flows from CLC and third party clients in respect of property and fixed income mandates), partially offset by an outflow of $0.9 billion from the infrastructure business transition as previously mentioned.

Corporate financial results

The Corporate division comprises central functions such as the group executive, finance, treasury, legal, human resources, risk management and strategy. The Corporate division financial results also include interest received on Group cash balances and any interest and borrowing costs associated with the Group debt facilities.

Corporate's normalised net loss before tax was $31.9 million for the period, compared to a loss of $30.7 million in the PCP. The increase reflects reduced net income (down $0.5 million) and higher expenses (up $1.2 million), partially offset by lower interest and borrowing costs (down $0.5 million).

Capital management

Challenger's capital position is managed at both the Group and the prudentially-regulated CLC level, with the objective of maintaining the financial stability of the Group and CLC whilst ensuring that shareholders earn an appropriate risk adjusted return. Refer to Note 12 Contributed equity in the financial report for further information on the Group's Internal Capital Adequacy Assessment Process (Group ICAAP). As noted previously, several capital management initiatives were undertaken in the period to fund CLC's growth whilst providing capital flexibility to the Group.

Group net assets attributable to equity holders at 31 December 2014 were $2.4 billion, up from $2.2 billion at 30 June 2014. The movement in Group net assets is predominantly due to the increase in contributed equity from the previously mentioned capital management initiatives and statutory net profit after tax, partially offset by dividend payments to shareholders and reserve movements.

Dividend and share buy-back policy

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

The Board regularly reviews the mix between dividends and share buy-back as part of the Group's capital management plan. With the forecast increase in dividend franking levels, in August 2014 the Board increased the targeted dividend payout ratio to a range of 45% to 50% of normalised net profit after tax. However, the actual dividend payout ratio will depend on prevailing market conditions and capital allocation priorities.

There were no shares bought back in in the period and Challenger does not anticipate any during the second half of the 2015 financial year.

CLC regulatory capital base

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

CLC's regulatory capital base and prescribed capital amount (PCA) have been calculated based on capital standards issued by APRA. APRA issued new capital standards in October 2012, the Life and General Insurance Capital (LAGIC) standards, which became effective from 1 January 2013. CLC's regulatory capital disclosures have been prepared based on the LAGIC capital standards.

CLC's excess capital above the PCA at 31 December 2014 was $1,174.7 million, up $272.1 million from 30 June 2014, resulting in a PCA ratio of 1.75 times (30 June 2014: 1.66 times) and the common equity Tier 1 (CET1) ratio was 1.21 times (30 June 2014: 1.31 times).

The increase in excess regulatory capital resulted from increased retained earnings and the capital management initiatives undertaken in the period, partially offset by higher capital requirements as a result of CLC's increased investment in property assets. Property investment assets require a higher PCA than fixed income investments. As a result, following the increased asset allocation to property, CLC's PCA is higher and excess capital position is lower.

CLC's 31 December 2014 excess capital position includes a LAGIC transition balance of $215.2 million. Half of the remaining transition balance ($107.6 million) subsequently amortised on 1 January 2015, with the remainder due to amortise on 1 January 2016.

Subordinated debt

CLC's total regulatory capital base includes $504.7 million of admissible subordinated debt. Subordinated debt tranches issued prior to 1 January 2013 will continue to be fully eligible as Tier 2 regulatory capital under LAGIC until each tranche's first call date after 1 January 2013, and will then amortise over four years. For tranches already past their call date, under LAGIC the first coupon date is considered the first call date.

CLC's subordinated debt includes $147.2 million which had a call date on 7 June 2013. As a result, under APRA's transition arrangements, only $88.3 million (i.e. 60% of the total amount) is eligible as Tier 2 regulatory capital at 31 December 2014.

2. Review of operations (continued)

Capital management (continued)

Subordinated debt (continued)

The largest tranche of CLC's existing subordinated debt comprises $385.4 million with a call date in November 2017. As such, this tranche will continue to be fully eligible as Tier 2 regulatory capital until its call date in November 2017 and will continue to be partially eligible until November 2021.

CLC target surplus

CLC maintains a target level of capital representing APRA's PCA plus a target surplus. The target surplus is a level of excess capital that CLC seeks to carry over-and-above APRA's minimum requirement.

CLC's target surplus is set to ensure that it provides a buffer against adverse market conditions having, regard to CLC's credit rating. CLC uses internal capital models to determine its target surplus, which are risk-based and are responsive to changes in CLC's asset allocation and market conditions.

While CLC does not target a specific PCA ratio, CLC's internal capital models result in a PCA ratio target under current circumstances in the range of 1.4 to 1.6 times. This range will change over time and is dependent on numerous factors. CLC's PCA ratio at 31 December 2014 was 1.75 times, up from 1.66 times at 30 June 2014. A higher PCA ratio is currently maintained as CLC's capital position contemplates the amortisation of the LAGIC transition balance of $107.6 million on 1 January 2015 and 1 January 2016.

CLC excess regulatory capital and Group cash

In addition to CLC's excess regulatory capital, Challenger maintains cash at a Group level which can be used to meet regulatory requirements. Group cash at 31 December 2014 was $126.0 million, down $15.2 million from 30 June 2014. Challenger maintains an undrawn Group corporate debt facility of $350.0 million to provide additional financial flexibility. The facility remained undrawn throughout the period.

CLC's excess regulatory capital plus Group cash at 31 December 2014 was $1,300.7 million, up $256.9 million from $1,043.8 million at 30 June 2014. The increase in the excess capital and Group cash includes the impact of the capital initiatives, positive retained earnings and changes in underlying capital intensity in CLC.

APRA's Level 3 (conglomerate) proposals

The Group is a Level 3 Head under the APRA conglomerates framework. Level 3 groups are groups of companies that perform material activities across more than one APRA-regulated industry and/or in one or more non-APRA regulated industries. APRA is currently developing a supervisory framework for Level 3 (conglomerate) groups, which was due to be effective from 1 January 2015. Draft Level 3 standards were issued by APRA in May 2013. However, APRA is yet to confirm the implementation date. In August 2014, APRA deferred a decision on its final standards and implementation until the Government response to the recommendations of the Financial System Inquiry is announced.

Credit ratings

Challenger Limited and CLC are rated by Standard & Poor's (S&P). In December 2014, S&P reaffirmed both CLC and Challenger Limited's credit ratings.

Ratings were confirmed as:

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

The S&P ratings reflect the financial strength of Challenger Limited and CLC. In particular, they demonstrate Challenger's strong business profile, positive earnings and robust capital position.

3. Dividends and share buy-back

On 19 August 2014, the Directors of the Company declared a final dividend on ordinary shares in respect of the year ended 30 June 2014 of 13.5 cents per share (franked at 40%). The final dividend totalling $71.3 million was paid on 30 September 2014.

On 16 February 2015, the Directors declared an interim dividend on ordinary shares in respect of the half year ended 31 December 2014 of 14.5 cents per share (franked at 70%). The interim dividend is payable on 31 March 2015, and has not been provided for in the 31 December 2015 interim financial report.

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

The Challenger Limited Board regularly reviews the mix between dividends and share buy back as part of the Group's capital management plan. With the forecast increase in dividend franking levels, in August 2014 the Challenger Limited Board increased the targeted dividend payout ratio to a range of 45% to 50% of normalised net profit after tax.

Challenger's final 2015 dividend is expected to be in the range of 45% to 50% of normalised net profit after tax and 100% franked. However, the actual dividend payout ratio and franking will depend on the prevailing market conditions and capital allocation priorities.

There is no dividend reinvestment plan in operation for the interim 2015 dividend.

There were no shares bought back in in the period and Challenger does not anticipate buying back shares during the second half of the 2015 financial year.

4. Likely developments and expected results

Challenger 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 three core strategic objectives:

1. to be recognised as the leader in retirement income solutions in Australia;
2. to increase the portion of the Australian retirement pool allocated to secure and lifetime income products; and
3. within the Funds Management business, to be an active investment manager providing superior returns from aligned platforms.

Life segment outlook

The Australian retirement incomes market is expected to grow strongly over the next 20 years as Australia's baby boomers (born 1946 to 1964) move from retirement saving to retirement spending. Over this period, the number of Australians over 65, which is the target annuity demographic, will increase by 75%.

4. Likely developments and expected results (continued)

Life segment outlook (continued)

Challenger Life is well positioned to benefit from changes in retiree risk preferences, including increased focus on longevity risk by retirees. Annuities address many of the financial concerns retirees face. Demand for annuity products is being amplified through Challenger's market-leading distribution, product innovation and strong retirement incomes brand recognition.

Challenger is also investing in technology to allow annuities to easily integrate with account-based pensions as there is a growing acceptance that annuities are part of an optimal retirement income strategy. Integrating annuities with account-based pensions supports income layering and enables retirement income model portfolios to provide guaranteed incomes. In the period, Challenger announced strategic partnerships with Colonial First State and VicSuper to integrate Challenger annuities into both platforms and product offerings. Challenger expects to announce further partnerships, which will drive additional long-term annuity sales and business growth.

The Australian Federal Government commissioned the Financial System Inquiry to provide a blueprint for Australia's financial system over the next decade. The Financial System Inquiry recommended that the retirement phase of superannuation would benefit greatly from pre-selected retirement products for members that provide both regular and stable income streams overlaid with longevity protection. Annuities provide both and are expected to be part of pre-selected retirement products offered by superannuation funds.

As Australia's leading retirement income specialist, Challenger is uniquely positioned to further benefit should the Government adopt the Financial System Inquiry recommendations.

Funds Management segment outlook

The Australian funds management market remains an attractive market underpinned by mandated superannuation contribution flows. Superannuation contributions increased to 9.5% of gross salaries on 1 July 2014 and are scheduled to increase to 12.0% by 2022. The mandated nature of Australia's superannuation system is expected to significantly grow the size of Australia's superannuation assets from $1.9 trillion[1] at September 2014 to over $7 trillion[2] in the next 20 years.

Fidante Partners continues to identify new investment manager talent. The platform has a variety of managers across Australian equities, international equities, fixed income and infrastructure. Fidante Partners is adding capacity to existing managers and has significant capacity to increase FUM, which is expected to underwrite future earnings growth.

Challenger Investment Partners continues to build out its client base and product offering, and remains focused on growing its third party fiduciary business. There are opportunities to add new mandates from domestic and international institutions, superannuation funds and sovereign wealth funds.

Challenger's Funds Management business is well positioned to benefit from growth in Australia's superannuation system. The Funds Management platform has multiple brands and strategies with significant manager capacity. Coupled with Challenger's distribution capability, institutional strength administration platform and strong boutique investment manager performance, the Funds Management business is well positioned to continue to increase shareholder returns.

Risks

The outlook above is subject to the following business risks:

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

Guidance for the 2015 financial year

Retail annuity net book growth

In November 2014, Challenger announced it would discontinue the Care Annuity product in its current form as a result of the Department of Social Services redefining how the Care Annuity would be treated for social security purposes. A replacement Care Annuity product is in development and Challenger expects to re-enter the aged care market. At the time of the Department of Social Services announcement in November 2014, Challenger withdrew its financial year 2015 net book growth guidance (12% to 14%) until further details on the Care Annuity could be provided.

The 2015 retail annuity net book growth is now expected to grow between 11% and 13%, reduced by 1% from the original growth target above. The replacement Care Annuity product is still in development and the launch date of a replacement product is still to be determined. The growth target of between 11% and 13% is not dependent on a replacement product being launched in the second half of this financial year.

Based on the closing 30 June 2014 Life retail annuity book ($7,824 million), book growth of between 11% and 13% equates to total growth of between ~$850 million and ~$1.0 billion in financial year 2015.

Life cash operating earnings

Life's COE guidance is $535.0 million to $545.0 million and includes the impact of both Accurium earnings and the life risk reinsurance transactions undertaken, as well as the capital management initiatives completed in the current period.

Based on the mid-point of both retail net book growth and COE guidance, the implied second half 2015 financial year COE margin is expected to be unchanged from the first half at circa 4.4%.

Normalised cost to income ratio

Challenger's medium-term normalised cost to income ratio target is 32% to 36%.

Challenger's 2015 financial year cost to income ratio is expected to be approximately 34%, which is broadly unchanged from the 2014 financial year. An increase in total expenses is expected in the current financial year in order to support the growth in Challenger's business, including costs associated with integrating annuity products on platforms and expanding Life's asset origination capability.

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[1] *APRA Superannuation statistics – September 2014*

[2] *Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2013–2033 – September 2013.*

5. 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.

6. Rounding

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

7. Auditor's independence declaration

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

EY
Building a better working world

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

Tel: +61 2 9248 5555
Fax: +61 2 9248 5959
ey.com/au

Auditor's independence declaration to the Directors of Challenger Limited

In relation to our review of the half year financial report of Challenger Limited for the six months ended 31 December 2014, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.

Ernst & Young

Ernst & Young

David Jewell

D N Jewell
Partner

Sydney
16 February 2015

Liability limited by a scheme approved under Professional Standards Legislation.

8. Authorisation

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

G A Cubbin
Director

Sydney
16 February 2015

B R Benari
Director

Sydney
16 February 2015

Interim financial report

Contents — **Page**

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

Income statement and statement of comprehensive income

For the six months ended 31 December

	Note	2014 $M	2013 $M
Revenue	3	846.6	772.3
Expenses	4	(520.8)	(445.1)
Finance costs		(149.8)	(121.6)
Share of profits of associates		6.2	6.8
Profit before income tax		**182.2**	**212.4**
Income tax expense	5	(36.2)	(25.1)
Profit for the period		**146.0**	**187.3**
Profit attributable to equity holders		130.1	166.3
Profit attributable to non-controlling interests		15.9	21.0
Profit for the period		**146.0**	**187.3**
Other comprehensive income			
Items that may be reclassified to profit and loss, net of tax			
Translation of foreign entities		9.2	0.7
Hedge of net investment in foreign entities		(9.9)	3.8
Cash flow hedges – SPV[1]		2.5	(2.9)
Other comprehensive income net of tax for the period		**1.8**	**1.6**
Total comprehensive income for the period		**147.8**	**188.9**
Comprehensive income attributable to equity holders		131.9	167.9
Comprehensive income attributable to non-controlling interests		15.9	21.0
Total comprehensive income for the period		**147.8**	**188.9**
Earnings per share (cents)			
Basic earnings per share	7	24.2	32.3
Diluted earnings per share	7	22.8	30.8

[1] SPV = Special Purpose Vehicles.

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

Statement of financial position

As at

	Note	31 Dec 2014 $M	30 June 2014 $M	31 Dec 2013 $M
Assets				
Cash and cash equivalents		682.9	391.4	395.1
Cash and cash equivalents – SPV		200.0	216.6	255.1
Receivables		216.7	148.5	223.5
Mortgage assets – SPV		2,561.2	2,978.9	3,382.1
Derivative assets		733.8	318.0	237.5
Financial assets – fair value through profit and loss	8	10,424.5	10,027.3	9,582.3
Investment property held for sale	9	177.9	222.7	-
Investment and development property	9	2,735.6	2,222.1	2,585.0
Finance leases		44.5	39.4	11.1
Property, plant and equipment		138.1	138.1	143.6
Current tax assets		9.9	-	0.5
Investments in associates		39.4	39.4	36.4
Other assets		63.7	35.1	42.7
Goodwill		531.0	531.0	506.8
Other intangible assets		16.2	14.8	15.3
Total assets		**18,575.4**	**17,323.3**	**17,417.0**
Liabilities				
Payables		191.0	443.3	222.0
Derivative liabilities		721.7	222.5	326.5
Interest bearing financial liabilities	10	2,835.3	2,370.0	2,311.8
Interest bearing financial liabilities – SPV		2,518.5	2,931.4	3,335.2
External unit holders' liabilities		954.8	1,072.4	1,000.3
Provisions		20.5	26.5	26.1
Current tax liabilities		-	34.4	-
Deferred tax liabilities		150.4	122.4	161.7
Life contract liabilities	11	8,573.1	7,824.3	7,617.2
Total liabilities		**15,965.3**	**15,047.2**	**15,000.8**
Net assets		**2,610.1**	**2,276.1**	**2,416.2**
Equity				
Contributed equity	12	1,524.3	1,237.5	1,263.2
Reserves		13.8	69.8	52.1
Retained earnings		904.8	846.0	737.0
Total equity attributable to equity holders of Challenger Limited		**2,442.9**	**2,153.3**	**2,052.3**
Non-controlling interests		167.2	122.8	363.9
Total equity		**2,610.1**	**2,276.1**	**2,416.2**

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

Statement of changes in equity

	Note	Attributable to equity holders of Challenger Limited								
		Contri-buted equity $M	Share based payment reserve $M	Cash flow hedge reserve – SPV $M	Foreign currency transl-ation reserve $M	Adjusted control-ling interest reserve $M	Retained earnings $M	Total share-holder equity $M	Non-control-ling interests $M	Total equity $M
Balance at 1 July 2014		1,237.5	54.9	(0.4)	(4.0)	19.3	846.0	2,153.3	122.8	2,276.1
Profit for the period		-	-	-	-	-	130.1	130.1	15.9	146.0
Other comprehensive income for the period		-	-	2.5	(0.7)	-	-	1.8	-	1.8
Total comprehensive income for the period		**-**	**-**	**2.5**	**(0.7)**	**-**	**130.1**	**131.9**	**15.9**	**147.8**
Other equity movements										
Ordinary shares issued	12	287.2	-	-	-	-	-	287.2	-	287.2
Shares purchased in the CPP Trust	12	(60.9)	-	-	-	-	-	(60.9)	-	(60.9)
Vested shares released from the CPP Trust	12	75.5	-	-	-	-	-	75.5	-	75.5
CPP deferred share purchases and settlements	12	(15.0)	-	-	-	-	-	(15.0)	-	(15.0)
Share-based payment expense less releases		-	(56.1)	-	-	-	-	(56.1)	-	(56.1)
Dividends paid	6	-	-	-	-	-	(71.3)	(71.3)	-	(71.3)
Other movements		-	-	-	-	(1.7)	-	(1.7)	28.5	26.8
Balance at 31 Dec 2014		**1,524.3**	**(1.2)**	**2.1**	**(4.7)**	**17.6**	**904.8**	**2,442.9**	**167.2**	**2,610.1**
Balance at 1 July 2013		1,271.9	30.0	3.6	(2.0)	18.2	625.7	1,947.4	346.8	2,294.2
Profit for the period		-	-	-	-	-	166.3	166.3	21.0	187.3
Other comprehensive income for the period		-	-	(2.9)	4.5	-	-	1.6	-	1.6
Total comprehensive income for the period		**-**	**-**	**(2.9)**	**4.5**	**-**	**166.3**	**167.9**	**21.0**	**188.9**
Other equity movements										
Shares purchased in the CPP Trust	12	(15.6)	-	-	-	-	-	(15.6)	-	(15.6)
Vested shares released from the CPP Trust	12	15.3	-	-	-	-	-	15.3	-	15.3
CPP deferred share purchases and settlements	12	(8.4)	-	-	-	-	-	(8.4)	-	(8.4)
Share-based payment expense less releases		-	(2.8)	-	-	-	-	(2.8)	-	(2.8)
Dividends paid	6	-	-	-	-	-	(55.0)	(55.0)	-	(55.0)
Other movements		-	-	-	-	3.5	-	3.5	(3.9)	(0.4)
Balance at 31 Dec 2013		**1,263.2**	**27.2**	**0.7**	**2.5**	**21.7**	**737.0**	**2,052.3**	**363.9**	**2,416.2**

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

Statement of cash flows

For the six months ended 31 December

	Note	2014 $M	2013 $M
Operating activities			
Receipts from customers		299.1	321.6
Annuity and premium receipts	11	1,578.6	1,459.8
Annuity and claim payments	11	(1,182.2)	(1,079.6)
Payments to reinsurer	11	(4.6)	(4.0)
Receipts from external unit holders		548.9	290.1
Payments to external unit holders		(671.3)	(1,042.1)
Interest paid to external unit holders		(47.6)	(18.4)
Payments to vendors and employees		(274.2)	(299.0)
Dividends received		34.0	26.9
Interest received		270.7	271.8
Interest paid		(39.1)	(38.4)
Income tax paid		(43.7)	(2.2)
Net cash inflows/(outflows) from operating activities	14	**468.6**	**(113.5)**
Investing activities			
Payments for net purchases of investments		(813.3)	(432.3)
Net mortgage loan repayments		418.8	609.0
Payments for net purchases of property, plant and equipment		(3.7)	(3.2)
Net cash (outflows)/inflows from investing activities		**(398.2)**	**173.5**
Financing activities			
Proceeds from issue of Challenger Capital Notes		345.0	-
Proceeds from issue of ordinary shares		290.2	-
Costs associated with issue of Challenger Capital Notes and ordinary shares		(13.4)	-
Proceeds from borrowings – interest bearing liabilities		194.6	21.5
Repayment of borrowings – interest bearing liabilities		(464.6)	(662.1)
Payments for treasury shares, net of option proceeds and share buy-back[1]		(74.8)	(15.6)
Dividends paid		(71.3)	(55.0)
Distributions paid to non-controlling interests		(1.2)	(7.9)
Net cash inflows/(outflows) from financing activities		**204.5**	**(719.1)**
Net increase/(decrease) in cash and cash equivalents		274.9	(659.1)
Cash and cash equivalents at the beginning of the period		608.0	1,309.3
Cash and cash equivalents at the end of the period		**882.9**	**650.2**
Cash and cash equivalents		682.9	395.1
Cash and cash equivalents – SPV		200.0	255.1
Cash and cash equivalents at the end of the period		**882.9**	**650.2**

[1]For the period ending 31 December 2014, the amount relates to payments for treasury shares only.

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

Notes to the financial statements

For the six months ended 31 December 2014

1. Basis of preparation and summary of significant accounting policies

Challenger Limited (the Company or the parent entity) is a company limited by shares, incorporated in Australia, whose shares are publicly traded on the Australian Securities Exchange (ASX) under code CGF.

This interim financial report of Challenger Limited and its controlled entities (the Group) for the six months ended 31 December 2014 was authorised for issue in accordance with a resolution of the Directors of the Company on 16 February 2015.

(i) Basis of preparation

This general purpose interim financial report for the six months ended 31 December 2014 has been prepared in accordance with AASB 134 *Interim Financial Reporting* and the *Corporations Act 2001*.

The interim financial report does not include all the notes normally included in an annual financial report. It is recommended that this interim financial report be read in conjunction with the financial report for the year ended 30 June 2014 and any public announcements made by the Group in accordance with the continuous disclosure obligations of the ASX listing rules.

Unless stated otherwise, the interim financial report is presented in Australian dollars and amounts are rounded to the nearest $100,000.

(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 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 add 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

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 standard also includes the new expected credit loss model for impairment. The model requires an entity to recognise expected credit losses at all times and to update the amount of expected credit losses at each reporting date to reflect changes in credit risk of the financial instruments.

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

AASB 15 *Revenue from Contracts with Customers*

The new revenue standard establishes a single, comprehensive framework for revenue recognition and replaces the previous revenue standards AASB 118 *Revenue* and AASB 111 *Construction Contracts*. The standard does not apply to leases, financial instruments and insurance contracts. 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.

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.

2. Segment information

Business segments

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

	Life		Funds Management		Total reporting segments		Corporate and other[2]		Total	
For the six months ended 31 December	**2014 $M**	**2013 $M**	**2014 $M**	**2013 $M**	**2014 $M**	**2013 $M**	**2014 $M**	**2013 $M**	**2014 $M**	**2013 $M**
Net income	257.8	237.2	56.1	53.8	313.9	291.0	0.7	1.2	314.6	292.2
Operating expenses	(42.0)	(36.6)	(35.3)	(33.1)	(77.3)	(69.7)	(30.9)	(29.7)	(108.2)	(99.4)
Normalised EBIT	215.8	200.6	20.8	20.7	236.6	221.3	(30.2)	(28.5)	206.4	192.8
Interest and borrowing costs							(1.7)	(2.2)	(1.7)	(2.2)
Normalised net profit/(loss) before tax	**215.8**	**200.6**	**20.8**	**20.7**	**236.6**	**221.3**	**(31.9)**	**(30.7)**	**204.7**	**190.6**
Tax on normalised profit									(49.8)	(27.1)
Normalised net profit after tax									**154.9**	**163.5**
Investment experience after tax									(24.8)	2.8
Profit attributable to equity holders									**130.1**	**166.3**
Other statutory segment information										
Revenue from external customers	386.0	321.5	64.4	58.1	450.4	379.6	0.4	0.2	450.8	379.8
Interest revenue	370.5	370.6	-	-	370.5	370.6	25.3	21.9	395.8	392.5
Interest expense	(143.8)	(119.2)	-	-	(143.8)	(119.2)	(6.0)	(2.4)	(149.8)	(121.6)
Intersegment revenue	(12.4)	(11.7)	12.4	11.7	-	-	-	-	-	-
Depreciation and amortisation	(6.1)	(5.3)	-	-	(6.1)	(5.3)	(3.8)	(3.8)	(9.9)	(9.1)
As at 31 December										
Segment assets	12,994.3	11,379.6	149.7	147.4	13,144.0	11,527.0	5,255.9	5,402.3	18,399.9	16,929.3
Segment liabilities	(10,633.4)	(9,428.2)	(23.4)	(16.8)	(10,656.8)	(9,445.0)	(5,300.2)	(5,432.0)	(15,957.0)	(14,877.0)
Net assets attributable to equity holders	**2,360.9**	**1,951.4**	**126.3**	**130.6**	**2,487.2**	**2,082.0**	**(44.3)**	**(29.7)**	**2,442.9**	**2,052.3**

[1] Refer the next page for definitions of the terms used in the management view of segments.
[2] Other includes corporate companies, corporate SPV, non-controlling interests and group eliminations.

Definitions

Operating segments

The format of the segment information is the same as that provided to the Chief Executive Officer (the chief operating decision maker) of the Group. The Group operates in the following segments:

Life

The Life segment principally includes the annuity and life insurance business carried out by Challenger Life Company Limited (CLC) and Accurium Actuarial Pty Limited (SMSF actuarial certificates). CLC invests in assets providing long-term income streams for customers. CLC offers fixed rate retirement and superannuation products that are designed for investors who are seeking a low-risk investment for a period of time and seek capital protection.

Funds Management

Funds Management earns fees from its Fidante Partners and Challenger Investment Partners operations, providing an end-to-end funds management business as well as managing a number of unlisted fund mandates. Funds Management has equity investments in a number of the Fidante Partners boutique fund managers and, through the Challenger Investment Partners business, offers a range of managed investments across the major asset classes.

Corporate and other

Consists of other income and costs that fall outside the day-to-day operations of the reportable segments. These include the costs of the Group CEO and CFO, shared services across the Group, long-term incentive costs, Directors' fees, corporate borrowings and associated borrowing costs and shareholder registry services.

To reconcile to Group results, Corporate and other also includes eliminations and non-core activities of the Group.

Normalised vs. statutory results

Net income and **operating expenses** differ from **revenue** and **expenses** as disclosed in the income statement as certain direct costs (including commissions, property expenses and management fees) included in expenses are netted off against revenues in deriving the management view of net income above. Net income consists of the following sub-categories of management views of revenue:

- normalised cash operating earnings (Life segment).
- net fee income (Funds Management segment).
- other income (Corporate and other segment).

2. Segment information (continued)

Definitions (continued)

Normalised vs. statutory results (continued)

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, commission and fees.

Normalised EBIT

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

Interest and borrowing costs differ from **finance costs** as disclosed in the income statement for similar reasons to revenue and expenses, with the major difference arising from the netting of SPV finance costs against SPV revenue in 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 income statement, particularly during periods of market volatility. As the Group is generally a long-term holder of assets, due to assets being held to match the term of 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 normalised results so as to more accurately reflect the underlying performance of the Group.

Investment experience is calculated as the difference between the actual investment gains/losses (both realised and unrealised) and the normalised capital growth (see below. Investment experience also includes any actuarial assumption changes, including the impact of changes in economic variables. These assumption changes include changes to bond yields and inflation factors, expense assumptions, accounting losses on writing new business net of the unwind of prior period losses and other factors applied in the valuation of life contract liabilities. 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 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.

Actuarial assumption changes represent the impact of changes in macroeconomic variables, including bond yields and inflation factors, expense assumptions, mark to market 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 derivative hedges.

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.

Reconciliation of management to statutory view of after-tax profit	31 Dec 2014 $M	31 Dec 2013 $M
Operating segments normalised net profit before tax	236.6	221.3
Corporate and other normalised net loss before tax	(31.9)	(30.7)
Normalised net profit before tax (management view of pre-tax profit)	**204.7**	**190.6**
Tax on normalised profit	(49.8)	(27.1)
Normalised net profit after tax	**154.9**	**163.5**
Investment experience after tax	(24.8)	2.8
Profit attributable to non-controlling interests excluded from management view	15.9	21.0
Statutory view of profit after tax	**146.0**	**187.3**

2. Segment information (continued)

Reconciliation of management view of revenue to statutory revenue	31 Dec 2014 $M	31 Dec 2013 $M
Operating segments	313.8	291.0
Corporate and other	0.7	1.2
Net income (management view of revenue)	**314.5**	**292.2**
Expenses and finance costs offset against revenue		
SPV expenses and finance costs offset against SPV income	46.6	63.0
Commission expenses offset against related income	22.6	25.9
Amortisation of deferred portfolio and origination costs offset against mortgage income	0.7	0.9
Change in life contract liabilities and reinsurance contracts recognised in expenses	296.9	231.0
Property-related expenses offset against property income	27.4	32.1
Interest and loan amortisation costs	100.6	59.6
Management fees	43.9	41.1
Adjustment for non-controlling interests and other items	28.8	22.4
	567.5	476.0
Difference between management view of investment experience and statutory recognition		
Actual capital growth	45.4	15.8
Normalised capital growth	(34.5)	(25.9)
Actuarial assumption changes	(46.3)	14.2
Statutory view of revenue (refer Note 3 Revenue)	**846.6**	**772.3**

3. Revenue

	31 Dec 2014 $M	31 Dec 2013 $M
Fixed income securities and cash[1]	566.2	448.7
Investment property and property securities	224.4	111.9
Equity and infrastructure investments	57.7	34.4
Fee revenue	77.7	65.3
Life contract and reinsurance revenue[2]	(60.1)	113.3
Realised and unrealised losses on hedges and foreign exchange translation	(19.3)	(1.3)
Total revenue	**846.6**	**772.3**

[1] Includes fair value movements on subordinated debt.
[2] 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 4 Expenses.

4. Expenses

	31 Dec 2014 $M	31 Dec 2013 $M
Life contract and reinsurance expenses[1]	296.9	231.0
Investment property-related expenses[2]	36.5	32.1
Fee expenses	44.9	42.1
Commission expenses	22.6	25.9
Employee benefits expenses	78.7	71.0
Other expenses	41.2	43.0
Total expenses	**520.8**	**445.1**

[1] Cost of life 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 3 Revenue.

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

5. Income tax

Analysis of income tax expense	31 Dec 2014 $M	31 Dec 2013 $M
Current income tax benefit/(expense) for the period	16.9	(15.5)
Current income tax benefit prior period adjustment	0.4	3.1
Deferred income tax expense	(53.5)	(12.7)
Income tax expense	**(36.2)**	**(25.1)**
Income tax (expense)/benefit on translation of foreign entities	(3.7)	2.3
Income tax benefit/(expense) on hedge of net investment in foreign entities	4.3	(2.2)
Income tax benefit from other comprehensive income	**0.6**	**0.1**
Reconciliation of income tax expense		
Profit before income tax	**182.2**	**212.4**
Prima facie income tax based on the Australian company tax rate of 30% (31 Dec 2013: 30%)	(54.7)	(63.7)
Tax effect of amounts not assessable/deductible in calculating taxable income:		
- non-assessable and non-deductible items[1]	6.8	29.2
- rate differential on offshore income	1.1	1.5
- non controlling interests	4.8	6.3
- other items	5.8	1.6
Income tax expense	**(36.2)**	**(25.1)**
Underlying effective tax rate[2]	**21.8%**	**21.0%**

[1] The 31 December 2013 amounts included a reduction in tax expense of $15.0 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 prior financial year was the final period for this tax deduction.

[2] The calculation of the underlying effective tax rate excludes the 31 December 2013 reduction in income tax expense of $15.0 million (in respect of the application of the TOFA law) and non-controlling interests profit of $15.9 million ($21.0 million at 31 December 2013) from profit before income tax.

Unused capital losses

The Group has $132.6 million (30 June 2014: $141.0 million) of gross unused capital losses for which no deferred tax asset has been recognised.

Unused revenue losses

All revenue losses of the Challenger tax consolidated group have been recognised as a deferred tax asset. A deferred tax asset in relation to $27.8 million (June 2014: $24.4 million) of net revenue losses has not been recognised in respect of non-tax consolidated group entities as it is unlikely sufficient assessable gains will be derived by these entities to utilise the losses.

6. Dividends paid and proposed

	31 Dec 2014 $M	31 Dec 2013 $M
Dividends declared and paid during the period		
Final 30 June 2014 40% franked dividend: 13.5 cents (2013: 10.5 cents unfranked)	71.3	55.0
Dividend proposed (not recognised as a liability at period end)		
2015 interim 70% franked dividend: 14.5 cents (2014 interim: 12.5 cents unfranked)	81.3	65.3

	6 months to 31 Dec 2014 $M	Year to 30 June 2014 $M
Group franking credits account		
Franking account balance at the beginning of the period	25.3	8.0
Franking credits from the payment of income tax during the period	43.2	9.3
Franking credits from dividends received during the period	5.0	6.9
Franking debit from final 30 June 2014 dividend payments to shareholders	(12.3)	-
Other	-	1.1
Franking account balance at the end of the period	**61.2**	**25.3**

There is no dividend reinvestment plan in operation for dividends.

7. Earnings per share

	31 Dec 2014 cents	31 Dec 2013 cents
Basic earnings per share	24.2	32.3
Diluted earnings per share	22.8	30.8
	$M	**$M**
Profit attributable to equity holders used in the calculation of earnings per share	130.1	166.3
Add: interest expense on Challenger capital notes	3.7	-
Earnings used in calculation of diluted earnings per share	**133.8**	**166.3**
Number of shares	**Number**	**Number**
Weighted average ordinary shares for basic earnings per share calculation	538,215,193	514,460,073
Weighted average effect of dilution	48,392,978	25,874,647
Weighted average ordinary shares for diluted earnings per share calculation	**586,608,171**	**540,334,720**

In determining the weighted average number of ordinary shares used in the calculation of earnings per share, a reduction is made for the average number of treasury shares held. The weighted average number of treasury shares for the period was 17,818,025 (31 December 2013: 16,402,512). There have been no material transactions involving ordinary shares or potential ordinary shares since the reporting date and before the completion of the financial report.

On 9 October 2014, the Company completed the issue of the Challenger Capital Notes (Notes), raising $345.0 million of new debt funding. The Notes may be redeemed or resold for cash or converted by the Company on 25 May 2020 (or at an earlier date in certain circumstances), subject to APRA's prior written approval. Otherwise, the Notes will mandatorily convert into ordinary equity on 25 May 2022 (subject to certain conditions being satisfied). If the conditions to mandatory conversion are not met on 25 May 2022, conversion will be deferred to the next payment date when the conditions are retested.

The Notes have not been included in the determination of basic earnings per share but have been included in the diluted earnings per share weighted for the period since the Notes were on issue. The impact on the weighted average effect of dilution was 25,413,833 shares.

8. Financial assets – fair value through profit and loss

	31 Dec 2014 $M	30 June 2014 $M	31 Dec 2013 $M
Fixed income securities			
Domestic sovereign bonds and semi-government bonds	1,740.7	1,625.8	1,393.9
Floating rate notes and corporate bonds	4,721.0	4,682.4	4,480.0
Residential mortgage and asset-backed securities	2,351.3	2,062.6	2,015.2
Non-SPV mortgage assets	261.0	153.2	196.6
	9,074.0	**8,524.0**	**8,085.7**
Equity securities			
Shares in listed and unlisted corporations	59.1	73.9	154.3
Unit trusts, managed funds and other	245.2	307.9	276.4
	304.3	**381.8**	**430.7**
Infrastructure investments			
Units in listed and unlisted infrastructure trusts	277.1	360.7	331.9
Other infrastructure investments	310.2	291.5	273.1
	587.3	**652.2**	**605.0**
Property securities			
Indirect property investments in listed and unlisted trusts	458.9	469.3	460.9
Total financial assets – fair value through profit and loss	**10,424.5**	**10,027.3**	**9,582.3**

9. Investment and development property

	31 Dec 2014 $M	30 June 2014 $M	31 Dec 2013 $M
Investment property held for sale[1]	177.9	222.7	-
Investment property in use	2,640.0	2,125.5	2,488.7
Investment property under development[2]	19.1	18.8	18.7
Total investment property	**2,837.0**	**2,367.0**	**2,507.4**
Development property[3]	76.5	77.8	77.6
Total investment and development property	**2,913.5**	**2,444.8**	**2,585.0**

[1] Held for sale properties: CSIRO $170.0 million (a contract of sale was exchanged on 25 August 2014 and settled on 30 January 2015); Osada Nagasaki $7.9 million.
[2] Investment property under development is shown at fair value.
[3] Development property is held at the lower of cost or net realisable value, being fair value on completion less costs to complete and estimated selling costs.

10. Interest bearing financial liabilities

	31 Dec 2014		30 June 2014		31 Dec 2013	
	Facility	Outstanding	Facility	Outstanding	Facility	Outstanding
	$M	$M	$M	$M	$M	$M
Bank loans						
Recourse – corporate	350.0	-	350.0	-	250.0	-
Non-recourse – controlled property trusts[1]	771.4	555.9	809.0	646.0	813.9	752.8
Non-recourse – controlled infrastructure trusts	206.1	205.0	206.1	206.1	206.1	206.1
Non-recourse – repurchase agreements	1,163.3	1,163.3	978.3	978.3	729.2	729.2
Total bank loans	**2,490.8**	**1,924.2**	**2,343.4**	**1,830.4**	**1,999.2**	**1,688.1**
Non-recourse non-bank loans						
Subordinated debt issuance	560.7	560.7	525.9	525.9	509.5	509.5
Challenger Capital Notes	336.2	336.2	-	-	-	-
Loan note finance	3.3	3.3	3.2	3.2	103.1	103.1
Controlled property trusts	10.9	10.9	10.5	10.5	11.3	11.1
Total non-bank loans	**911.1**	**911.1**	**539.6**	**539.6**	**623.9**	**623.7**
Total interest bearing financial liabilities	**3,401.9**	**2,835.3**	**2,883.0**	**2,370.0**	**2,623.1**	**2,311.8**
Current		1,178.1		1,043.1		729.3
Non-current		1,657.2		1,326.9		1,582.5
		2,835.3		**2,370.0**		**2,311.8**

[1] Total facility limit consists of redraw loan facilities limits totalling $300.0 million and non-redraw loan facilities limits totalling $492.6 million.

Bank loans

Recourse – corporate

The facility was renewed on 13 May 2014 with amended terms. The amount was increased to $350.0 million in two equal tranches with three and five year durations which are secured by guarantees in place between members of the Group. A floating interest rate was applicable to this facility during the period.

Non-recourse - controlled property trusts

The loans have variable terms and are generally secured by way of first-ranking mortgages over the investment properties. The 31 December 2014 balance includes $237.1 million (30 June 2014: $246.0 million) of Yen denominated loans in the Japanese property trusts. Other controlled property trusts loans total $340.0 million (June 2014: $400.0 million). A total of $11.5 million of these liabilities are secured against properties available for sale and so have been classified as current.

Non-recourse - controlled infrastructure trusts

The facility expires in June 2016 and is secured by way of first-ranking mortgages over the corresponding infrastructure assets.

Non-recourse - repurchase agreements

Challenger Life Company Limited (CLC) has entered into repurchase agreements with the Reserve Bank of Australia and other banking institutions whereby fixed income securities (or portfolios of fixed income securities), predominantly Commonwealth Government and semi-government bonds, are sold for cash whilst simultaneously agreeing to repurchase the securities at a fixed price and fixed date in the future. These agreements are used for liquidity management purposes and to hedge exposures on the external unit holders' liabilities, and are interest bearing, with interest factored into the sellback price and paid on repurchase.

Non-recourse 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. 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 Life and General Insurance Capital (LAGIC) standards on 1 January 2013, this subordinated debt issuance continues to be fully eligible as Tier 2 regulatory capital until each tranche's first call date (or coupon date,

10. Interest bearing financial liabilities (continued)

Non-recourse non-bank loans (continued)

Subordinated debt issuance (continued)

where the tranche was already past its call date) after 1 January 2013, thereafter amortising over four years. At 31 December 2014, $504.7 million of the subordinated debt was eligible as Tier 2 regulatory capital.

Challenger Capital Notes

On 9 October 2014, the Company completed the issue of the Challenger Capital Notes (Notes), raising $345.0 million of new debt funding. The Notes may be redeemed or resold for cash or converted by the Company on 25 May 2020 (or at an earlier date in certain circumstances), subject to APRA's prior written approval. Otherwise, the Notes will mandatorily convert into ordinary equity on 25 May 2022 (subject to certain conditions being satisfied). If the conditions to mandatory conversion are not met on 25 May 2022, conversion will be deferred to the next payment date when the conditions are retested. Conversion will occur on the payment date on which the mandatory conversion conditions are satisfied. Costs associated with the transaction have been capitalised against the liability and will be expensed to the profit and loss over the life of the Notes. The Notes will not constitute regulatory capital of the Company, although APRA has confirmed that the proceeds from the Notes may be used to fund a subscription for additional Tier 1 capital of CLC.

Loan note finance

The Group entered into a restricted recourse GBP25.0 million loan in September 2006 that is secured against properties. The loan balance plus all capitalised interest has been marked to fair value at 31 December 2014, consistent with the treatment of the corresponding (offsetting) asset.

Controlled property trusts

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

11. Life contract liabilities

	31 Dec 2014 $M	30 June 2014 $M	31 Dec 2013 $M
Life investment contract liabilities – at fair value	6,568.3	6,210.1	6,406.8
Life insurance contract liabilities – at margin on services value[1]	1,950.8	1,556.6	1,155.4
Reinsurance contract liabilities – at margin on services value	54.0	57.6	55.0
Total life contract liabilities	**8,573.1**	**7,824.3**	**7,617.2**

[1] 31 December 2014 includes $182.3 million (30 June 2014: $105.2 million) of present value of future profit margins in relation to wholesale life reinsurance risk contracts.

	Life investment contract liabilities		Life insurance contract liabilities		Reinsurance contract liabilities		Total life contract liabilities	
Movement in life contract liabilities	31 Dec 2014 $M	31 Dec 2013 $M	31 Dec 2014 $M	31 Dec 2013 $M	31 Dec 2014 $M	31 Dec 2013 $M	31 Dec 2014 $M	31 Dec 2013 $M
Opening balance	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	1,255.8	1,186.9	322.8	272.9	-	-	1,578.6	1,459.8
Payments and withdrawals	(1,086.3)	(1,035.2)	(95.9)	(44.4)	(4.6)	(4.0)	(1,186.8)	(1,083.6)
Revenue per Note 3	57.9	(42.4)	2.2	(68.9)	-	(2.0)	60.1	(113.3)
Expense per Note 4	130.8	147.5	165.1	82.3	1.0	1.2	296.9	231.0
Closing balance	**6,568.3**	**6,406.8**	**1,950.8**	**1,155.4**	**54.0**	**55.0**	**8,573.1**	**7,617.2**

Methodology applied in the valuation of life contract liabilities

Life investment contracts are policies regulated by the *Life Insurance Act 1995* (the Life Act) that do not meet the definition of an insurance contract (under AASB 4 *Insurance Contracts*) and are measured at fair value through profit and loss. Life insurance contracts are policies regulated by the Life Act that meet the definition of an insurance contract under AASB 4 and are measured using the margin on services (MoS) methodology. This includes inwards reinsurance of longevity and mortality risks.

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

Key assumptions applied in the valuation of life contract liabilities

Discount rates

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

11. Life contract liabilities (continued)

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

Discount rates (continued)

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 30 June 2014. Discount rates applied for Australian liabilities were between 2.7-4.0% (30 June 2014: 3.0-5.4%) per annum.

Maintenance expenses

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

Inflation estimates

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 1.2% for short-term and 2.8% for long-term inflation (30 June 2014: 1.7% short-term, 2.9% long-term) per annum.

No surrenders or voluntary discontinuances are assumed for life investment contracts. Where policy holders 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 reference male and female lives separately and incorporate factors that allow for mortality improvements since the date of the investigation.

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 for individual lifetime annuities applied are between 1.0-4.0% (30 June 2014: 1.0-4.0%) per annum.

Impact of changes in assumptions on life insurance contracts

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

Restrictions on assets

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

Statutory fund information

The Company has three statutory funds. Fund 1 is a non-investment-linked fund and fund 3 is investment-linked. Both of these are closed to new business. Fund 2 contains non-investment-linked contracts, including the Group's term annuity business, lifetime annuity policies and the related reinsurance, plus the wholesale mortality and longevity reinsurance. Life contract liabilities for funds 1, 2 and 3 are $4.3 million, $8,565.2 million and $3.6 million respectively (30 June 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 $1,796.0 million (30 June 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 31 December 2014 valuation of life contract liabilities, $2,008.0 million of principal payments on fixed term and lifetime business are expected in in the year to 31 December 2015 (30 June 2015: $1,684.0 million).

Life insurance risk

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

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.

12. Contributed equity

Analysis of contributed equity	6 months to 31 Dec 2014 No. of shares M	6 months to 31 Dec 2014 $M	Year to 30 June 2014 No. of shares M	Year to 30 June 2014 $M	6 months to 31 Dec 2013 No. of shares M	6 months to 31 Dec 2013 $M
Ordinary shares issued	569.7	1,622.7	530.9	1,335.5	530.9	1,335.5
CPP Trust shares treated as treasury shares	(9.2)	(51.6)	(12.5)	(66.2)	(9.0)	(40.5)
CPP deferred share purchases treated as treasury shares	(7.6)	(46.8)	(7.8)	(31.8)	(7.8)	(31.8)
Total contributed equity	**552.9**	**1,524.3**	**510.6**	**1,237.5**	**514.1**	**1,263.2**
Movement in contributed equity						
Ordinary shares						
Opening balance	530.9	1,335.5	530.9	1,335.5	530.9	1,335.5
Ordinary shares issued	38.8	287.2	-	-	-	-
Closing balance	**569.7**	**1,622.7**	**530.9**	**1,335.5**	**530.9**	**1,335.5**
CPP Trust						
Opening balance	12.5	66.2	8.7	40.2	8.7	40.2
Shares purchased (including settled forwards)	10.3	60.9	7.6	43.2	3.6	15.6
Vested shares released to employees	(13.6)	(75.5)	(3.8)	(17.2)	(3.3)	(15.3)
Closing balance	**9.2**	**51.6**	**12.5**	**66.2**	**9.0**	**40.5**
CPP deferred share purchases						
Opening balance	7.8	31.8	6.6	23.4	6.6	23.4
CPP deferred share purchases	4.6	33.8	3.0	14.0	3.0	14.0
Settled forward purchases	(4.8)	(18.8)	(1.8)	(5.6)	(1.8)	(5.6)
Closing balance	**7.6**	**46.8**	**7.8**	**31.8**	**7.8**	**31.8**

Terms and conditions of contributed equity

Ordinary shares

A holder of an ordinary share is entitled to receive dividends and to one vote on a show of hands and on a poll.

Challenger Performance Plan Trust (CPP Trust)

The CPP Trust is a controlled entity and holds shares in the Company. As a result, the CPP Trust's shareholding in the Company is disclosed as treasury shares and deducted from equity. Dividends paid from the Company to the CPP Trust are eliminated on consolidation.

CPP deferred share purchases

The shares purchased under forward agreements are treated as treasury shares from the date of the agreement. Shares are transferred to the CPP Trust on the future settlement date.

Capital management

A company is generally limited in the risk-taking activities that it can engage in by the amount of capital it holds, with capital acting as a buffer against risk, ensuring that there are sufficient resources to enable the Company to continue normal business in the event of an unexpected loss.

The Group manages capital risk via an Internal Capital Adequacy Assessment Process (ICAAP) at both the Group and the prudentially-regulated CLC level. The objective of the ICAAP is to maintain financial stability of the Group and CLC whilst ensuring that shareholders earn an appropriate risk-adjusted return through optimisation of the capital structures. The ICAAPs are approved by the respective boards and are reviewed at least annually.

ICAAP summary statement – Challenger Limited

The Group is a Level 3 Head under the APRA conglomerates framework. Level 3 groups are groups of companies that perform material activities across one or more APRA-regulated industries and/or in one or more non-APRA regulated industries. APRA is currently developing a supervisory framework for Level 3 (conglomerate) groups, which was due to be effective from 1 January 2015. Draft Level 3 standards have been issued by APRA. However, APRA is yet to confirm the implementation date. In August 2014, APRA deferred a decision on its final standards and implementation until the Government response to the recommendations of the Financial System Inquiry has been announced.

Under the draft standards, the Group is required to have an ICAAP Summary Statement. The Group's ICAAP Summary Statement aims to maintain an investment grade credit rating and robust capital ratios in order to support its business objectives, protect regulated entities within the Group from operational and other risks outside those regulated entities and maximise shareholder returns. The Group believes that maintaining an investment grade rating is the most appropriate target from a capital structure perspective and is essential in order to secure access to capital at a reasonable cost.

Credit ratings

Standard & Poor's long-term credit ratings for the Group and CLC at the statement of financial position date are 'BBB+' (stable) and 'A' (stable) respectively. There were no changes to either the Group or CLC ratings during the period and they reflect the financial strength of the Group and CLC. In particular, they demonstrate Challenger's strong business profile, earnings and capital position.

12. Contributed equity (continued)

Capital management (continued)

Equity placement and share purchase plan

In August 2014, Challenger conducted an underwritten institutional ordinary share placement, raising $250.0 million with 33.2 million ordinary shares issued. Challenger also conducted a share purchase plan (SPP) for retail investors which raised $40.2 million (with 5.6 million new ordinary shares issued) in October 2014. Total issue costs (net of tax) were $3.0 million, resulting in net proceeds of $287.2 million. The majority of the proceeds from the institutional share placement and SPP were injected into CLC as common equity tier 1 (CET1) capital.

Dividends and share buy-back

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

The Challenger Limited Board regularly reviews the mix between dividends and share buy-back as part of the Group's capital management plan. With the forecast increase in dividend franking levels, in August 2014 the Challenger Limited Board increased the targeted dividend payout ratio to a range of 45% to 50% of normalised net profit after tax. However, the actual dividend payout ratio will depend on prevailing market conditions and capital allocation priorities.

There were no shares bought back in the six months ended 31 December 2014 and Challenger does not anticipate buying back shares in the second half of the 2015 financial year.

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

Prescribed capital amount (PCA)

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

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

CLC's excess capital above the PCA at 31 December 2014 was $1,174.7 million, up $272.1 million for the period. CLC's PCA ratio at 31 December 2014 was 1.75 times (30 June 2014: 1.66 times) and the CET1 ratio was 1.21 times. The increase in excess regulatory capital was due to the capital management initiatives undertaken in the period, partially offset by higher capital requirements as a result of Life's increased investment assets and property exposures.

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 31 December 2014 excess capital position includes a LAGIC transition balance of $215.2 million (31 December 2013: $322.8 million). $107.6 million of the remaining LAGIC transition balance will amortise on each of 1 January 2015 and 1 January 2016. Excluding the full LAGIC transition balance ($215.2 million), CLC's PCA ratio at 31 December 2014 was 1.54 times (30 June 2014: 1.44 times).

CLC's target surplus

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

While CLC does not target a specific PCA ratio, CLC's internal capital models result in a PCA ratio under current circumstances in the range of 1.4 to 1.6 times. This range can change over time and is dependent on multiple factors. CLC's PCA ratio is currently higher than this range of 1.4 to 1.6 times, as CLC's capital position contemplates the amortisation of the LAGIC transition balance of $107.6 million on each of 1 January 2015 and 1 January 2016.

Subordinated debt

CLC's total regulatory capital base includes $504.7 million of admissible subordinated debt. Subordinated debt tranches issued prior to 1 January 2013 will continue to be fully eligible as Tier 2 regulatory capital under LAGIC until each tranche's first call date after 1 January 2013, and will then amortise over four years. For tranches already past their call date, under LAGIC the first coupon date is considered the first call date.

CLC's subordinated debt includes $147.2 million which had a call date on 7 June 2013. As a result, under APRA's transition arrangements, only $88.3 million (i.e. 60% of the total amount) is eligible as Tier 2 regulatory capital on 31 December 2014.

12. Contributed equity (continued)

CLC's excess capital under LAGIC	31 Dec 2014 $M	30 June 2014 $M
Common equity Tier 1 regulatory capital	1,886.7	1,783.1
Additional Tier 1	345.0	-
Tier 2 regulatory capital – subordinated debt[1]	504.7	476.8
CLC total regulatory capital base	**2,736.4**	**2,259.9**
Prescribed capital amount		
Asset risk charge[2]	1,718.0	1,530.5
Insurance risk charge	143.5	83.9
Operational risk charge	23.9	22.8
Aggregation benefit	(108.5)	(64.7)
Prescribed capital amount – excluding transition relief	**1,776.9**	**1,572.5**
LAGIC transition relief[3]	(215.2)	(215.2)
CLC prescribed capital amount	**1,561.7**	**1,357.3**
CLC excess over prescribed capital amount	**1,174.7**	**902.6**
Capital adequacy ratio (times)	**1.75**	**1.66**

[1] Differs from $560.7 million disclosed in Note 10 Interest bearing financial liabilities due to $2.8 million of accrued interest and ($58.8 million) of inadmissible Tier 2 regulatory capital.
[2] The asset risk charge includes the combined stress scenario adjustment.
[3] LAGIC transition relief reduces by $107.6 million on each of 1 January 2015 and 1 January 2016.

13. Fair values of financial assets and liabilities

Fair value determination and classification

Fair value reflects the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The majority of the Group's financial instruments are held in the life insurance statutory funds of CLC and, as a result, are required by AASB 1038 *Life Insurance Contracts* to be designated at fair value through profit and loss where this is permitted under AASB 139 *Financial Instruments: Recognition and Measurement*.

Financial instruments measured at fair value are categorised under a three level hierarchy defined by AASB 13 *Fair Value Measurement*, reflecting the availability of observable market inputs when estimating the fair value. If different levels of inputs are used to measure a financial instrument's fair value, the classification within the hierarchy is based on the lowest level that is significant to the fair value measurement. The three levels are:

Level 1 unadjusted quoted prices in active markets are the valuation inputs for identical assets or liabilities (i.e. listed securities).

Level 2 valuation inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) are used.

Level 3 there are valuation inputs for the asset or liability that are not based on observable market data (unobservable inputs).

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

Valuation techniques

The Group's listed and unlisted fixed income securities, Government/semi-government securities and over-the-counter derivative financial instruments are all classified 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. Both are therefore Level 2. Internally-rated fixed income securities are Level 3 as the determination of an equivalent credit rating is a significant non-observable input.

Equity, infrastructure and property securities that are exchange traded are 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.

13. Fair values of financial assets and liabilities (continued)

Valuation techniques (continued)

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

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

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the statement of financial position at fair value. These balances are carried at amortised cost. All other financial instruments are either designated at fair value through the profit and loss at initial recognition, or the carrying amount materially approximates the fair value:

	31 Dec 2014		30 June 2014		31 Dec 2013	
Difference between amortised cost and fair value	**Carrying value $M**	**Fair value $M**	**Carrying value $M**	**Fair value $M**	**Carrying value $M**	**Fair value $M**
Mortgage assets – SPV[1]	2,561.2	2,643.0	2,978.9	3,061.8	3,382.1	3,462.8
Interest bearing financial liabilities – SPV[2]	2,518.5	2,445.4	2,931.4	2,832.0	3,335.2	3,212.0

[1] Mortgage assets – SPV would be predominantly classified as Level 3 in the fair value hierarchy.
[2] Interest bearing financial liabilities – SPV would be predominantly classified as Level 2 in the fair value hierarchy.

Valuation process

For financial instruments and investment properties categorised within Level 3 of the fair value hierarchy, the valuation process applied in valuing such instruments is governed by the CLC Valuation Committee 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 below table 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:

	Level 1 $M	Level 2 $M	Level 3 $M	Total $M
31 Dec 2014				
Derivative assets	-	733.8	-	733.8
Fixed income securities	-	7,379.0	1,695.0	9,074.0
Equity securities	20.3	51.6	232.4	304.3
Infrastructure investments	125.7	-	461.6	587.3
Property securities	338.5	-	120.4	458.9
Investment property[1]	-	170.0	2,667.0	2,837.0
Total assets	**484.5**	**8,334.4**	**5,176.4**	**13,995.3**
Derivative liabilities	0.1	721.3	0.3	721.7
Interest bearing financial liabilities	-	85.4	564.0	649.4
External unit holders' liabilities	-	954.8	-	954.8
Life investment contract liabilities	-	89.0	6,479.3	6,568.3
Total liabilities	**0.1**	**1,850.5**	**7,043.6**	**8,894.2**

[1] Investment property reflected in Level 2 comprises the held for sale property CSIRO, for which a contract of sale was exchanged on 25 August 2014 and which settled on 30 January 2015. Level 3 includes the held for sale property Osada Nagasaki ($7.9 million) which is valued consistent with other investment property valuation techniques and hence is classified as Level 3.

13. Fair values of financial assets and liabilities (continued)

	Level 1 $M	Level 2 $M	Level 3 $M	Total $M
30 June 2014				
Derivative assets	-	318.0	-	318.0
Fixed income securities	-	7,182.4	1,341.6	8,524.0
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
Total assets	**645.5**	**7,769.1**	**4,297.7**	**12,712.3**
Derivative liabilities	0.2	222.1	0.2	222.5
Interest bearing financial liabilities	-	141.6	529.1	670.7
External unit holders' liabilities	-	1,072.4	-	1,072.4
Life investment contract liabilities	-	100.9	6,109.2	6,210.1
Total liabilities	**0.2**	**1,537.0**	**6,638.5**	**8,175.7**
31 Dec 2013				
Derivative assets	-	237.5	-	237.5
Fixed income securities	-	6,610.3	1,475.4	8,085.7
Equity securities	177.1	70.6	183.0	430.7
Infrastructure investments	91.7	-	513.3	605.0
Property securities	148.4	-	312.5	460.9
Investment property	-	-	2,507.4	2,507.4
Total assets	**417.2**	**6,918.4**	**4,991.6**	**12,327.2**
Derivative liabilities	-	326.5	-	326.5
Interest bearing financial liabilities	-	143.1	612.5	755.6
External unit holders' liabilities	-	1,000.3	-	1,000.3
Life investment contract liabilities	-	101.2	6,305.6	6,406.8
Total liabilities	**-**	**1,571.1**	**6,918.1**	**8,489.2**

Level 3 reconciliation

The following table shows a reconciliation of the movement in the fair value of financial instruments categorised within Level 3 over the period:

	31 Dec 2014		30 June 2014		31 Dec 2013	
	Assets $M	Liabilities $M	Assets $M	Liabilities $M	Assets $M	Liabilities $M
Balance at the beginning of the period	2,153.4	6,580.9	2,654.0	6,642.2	2,654.0	6,642.2
Fair value gains/(losses)	164.3	285.7	(29.4)	223.9	98.7	116.2
Acquisitions	892.3	1,196.1	784.7	2,043.5	557.6	1,047.0
Maturities and disposals	(699.5)	(1,019.0)	(1,110.6)	(2,271.1)	(653.6)	(887.3)
Transfers to other categories[1,2]	(1.1)	(0.1)	(145.3)	-	(172.5)	-
Balance at the end of the period[3]	**2,509.4**	**7,043.6**	**2,153.4**	**6,638.5**	**2,484.2**	**6,918.1**
Unrealised gains/(losses) included in the income statement for assets and liabilities held at the statement of financial position date	71.9	(285.7)	(48.3)	(223.9)	79.6	(116.2)

[1] The Group transfers between levels of the fair value hierarchy as at the end of the reporting period during which the transfer has occurred.
[2] Transfers to other categories are due to changes in the market observability of inputs used in the valuation of financial instruments. There were no transfers between Level 1 and Level 2 during the reporting period.
[3] Does not include investment property.

13. Fair values of financial assets and liabilities (continued)

Level 3 sensitivities

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

	Level 3 value $M	Positive impact $M	Negative impact $M	Reasonable change in non-observable input
31 Dec 2014				
Fixed income securities	1,695.0	60.1	(22.8)	Primarily credit spreads
Interest bearing financial liabilities	(564.0)	(25.4)	26.4	Primarily credit spreads
Net fixed income	**1,131.0**	**34.7**	**3.6**	
Equity, infrastructure, property assets	814.4	46.1	(45.8)	Primarily discount rate on cash flow models
Investment contract liabilities	(6,479.3)	4.3	(4.3)	Primarily expense assumptions
Derivative liabilities	(0.3)	0.3	(0.3)	Primarily credit spreads
Net Level 3	**(4,534.2)**	**85.4**	**(46.8)**	
30 June 2014				
Fixed income securities	1,341.6	66.2	(13.2)	Primarily credit spreads
Interest bearing financial liabilities	(529.1)	(22.9)	24.2	Primarily credit spreads
Net fixed income	**812.5**	**43.3**	**11.0**	
Equity, infrastructure, property assets	811.8	42.3	(41.9)	Primarily discount rate on cash flow models
Investment contract liabilities	(6,109.2)	4.5	(4.5)	Primarily expense assumptions
Derivative liabilities	(0.2)	0.1	(0.1)	Primarily credit spreads
Net Level 3	**(4,485.1)**	**90.2**	**(35.5)**	
31 Dec 2013				
Fixed income securities	1,475.4	66.3	(7.9)	Primarily credit spreads
Interest bearing financial liabilities	(612.5)	(23.7)	22.0	Primarily credit spreads
Net fixed income	**862.9**	**42.6**	**14.1**	
Equity, infrastructure, property assets	1,008.8	50.6	(50.6)	Primarily discount rate on cash flow models
Investment contract liabilities	(6,305.6)	4.4	(4.4)	Primarily expense assumptions
Derivative liabilities	-	-	-	
Net Level 3	**(4,433.9)**	**97.6**	**(40.9)**	

14. Reconciliation of profit to operating cash flow

	31 Dec 2014 $M	31 Dec 2013 $M
Profit for the period	**146.0**	**187.3**
Adjusted for		
Net realised (gains)/losses on disposal of investment assets	(142.7)	30.9
Net unrealised gain on revaluation of investment assets	(119.8)	(88.8)
Share of associates' net profit	(6.2)	(6.8)
Change in life contract liabilities	357.0	117.7
Depreciation and amortisation expense	9.9	9.1
Share-based payments	12.9	12.2
Operating cash flow not recognised in revenue		
Dividends from associates	11.6	10.3
Change in operating assets and liabilities, net of acquisition/disposal of controlled entities		
Increase in receivables	(34.6)	(21.7)
Increase in other assets	(2.9)	(8.4)
Decrease in payables	(14.5)	(2.5)
Decrease in provisions	(6.0)	(0.9)
Increase in life contract liabilities	391.8	376.2
Decrease in external unit holders' liabilities	(117.6)	(751.1)
(Decrease)/increase in net tax liabilities	(16.3)	23.0
Net cash inflows/(outflows) from operating activities	**468.6**	**(113.5)**

15. Subsequent events

At the date of this 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 years which is not already reflected in this report.

16. Contingent liabilities, contingent assets and credit commitments

Warranties

Over the course of its corporate activity the Group has given, as a seller of companies and as a vendor of real estate properties, warranties to purchasers on several agreements that are still outstanding at 31 December 2014. Other than noted below, at the date of this report no material claims against these warranties have been received by the Group.

Parent entity guarantees and undertakings

Challenger Limited has extended the following guarantees and undertakings to entities in the Group:

1. A guarantee supporting the corporate banking facility and certain other financial commitments, such as hedging arrangements;
2. Letters of support in respect of certain subsidiaries in the normal course of business. The letters recognise Challenger Limited's intention to provide support to those subsidiaries so that they can continue to meet their obligations;
3. Australian Financial Services Licence deeds of undertaking as an eligible provider; and
4. Guarantees to support contractual commitments on warrants to certain third parties.

Third party guarantees

Bank guarantees have been issued by a third party financial institution on behalf of the Group and its subsidiaries for items in the normal course of business, such as rental contracts. The amounts involved are not considered to be material to the Group.

Contingent future commitments

CLC has made capital commitments to external counterparties for future investment opportunities such as development or investment purchases. As at 31 December 2014 there are potential future commitments totalling $338.9 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.

Contingent tax assets and liabilities

From time to time the Group has interactions with the ATO in relation to the taxation treatments of various matters. Any potential tax liability resulting from these interactions is only provided for when it is probable that an outflow will occur and reliable estimate of the amount can be made.

16. Contingent liabilities, contingent assets and credit commitments (continued)

Other information

In the normal course of business, the Group enters into various contracts that could give rise to contingent liabilities in relation to performance obligations under those contracts. The information usually required by Australian Accounting Standards is not disclosed for a number of such contracts on the grounds that it may seriously prejudice the outcome of the claims. At the date of this report, significant uncertainty exists regarding any potential liability under these claims.

Directors' declaration

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

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

   i. giving a true and fair view of the Group's financial position as at 31 December 2014 and of its performance for the six month period ended on that date; and

   ii. complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*; and

b) there are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable.

On behalf of the Board.

G A Cubbin Director	B R Benari Director
Sydney 16 February 2015	Sydney 16 February 2015

Independent auditor's report

Building a better working world

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Independent auditor's report to the members of Challenger Limited

Report on the financial report

We have reviewed the accompanying half year financial report of Challenger Limited, which comprises the Statement of financial position as at 31 December 2014, and the Income Statement, Statement of Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the six months ended on that date, other selected explanatory notes and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the half year end or from time to time during the half year.

Directors' responsibility for the half year financial report

The directors of the company are responsible for the preparation of a half year 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 a half year financial report that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express a conclusion on the half year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 Review of Interim and Other Financial Reports Performed by the Independent Auditor of the Entity, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the financial report is not in accordance with the Corporations Act 2001 including: giving a true and fair view of the consolidated entity's financial position as at 31 December 2014 and its performance for the half year ended on that date; and complying with Accounting Standard AASB 134 Interim Financial Reporting and the Corporations Regulations 2001. As the auditor of Challenger Limited and the entities it controlled during the half year, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an 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.

Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half year financial report of Challenger Limited is not in accordance with the *Corporations Act 2001*, including:

(i) giving a true and fair view of the consolidated entity's financial position as at 31 December 2014 and of its performance for the half year ended on that date; and

(ii) complying with Accounting Standard AASB 134 Interim Financial Reporting and the *Corporations Regulations 2001*.

Ernst & Young

Ernst & Young

David Jewell

D Jewell
Partner

Sydney
16 February 2015

Investor information

ASX listing

Challenger Limited shares are listed on the ASX under code CGF and company information, as well as trading information, can be accessed via the ASX website at www.asx.com.au. Share prices can also be accessed on Challenger's website at www.challenger.com.au.

Key dates for the 2015 interim dividend:

Ex-dividend date	2 March 2015
Record date	4 March 2015
Payment date	31 March 2015

Shareholder queries

Contact Computershare Investor Services for information about the Challenger Limited share registry if you have any questions about your shareholding:

Computershare Investor Services Pty Limited

Level 4, 60 Carrington Street, Sydney NSW 2000

Telephone: 1800 780 782

Facsimile: 02 8234 5050

To assist with all enquiries, quote your current address and Security Reference Number (SRN) when corresponding with Computershares Investor Services.

Appendix 1 – ASX Appendix 4D (listing rule 4.2A.3)

Appendix 4D item	Cross reference
Reporting period and previous corresponding period (4D item 1)	Page 2
Results for announcement to the market (4D item 2)	Page 2
Net tangible assets per security (4D item 3)	Refer below
Details of entities over which control was gained or lost (4D item 4)	There were no material entities over which control was gained or lost during the period
Dividend information (4D item 5)	Page 2
Dividend reinvestment plan (4D item 6)	Challenger Limited has suspended its dividend reinvestment plan
Details of associates and joint ventures (4D item 7)	Refer below
Foreign entities (4D item 8)	Not applicable
Audit dispute or qualification (4D item 9)	There are no audit disputes or qualifications in respect of the interim financial report

Net tangible assets per security (4D item 3)	31 Dec 2014 $M	31 Dec 2013 $M
Net assets	**2,610.1**	**2,416.2**
Less:		
- intangible assets	16.2	15.3
- goodwill	531.0	506.8
- non-controlling interests	167.2	363.9
Net tangible assets	**1,895.7**	**1,530.2**
Ordinary shares, net of treasury shares (number - million)	552.9	514.1
Net tangible assets per security ($)	**3.43**	**2.98**

	Ownership interest	
Details of associates and joint ventures (4D item 7)	31 Dec 2014	31 Dec 2013
Alphinity Investment Management Pty Ltd	30%	30%
Ardea Investment Management Pty Ltd	30%	30%
Arete Investment Partners Pty Ltd	35%	-
Bentham Asset Management Pty Ltd	49%	49%
Challenger MBK Fund Management Pte Ltd	50%	50%
Greencape Capital Pty Ltd	35%	35%
Kapstream Capital Pty Ltd	25%	25%
Kinetic Investment Partners Pty Ltd	20%	20%
Merlon Capital Partners Pty Ltd	30%	30%
Metisq Capital Holdings Pty Ltd	49%	49%
Novaport Capital Pty Ltd	49%	49%
Tempo Asset Management Pty Ltd	40%	-
Wavestone Capital Pty Ltd	33%	33%
Whitehelm Capital Pty Ltd	30%	-

Authorisation

Michael Vardanega
Company Secretary

Sydney
16 February 2015

Directory

Principal place of business and registered office in Australia

Level 15

255 Pitt Street

Sydney NSW 2000

Telephone: 02 9994 7000

Investor services: 13 35 66

Facsimile: 02 9994 7777

Website: www.challenger.com.au

Directors

Peter Polson (Chair)

Brian Benari (Managing Director and Chief Executive Officer)

Graham Cubbin

Steven Gregg

Jonathan Grunzweig

Russell Hooper

Brenda Shanahan

JoAnne Stephenson

Leon Zwier

Company secretaries

Michael Vardanega

Andrew Brown

Share register

Computershare Investor Services Pty Ltd

Level 4

60 Carrington Street

Sydney NSW 2000

Telephone: 1800 780 782

Website: www.computershare.com.au

Auditor

Ernst & Young

680 George Street

Sydney NSW 2000